Franchising in Brazil

FACTSHEET

IMPORTANT ISSUES

01

Franchises as a business model

A franchise is a agreement between two parties, where one party (the franchisor) grants another party (the franchisee) the right to use its trademark or trade-name (and other IPRs) as well as certain business processes to produce and market a good or service according to certain specifications.

Nowadays, many EU SMEs opt to open franchises as their sole business line or to combine it with other business lines. The Brazilian market has also acknowledged these trends and the number of franchises has increased markedly in the last years.

Evolution of the number of franchises

Segments	2012	2013	Variation
Shoes and Personal Accessories	166	191	15.1%
Food	573	637	11.2%
Education and Training	270	284	5.2%
Sports, Health, Beauty and Leisure	435	508	16.8%
Tourism and hospitality	36	41	13.9%
Communication, Computers and Electronics	102	118	15.7%
Cleaning and Care	75	89	18.7%
Home and Construction	125	144	15.2%
Business Services and other retails	272	272	0,00%
Vehicles	99	108	9.1%
Clothing	273	311	13.9%
TOTAL	**2.426**	**2.703**	**11.4%**

Source: Portal do Franchising

The first thing we notice about the evolution of franchise in Brazil is the strong two-digit annual growth and such an increase makes this type of business very attractive to entrepreneurs and companies. Indeed, many European companies have chosen franchising as a way of expanding their business or entering the Brazilian Market. For example, INSTITUTO L´ORÉAL PROFESSIONNEL (*http://institutolp.com.br/*) or L'Occitane au Brésil (*http://br.loccitane.com*/l-occitane-au-br%C3%A9sil,43,2,38218,*0.htm*), which currently own a network of 25 convenience stores and 13 stores in Brazil.

Other European franchises that have been established in Brazil are, Dia (supermarkets), Costa Café (coffee), Pressto (laundry) or Nao Mais Pelo (depilation). For a European SME, franchising in Brazil is halfway between licensing its IPRs (mainly trademarks) and creating subsidiaries since it provides more control on how the product reaches the final consumer than licensing. Additionally, it is a considerably less expensive strategy than creating subsidiaries in the foreign country.

> *TIPS and WATCH-OUTS*
> Types of franchising
> There are two major types of franchising:
> + The product franchise
> + The service franchise

In the context of a long-term business plan, franchising could be used as a bridge before an expansion project in Brazil since the company can test how the Brazilian consumer accepts the offer of products/services and receive direct feedback from them, instead of obtaining it from wholesalers, licensors or other distributors. The main advantages for the franchisor are:

+ The possibility of expanding his/her business fast without investing a large amount of resources
+ Easier access to finance
+ Control of the way the product/service is offered to the end consumer
+ Helps to create a strong trademark reputation and corporate image

On the other hand the franchisee will benefit from:

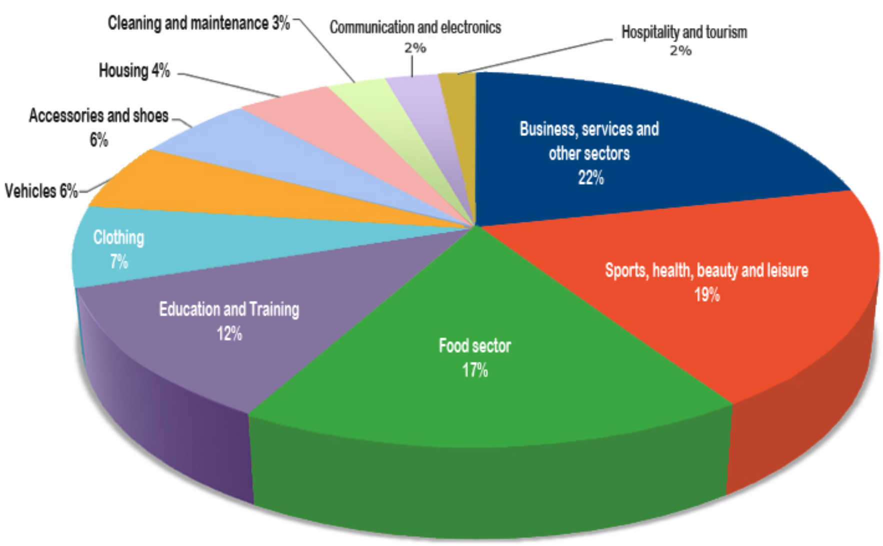
+ Using an already tested business model
+ A reduced learning curve
+ Trademark reputation
+ Assistance and advice regarding how to run the business
+ Marketing and advertising efforts made by the franchisor

However, not all business can adopt this model. Franchise is less interesting for low-margin businesses or those that depend heavily on the specific skills of a few workers (who need particular training, for example, in artistic or technical work).

According to the Brazilian Association of Franchising (ABF), the franchises that experienced the highest increase in turnover during 2013 were in the sports (services) and health care (products and services) sectors, with a 23,9% increase. Meanwhile, clothing and shoes (products) increased by 17,1% and restaurant and hotels (services) grew to 16,6%. These trends have been sustained over the last five years.

SUCCESS CASE
Founded in 2009, the Spanish-based company Llao Llao, has opened its frozen-yoghurt franchises all around Europe, and during this last three years has expand its business to South East Asia and Latin America, where owns one franchise in Chile and is planning to open more in Brazil, Uruguay, El Salvador and Venezuela.

Distribution of the number of franchises by business sector in 2013



02

Documents related to franchise

A. FRANCHISE DISCLOSURE DOCUMENT

The Franchise Disclosure Document is a formal offer that the franchisor should give to the future franchisee at least ten days prior to signing the contract. According to Brazilian Law, it is compulsory to provide potential franchisees with the following information:

+ Franchisor information: The company's background and its form of incorporation, its balance sheet and financial statements for the past two years; pending litigations, as well as the shareholders identity.
+ Franchise information: Detailed description of the franchise, general description of the business and activities to be performed by the franchisee; the ideal franchisee profile; description of the level of involvement of the franchisee in the operation and administration of the business; complete list of all franchisees of the network -as well as who left during the last twelve months- and the contact information of the members (name, address and telephone number).
+ Financial Information: The initial investment required to purchase, deploy and start up the franchise; value of the initial membership fee or franchise fee and guarantee; and estimated value of the facilities, equipment and initial inventory and payment terms; clear information about periodic fees and other amounts to be paid by the franchisee to the franchisor such as royalties, rentals or advertising fees.
+ IPRs status: its situation before the National Institute of Industrial Property (INPI) (registration, ownership and other relevant information).
+ Other contractual obligations: such as exclusivity, or rights of preference, other obligations imposed on the franchisee and termination conditions in case of expiration or breach.
+ A template of the contract and, if applicable, also the pre-standard franchise agreement adopted by the franchisor (full text, including its annexes and expiration date).

TIPS and WATCH-OUTS

Since the Franchise Offering Letter includes sensitive information (e.g financial statements or disclosure of part of the know-how), it is strongly recommended to include a confidentiality clause with regards to the information disclosed and documentation provided.

B. FRANCHISE AGREEMENT

Legally speaking, the franchise is a contract between two parties (franchisor and franchisee), where the former grants the latter the use of its Intellectual Property Rights and provides the franchisee with assistance and training on business management, marketing and other operational issues in exchange for a fee.

Usually, the scope of a franchising contract comprises the following aspects:

+ Intellectual Property Rights (non- exclusive licenses)
+ Know-how: on processes and good practices mainly;
+ Management advice or assistance: e.g. by providing training to employees or related to day-by-day business administration.
+ Marketing and Branding: establishing how the franchisee should use the distinctive signs, the layout of the establishment, advertising policy, promotions, etc.
+ Fees and royalties
+ Other clauses, such as confidentiality, exclusivity, breach of contract, liability, etc.

Depending on the characteristics of the business and of the parties there are different types of fees (or royalties) that could be introduced in to the contract:

+ Initial Fee or Franchise Fee: is a fixed amount of money that is usually paid at the time of signature of the agreement and it typically comprises the payment for the full business plan, the training of the franchisee and employees, as well as all the professional assistance related to the establishment and launch of the business.
+ Royalty Fee: amount of money that is periodically paid to the franchisor and that is usually calculated as a percentage of gross or net sales.
+ Other fees: depending on the characteristics of the franchise, the franchisee would also pay for certain services provided by the franchisor, such as:
    + Supply of products
    + Promotional and advertising services
    + Other services
+ According to Brazilian Law, "the franchise agreement should always be written and signed in the presence of 2 (two) witnesses and shall be valid regardless of whether it is registered with a notary or public agency". Thus, the franchising contract's formal validity is subject to two witnesses' signature requirement (on every page).

If the franchise agreement is signed outside Brazil, the agreement must be notarized and legalized before the local Brazilian Consulate.

TIPS and WATCH-OUTS
Registration of the franchise agreement is not mandatory and the sole requirement for its validity is that the contract is signed before two witnesses. However, if the franchisor is based abroad, the agreement should be registered with the INPI.

C. MASTER FRANCHISING AGREEMENTS

A Master Franchise Agreement (MFA) is a contract where the franchisor grants the master franchisee the right to sell unitary franchises within a territory during a defined period of time in exchange for a previously fixed sum. It usually depends on the number of unitary franchises opened and the degree of development of the business reached by the master franchisee. In practice, the master franchisee acts as a sub-franchisor, while the unitary franchises act as sub-franchisees. This method shifts part of the risk from the franchisor to the master franchisee and simplifies the franchisor's legal obligations (a single agreement instead of one for each franchisees).

This alternative may be interesting for European SMEs that have already been distributing their products/services within the Brazilian market and have a trusted partner in the country or a licensee that is interested in expanding the business, especially if the company is not interested in directly operating the franchise business or in opening a subsidiary. A Master Franchise Agreement should provide for clauses that regulate the relationship between master franchisor and master franchisee and the contract that the unit franchise should sign with the master franchisee.

TIPS and WATCH-OUTS

If you are planning to sign a Master Franchise Agreement, please take care when defining the master franchisee's liabilities and include special provisions in the event of termination of the contract to facilitate the subrogation in the position of the master franchisee in order to benefit from the franchise network created by him/her. Alternative Dispute Resolution systems before an International Institution are recommended and faster than traditional methods. Hence, include arbitration clauses, especially if your company does not have its headquarters in Brazil.
When drafting a MFA it is highly recommended to contact a legal expert. The MERCOSUR IPR SME Helpdesk offers free, confidential, fast first line legal advice for European SMEs. If you are not sure about what is the most accurate approach for your SME, do not hesitate to contact us. Our experts will be pleased to assist you. Know more at *www.mercosur-iprhelpdesk.eu*.

D. OPERATING MANUALS

The Operating Manual (where the businesses' core processes are detailed and explained to the franchisees) is one of the key documents of the franchise system and is normally incorporated in to the Franchise or Master Franchise agreements.

Every company defines its operational processes in order to optimize resources and improve the final quality of the products and services offered to its customers. This is especially important in franchising where these operational processes should be replicated by each of the franchisees. The Operating Manual informs the franchisee how to follow the operations performed by the franchise and depending on the sector it will include descriptions and specifications within these areas:

+ Franchise system
+ Operational methods such as methods for production-time, performance standards, technical specifications, installation and equipment handling or stock management.
+ Operational instructions: regarding staff training, pricing policy, marketing or advertising for example.
+ Outlet specificities, such as location, size or layout.
+ Standard documentation such as complaint forms, contracts, ordering forms…

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Further Brazilian specificities related to franchising

REGISTRATION WITH THE INPI

When the Franchisor is not from Brazil, the franchise agreement shall be registered with INPI (Instituto Nacional da Propriedade Industrial - INPI). The purpose of such registration is to enable its enforcement against third parties, to permit the franchisee to benefit from certain tax deductions and to allow the franchisee to make payments to foreign countries (in line with the clearance regulation of the Brazilian Federal Bank). The following documents should be presented before the INPI to register the agreement:

+ Original version (or certified copy) of the agreement;
+ Translation to Portuguese;
+ Power of attorney;
+ Statement signed by the franchisee acknowledging the receipt of the Franchise Disclosure Document ten days prior to the execution of the agreement.

TIPS and WATCH-OUTS
The INPI performs a formal examination of the content and examines the validity of the IPRs licensed within the agreement. Hence, it is of the utmost importance to check that the IPRs concerned are in force and valid.

APPLICABLE TAXES FOR FOREIGNER FRANCHISORS
Payments made to foreign franchisors are subject to the payment of a 15% withholding tax and a 10% tax as a Contribution for Intervention on the Economic Domain (CIDE). However, it is possible to agree that the withholding tax be paid by the franchisee.

Other general taxes are payable by foreign franchisors, such as the Tax for Services (ISS) ranging from 2% and 5%, a 1.65% tax for PIS (Social Security Fees/) and 7.6% for COFINS (Contribution to Social Security Financing) calculated over the total amount of royalties paid.

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Related links and additional information

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International Franchise Association (general information and resources)
www.franchise.org/

Brazilian Franchising Association (Associação Brasileira de Franchising (ABF)):*www.portaldofranchising.com.br*/

Brazilian Patent Office (INPI): *www.inpi.gov.br*

Sebrae: *www.sebrae.com.br/sites/PortalSebrae/artigos*/A-import%C3%A2ncia-dos-manuais-para-as-redes-de-franquias

A very complete guide on Master Franchising
www.unidroit.org/english/guides/2007franchising/franchising2007-guide-2nd-e.pdf

In English
www.thebfa.org/franchise-your-business

In Portuguese
www.mflip.com.br/pub/lamonica/index9/

In Spanish (how to become a franchisor, step by step)
http://www.franquiciadirecta.com/informacion/paraelfranquiciador/pasosaseguirparapoderconvertirtunegocioenfranquicia/206/1144/

WIPO "Role of intellectual property in enhancing competitiveness and growth of small and medium-sized enterprises in the franchising sector"
http://www.wipo.int/meetings/es/doc_details.jsp?doc_id=85962

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Glossary

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Franchise: Arrangement where one party (the franchisor) grants another party (the franchisee) the right to use its trademark or trade-name as well as certain business systems and processes to produce and market a good or service according to certain specifications.

Source: *www.businessdictionary.com*

Royalty: A payment to an owner for the use of property, especially patents, copyrighted works, franchises or natural resources. A royalty payment is made to the legal owner of a property, patent, copyrighted work or franchise by those who wish to make use of it, for example, for the purposes of generating revenue. In most cases, royalties are designed to compensate the owner for the asset's use and are legally binding.

Source: *www.investopedia.com*

Confidentiality Agreement: A legal agreement between two or more parties that is used to signify that a confidential relationship exists between them. A confidentiality agreement is used in strategic meetings where various parties become privy to sensitive corporate information which should not be made available to the general public or competitors.

Source: *www.investopedia.com*

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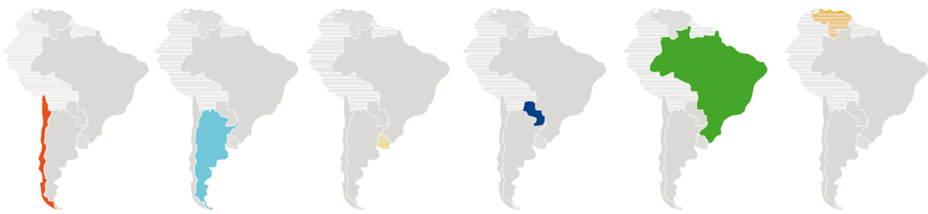

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