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Master Thesis

Franchising as a modern contractual realization of distribution (Particularly in Slovakia)

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1. Introduction

Distribution relations involve a number of legal and economic relations that arise in connection with the realization of the production and sale of goods or services. Entrepreneurs have to decide on the form of this realization.

Each year there are many new businesses. Entrepreneurs who are not willing to risk, but still want to do business choose franchising. Franchising increases certainty for small and medium entrepreneurs. It is based on tested concept, which should be a guarantee of success. It allows owners to combine the advantages of a small independent ownership, which is provided by a large chain. Franchising has become part of everyday life for most consumers today. The Brands like Mc Donald's or Holiday Inn are known all over the world. Numerous companies in different industries have adopted franchising as a way of your business.

It is now around 20 years since Slovakia's citizens could freely do business on the open market. In this relatively short time the business evolved into a form that is in many ways very similar to that in advanced countries. On the other hand, we still find ourselves in a situation where all available opportunities are not fully exploited. One of them is franchising. Although franchising is a worldwide well-known and commonly used, in Slovakia it didn't have such a success. This type of contractual cooperation is not currently modified in Slovak Commercial Code, which in my opinion is one of the main reasons why it is not know that much among the entrepreneurs in Slovakia.

The introduction is covered in Chapter 1. This work will focus on the identification, description and analysis of franchising as a form of contractual distribution.

Chapter 2 covers the theoretical background franchising is described different entry modes for a firm in an international market, their advantages and disadvantages and shortly described the history of the franchising. Further on the definitions, characteristic and types of franchising are presented.

In Chapter 3 the advantages and disadvantages of franchising are described as a reason for entrepreneurs to choose the franchising form of distributions. They are divided to franchisers advantages and disadvantages, franchisees advantages and disadvantages and consumers' advantages and disadvantages.

Chapter 4 explains the contractual issues of franchising agreement. It states the main structure of the contract and shortly explains contract design. In the last subchapter the operation manual of franchisee is presented, as an important part of the agreement.

In Chapter 5 the legal background of franchising in Slovakia is introduced. Current legal form of franchising in Slovakia, Franchise Associations /European and Slovakian/ and franchising in connection with a European Competition law. Work also aims to correct significant deficiencies in the Slovak Republic legal recognition of franchising.

Chapter 6 contains information about current development of franchising in USA, in Europe, and especially in Slovakia. I also research the use of franchising in USA, Europe, and Slovakia.

In Chapter 7 is the conclusion of this thesis, and it contains answers for all three research questions.

Research questions

The following research questions are dealt with in order to investigate the different aspects concerning the earlier mentioned problem statement:

1. What are the advantages and disadvantages for entrepreneurs while using franchising form of distribution?

2. Why is franchising not used in the same altitude in Eastern European Countries like it is used in US and other pro franchising countries?

3. Whether it is appropriate to create a new type of contract in the Slovak Commercial Code or whether the Slovak legislation is too complicated or incomplete?

2. Theoretical background of franchising

2.1. Entry modes

Organization can expand by entering into international market by different types of entry modes. These entry modes can be divided into two different groups: the equity market-based and the non equity contract-base. The equity based entry modes consists of joint ventures and wholly owned subsidiaries which can be established partly by acquisition or trough Greenfield ventures. The non equity based entry modes includes contractual agreements and export.[1] Since it is beyond the scope of this thesis further on only the most distinguishing features of classifications, advantages and disadvantages of each type of entry modes will be discussed.

„ A joint venture (JV) is an agreement between two or more legally independent companies, which pool their capabilities and resources together to a shared business. "[2] It is a new business set up by parties owning a proportion of the new company. Certainly it involves more risks but also more potential for return than non equity based entry modes, since it involves equity ownership and control. One of the benefits of an equity joint venture is a local partners' knowledge. "Under certain circumstances, joint ventures with a partner in the host country may help the firm deal with the peculiarities of the local market, access restricted resources, and even protect itself against political risk."[3] Other advantage is greater market owner can gain by joint ventures if resources are combined or when economies scale is generated. Finally, by creating a joint venture the development costs and risks can be avoided, reduced and shared. As main disadvantages could be taken into account the risk of giving control over technology to the partner what can lead to technology spillovers, the firms do not have full control and shared ownership can lead to conflict in control or management.

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[1] Yigang Pan and David K. Tse , The Hierarchical Model of Market Entry Modes, (Journal of international business studies vol. 31, 2000), http://www.palgrave-journals.com/jibs/journal/v31/n4/full/8490921a.html , p.1

[2] Elmar Lukas , Review of Financial Economics 16 (2007) 91–110, Dynamic market entry and the value of flexibility in transitional international joint ventures, (Review of Financial Economics vol. 16, 2007), http://www.sciencedirect.com/science/article/pii/S1058330006000425 , p. 92

[3] Guillen, M.F., Experience, Imitation, and the Sequence of Foreign Entry: Wholly Owned and Joint-Venture Manufacturing by South Korean Firms and Business Group in China, 1987-1995, (Journal of International Business Studies, 2003), http://www.palgrave-journals.com/jibs/journal/v34/n2/full/8400016a.html, p. 185

A wholly owned subsidiary (WOS) involves the highest stake of equity ownership and control, compared to the other entry modes. Advantages are the tight control of operations, realized experience curve and local economies, and a control of technology over a competitor. As a main disadvantage of this entry mode is bearing full costs and the risks of the business. WOS bears the greatest risks compared to other entry modes. When the firm expands by establishing a new subsidiary, the main decision is if acquiring an existing local company or starting a new venture is appropriate for them. This equity interest can be obtained by acquisition or Greenfield investments. Greenfield investments can be seen as an internal mode of expansion into foreign market by establishing a new subsidiary. "Greenfield FDI refers to investments that create new production facilities in the host countries (e.g. starting a new plant), whereas Brownfield FDI refers to cross-border mergers and acquisitions. "[4] Greenfield is a form of direct investment used by companies with specific advantages that are difficult to separate from the organization or/and no suitable takeover candidate was found in a local market. When parent company starts a new venture in foreign country it brings high risks to the company, because it requires high investments without knowledge of the local market. "The advantage of Greenfield investment is that all production facilities are built up from scratch and, thus, perfectly suit the investor's needs."[5]

Another way of expansion by establishing a new subsidiary is acquisition. „ Generally speaking, an acquisition occurs when one company takes a controlling ownership interest in another firm, a legal subsidiary of another firm, or selected assets of another firm, such as a manufacturing facility. An acquisition may involve the purchase of another firm's assets or stock, with the acquired firm continuing to exist as a legally owned subsidiary."[6] Acquisition became popular manly because of the quick access and gain of the greater market power. It is the largest and fastest strategy in international expansion. They often are very expensive, difficult to negotiate, subject to many regulations, and sometimes has troubled by intractable

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[4] Larry D. Qiu and Shengzu Wang , FDI Policy, Greenfield Investment and Cross-border Mergers, (Review of International Economics, 19(5), 2011), http://onlinelibrary.wiley.com/doi/10.1111/j.1467-9396.2011.00984.x/pdf, p. 1

[5] Becker, J.; Fuest, C. , Tax competition - Greenfield investment versus mergers and acquisitions , (Regional science & urban economics vol. 41, 2011,), http://ac.els-cdn.com/S0166046211000342/1-s2.0-S0166046211000342-main.pdf?_tid=715ca52a9b918dd7923fa46c7a66675e&acdnat=1340615769_8f8a41e6721ef49b8fa677f58c5e8ada, p. 1

[6] Donald M. DePamphilis, Ph.D, Mergers, Acquisitions, and Other Restructuring Activities (Fifth Edition), An Integrated Approach to Process, Tools, Cases, and Solutions, 2010, http://ac.els-cdn.com/B9780123748782000015/3-s2.0-B9780123748782000015, p. 657

cultural issues.[7] The high level of differentiation can have a negative effect on the company, because of the lack in the management differentiation.

Export as a non equity based entry modes is process of selling goods and services domestically-produced to another country. No investments for a establishing local operations are needed for this type of entry mode, because the country of production does not change. Most expanses are in a marketing form. „The disadvantages of exporting include high transportation costs, exchange rate fluctuations, and possible tariffs placed on imports into the local country. Moreover, the exporter has limited control over the marketing and distribution of its products in the local market."[8] There is direct and indirect export. Indirect export occurs when a company cooperates with another company in the same country which on behalf of the first company exports the goods. Direct exporting applies when domestic company exports by itself or uses intermediaries which are located in the targeted country.

Contractual agreements include franchising, licensing and strategic alliances. "The category of contractual agreements includes contract manufacturing, licensing, and other forms of non-equity contracts. "[9] Contracts are less risky and only small amount of investment costs are needed compared to other entry mode forms. They serve mostly as channels for exchange of know how and skills.

Licensing is a type of contractual agreement which allows a company in the country to use the property, such as trademarks, patents, and managerial skills, technology, and others for a pre-determined period. Licensor has to pay in return the royalties. Licensor is a person who gives another a license to make a limited rights or resources available to the targeted firm. Disadvantages of the entry mode are loss of control, lower income and risk of having the trademark or reputation ruined. The advantages are the fast expand with not that much risk and with no large capital investment. Also if company enters another country through licensing, the degree of competition will not change. The licensee can keep its monopoly position.[10]

Franchising is similar to licensing agreement. Compared to licensing franchising differs in terms of duration which is usually longer, service like assistance to the franchisee, operation manual, initial trainings and all the support necessary for the franchisee to run its

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8 See reference 6

9 See referenc 1, p. 544

10 Chun, B.G., Host country's strategic policies and multinational firm's choice of entry mode, Department of Economics, (Economic modelling vol. 29 ,2012) http://dx.doi.org/10.1016/j.econmod.2011.11.014, p. 436

business in the same way like it is done by the franchisor. "Franchising has two characteristics that distinguish it from other organizational forms such as equity joint ventures and strategic alliances. First, franchising typically occurs in businesses where there is a notable service component that must be performed near customers. The result is that service-providing outlets must be replicated and dispersed geographically. The second key characteristic is that franchise contracts typically reflect a unique allocation of responsibilities, decision rights, and profits between a centralized principal (the franchisor) and decentralized agents (franchisees)."[11] Some of the advantages of franchising are low risk and low expenses cost. Disadvantages are possibility of ruining the name, reputation of the company, possibility that franchisee will turn into competitor and quality control.

Strategic alliance is series of different relationships between firms that market internationally and their cooperation by shared research, formal joint ventures, or minority equity participation. We can define a strategic alliance as a cooperative agreement between two or more autonomous companies pursuing same objectives or working towards solving common problem through a period of sustained interaction.[12] They are motivated by the principal ideal of mutual knowledge exchange, controversy to licensing and franchising which is only one way transfer of knowledge. Its main objective is exchange of knowledge. Benefits are many for example overcoming protectionism barriers, dividing risks, gain of the access to the resources and capabilities that are lacking internally. The main disadvantage is probably cost expanses, due to the cash leaving the company but also due to the returns from which it could be denied. Another is the exposition of the technologies to its partner, which could later become a competitor.

Mentioned above are the main foreign investment entry modes, their classification, main features, some of their advantages and disadvantages. All of them are popular all over the world and useful for different companies in different situation for international expansion. To choose which one to use is a complicated decision which each company has to make. Further on I will focus mainly on franchising as a type of entry mode.

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[11] James G. Combs, Steven C. Michael, Gary J. Castrogiovanni ,P., Franchising: A Review and Avenues to Greater Theoretical Diversity, (Journal of management vol. 30, 2004), http://www.sciencedirect.com/science/article/pii/S0149206304000686, p. 908

12 Pyka, Andreas , Windrum, Paul , The Self-Organisation of Strategic Alliances, (2001), http://www.wiwi.uni-augsburg.de/vwl/institut/paper/209.pdf, p. 2

2.2. Franchising – history

The term franchising comes originally from French language and was first used in the post-Middle Ages. It referred to the special right or privilege grated by a king to the third parties to manufacture or trade in the interest of the State. "In strict legal terms the word 'franchise' means a grant of the rights from the crown and in some countries, e.g. the USA and Australia, it has been held by the courts that the world 'franchise' means a grant by a governmental authority."[13] Franchising as we understand it today is the one of the 19th and 20 century. The current economic theory sees franchise as a license which exploits the commercial rights of the third subject.[14]

Business franchising was developed as a new marketing method to be applied especially in American retailing. The expansion of franchise occurred as a consequence to the problematic situation of small independent businesses in competition with large companies. Franchising was a response to this problem and by providing small businesses the benefits of large companies with the name and image of the company, which was already in the minds of consumers and also significantly reduced the risks associated with the entry. During this period, world famous brands such as Mc Donald `s or` s Holiday Inn was created. This form of business is spreading rapidly in the fast food restaurant services and a little later the boom in the creation of hotel chains occurred.

On the European continent was first discovered franchising in the UK. Globally, franchising has increased significantly in the 70 and 80 of the 19th century, when the business created at your own risk represented a huge problem given the competitive environment. The biggest boom in franchising is seen in the USA, where around one third of retail works in franchise system. The growth of franchising started in USA where it has also the largest market place. "Franchised businesses account for over 38 percent of all retail sales in the United States and originate 12 percent of the gross national product."[15] "The former East-West political divide has been penetrated by increasing numbers of franchisors establishing a presence in China, Hungary, Poland, the Czech Republic, Romania, Russia and many other

[13] Mendelsohn, Martin , The guide to franchising, (7th edn. 2005, [London]: Thomson), p.16
[14] Česká Asociace Franchisingu, Franchising in Czech Republic [Franchising v České republice] (1.ed, Praha, ČAF, 2008)
[15] Francine Lafontaine, Pul H. Rubin , Franchise Contracting and Organization, (2005, Cheltenham [etc.]: Elgar), p.3

managed or formerly managed economies.[16] As mentioned above, franchising today is widespread all over the continents.

2.3. Franchising - definition, characteristics and types

There are many definitions of franchising. Various forms of franchise systems have individual elements in development and different countries have different legal definitions of franchising. International Franchise Association defines franchising „as an agreement or license between two legally independent parties which gives a person or group of people (franchisee) the right to market a product or service using the trademark or trade name of another business (franchisor), the franchisee the right to market a product or service using the operating methods of the franchisor, the franchisee the obligation to pay the franchisor fees for these rights and the franchisor the obligation to provide rights and support to franchisees.“[17] Probably the most elaborate definition of franchising is defined by European Franchise Federation. “Franchising is a system of marketing goods and/or services and/or technology, which is based upon a close and ongoing collaboration between legally and financially separate and independent undertakings, the Franchisor and its individual Franchisees, whereby the Franchisor grants its individual Franchisee the right, and imposes the obligation, to conduct a business in accordance with the Franchisor’s concept. The right entitles and compels the individual Franchisee, in exchange for a direct or indirect financial consideration, to use the Franchisor’s trade name, and/or trade mark and /or service mark, know-how, business and technical methods, procedural system, and other industrial and /or intellectual property rights, supported by continuing provision of commercial and technical assistance, within the framework and for the term of a written franchise agreement, concluded between parties for this purpose.“[18]

Based on the facts set on above franchising is a type of sales system through which products, services or technologies are sold. Legally separated and financial independent companies work in a close and constant cooperation. It is rather low capital intensive solution for international expansion of firms. It is mostly popular among service oriented firms, like fast food restaurants or hotel chains. They are characterized by low capital intensity and the

[16] See the reference 13, p.21
[17] International Franchise Association, http://franchise.org
[18] European Franchise Federation, http://www.eff-franchise.com

indissolubility of production and consumption. Service firms can not export abroad without being physically present in the targeted country in some sort of way.

Franchising is a sales system, where businesses cooperate together. Franchisor can use this system to take a strong position at relatively low cost and low risk. The big advantage is that the franchisee knows well local market. Franchisee acquires proven and tested know-how, sales, technology or management. It also allows him to use the franchisor brand. Franchisee pays him a regular franchise fee.

Business partners are sealed in the form of franchise agreement. The result of this form of business expansion is a franchise chain. Franchising usually involves long-term, several annual business relationship (5-25 years) under a contract between providers of franchising and franchisees.

The oldest type of franchising is the so-called production franchising. Franchisee obtains from franchisor precise instructions for production of a product that he can then produce and supply on the market. Franchisee obtains the right to take a trade name, trademark, know-how, assistance in implementation during realization of business. "There are franchises involving transactions between: manufacturers and wholesalers; manufacturers and retailers; wholesalers and retailers; retailers and retailers. "[19]

Distribution through franchising can be made through master - franchisee, in which franchisor provides the master franchisee the right to grant franchise to other franchisees (subfranchising). "Under master franchising contracts, franchisors can assign entire territories to franchisees for exclusive development. Some contracts may specify that the master franchisee must operate all the units within theirs territory."[20]

2.4. Summary of the Chapter

In this chapter I focused on the theoretical aspects of franchising. First I introduced different types of entry modes. Divided them into equity and nonequity based modes and characterized joint ventures, wholly owned subsidiaries, contractual agreements and export. Furthermore I described some of their advantages, disadvantages and their differences.

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[19] See p.23

[20] Kalnins, Arturs, Overestimation and Venture Survival: An Empirical Analysis of Development Commitments in International Master Franchising Ventures, (2005,Journal of economics & management strategy vol. 14 (2005) nr. 4), http://onlinelibrary.wiley.com/ , p.2

Secondly I summarized the history and development of franchising. Afterwards I defined the franchising, also by using the definition used from the International Franchise Association and European Franchise Federation. And at the end of this chapter I divided the franchising into so-called production franchising and business franchising and described their differences. Furthermore in my thesis I will focus on the business type of franchising.

3. Why entrepreneurs choose franchising- its advantages and disadvantages

Franchising brings many benefits. It might be even seem to be the best way to start a business. They should not forget their common objectives, which include a better position to market, lower costs, more realistic financial management, and smarter management organization.

Nothing, however, is so perfect and simple as it may seem at first sight. The franchisor and franchisee tend to minimize their disadvantages and maximize its benefits. Further on I summarize the advantages and disadvantages of franchising and divided them by three groups which are franchiser, franchisee and consumers.

3.1. Advantages for franchiser

From the point of agency theory, the existence of franchising is a priori evidence to its efficiency; it would be cut out by the business environment if it was not performing proficiently.[21]

Advantages for franchiser flow from the fact that it is a feature of franchising that the growth of the network is achieved by using mostly financial resources of the franchisees.

Franchiser uses licensing concept for a contract fee in the form of franchise fees. Franchisee owns the assets to be employed in the outlet, which means that no provision of capital by the franchisor for opening of each outlet is needed. "This does not mean that a franchisor does not need to find capital for its own business, but the capital requirements for its own business will not extend to the cost of establishing each outlet in its network. It enables the franchisor to achieve a rapid growth rate which has to generate sufficient surplus profits, raise capital or borrow to fund its development."[22] Franchiser capital requirements are lower since franchisee provides the capital to establish each outlet. With the initial franchising fee, franchisees have to pay also royalties and advertising fees.[23] Other advantage is available

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[21] See reference 11
[22] See reference 13
[23] See reference 17

because financial institutions, lend money more easily when the risk is spread between franchiser and franchisees.

The franchisee has the responsibility for the day-to-day management of the business. The franchisee will provide the local control, operate the franchisors system, recruit, train, motivate and supervise his stuff with the interest and concern of an owner. He has to bring his entrepreneurial skills and abilities to maximize the opportunities. [24]

Franchising is the optimal method of expanding business into new markets with minimal capital investment, because creation of a distribution network for a defined territory in a franchise agreement is a contractual obligation of franchisee. It offers the scope to single owner of a multiple chain to franchise future outlets which reduces the capital investments and manpower resources.[25] Franchisees knowledge of local interests, community involvement and knowledge is recruited and used for as advantage in exploiting new territorial areas for Franchisor. Franchisor is building a franchise network by use of franchisee empirical knowledge of local market. The franchisee is usually self motivated because he has invested his own time and money into the business, which means that he will work hard to bring in better results. Franchising also provides a balanced coverage of the market by franchisees in order to avoid the competitive relationship between franchisees.

The franchisor can have a smaller organization to control which means unanimity of procedures, which reflects on coherence, higher productivity and enhanced quality. Centralization of organization maintains more cost effective work force, reduction of key employees turnover and more efficient recruitment.

The major advantage of micro-economic perspective is ensuring franchisors product marketing. One of the requirements of franchise agreement is a contractual obligation of franchisees to take products, services and technology exclusively from the franchisor or franchisors subcontractors. Franchising is an effective way to build brand name and reputation because of advertising and marketing in accordance with a franchise agreement involves also franchisees.

In terms of competition is certainly microeconomic advantages franchisor as well as macro-economic disadvantage of franchising franchisor to increases the share of the market.

Franchising is one of the possible solutions to agency problems. Franchisee, against a subsidiary branch manager, is motivated to maximize profits. Franchisor is thus significantly reducing control costs.

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[24] See reference 13, p. 43
[25] See reference 13, p. 42

3.2. Disadvantages for Franchisor

Franchisor has to share the ownership of the business which he has formulated and developed. And with a wrong partner it can have a negative impact on profits and reputation of the whole organization. The franchisor often closely controls and co-ordinate the behavior of franchisees to provides that they build and keep a positive image for the entire franchised operation.[26] This means that the franchisor's own role changes drastically. Franchisee may think that he is his own boss in his own business, which is true, but in reality he is being only permitted for business with franchisors name and system for a finite term. Someone else can make decisions by which franchisor will be affected and these decision can even be more favorable to the franchisor then to franchisee.[27] This may cause conflicts of interest.

Although the franchisor by licensing premises substantially free him from routine matters, he is still responsible for the entire network. He has to ensure the reputation of the business and the therefore he is forced to constantly check that licensees comply with all prescribed standards.

Franchiser and franchisee may also have very different views on the volume of investment, which should be used by franchisee to upgrade or renovate the space and recovery of equipment and to meet the franchisor ordered norms. If licensee ignores to comply with all standards and norms, the result could cause a threat to the reputation of the entire network of stores.

Selection of the franchisee can be cause problems. Franchisor can make a mistake in selection by selecting not suitable person for self-employment, person which doesn't want to cooperate, or can use wrong selection procedures.[28] Selected franchisee may occur as a person incapable of leadership of the business. "Franchise businesses were also warned of the disadvantages of blind recruitment for potential franchisees as there can be negative outcomes if there is no cultural-fit between franchisees and brand values."[29] Although the headquarters is not capital involved at the premises, their poor management could damage it the franchiser

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[26]Wittman, Donald A , Economic analysis of the law: selected readings, (2003, Malden MA [etc.]: Blackwell,) p. 132,

[27] See reference 13, p. 43

[28] See reference 13, p. 44

[29] Munyaradzi W. Nyadzayo 1, Margaret Jekanyika Matanda 2, Michael T. Ewing , Industrial Marketing Management, Brand relationships and brand equity in franchising,(Industrial marketing management vol. 40 (2011), http://www.sciencedirect.com/science/article/pii/S0019850111001325, p. 7

too. This can lead to deterioration in the perception of the chain without obvious assistance or fault of franchisor.

Franchisor also faces the risk that franchisee due to its good results will acquire the impression that the franchisor is no longer needed. He may develop feeling of independence. There may be deviation from the original rules set by relationship between two parties or even effort to break away from the company headquarters. Using the same logic, based on the fear that the recipient license only lets headquarters train, and then with the acquired know-how to create their own independent operation, which will directly compete with the original concept.

A prospective franchisee is usually obliged to sign a confidentiality agreement. Both parties disclose sensitive information. This information (know-how, financial date et cetera) are business values essential to the franchisor's business concept and he must kept them from competitors.[30]

Franchisor further in connection with the provision of franchise faces the risks that in a situation where some plants are owned and managed directly by the headquarters and some in the administration of franchisees, may substantially different in working conditions for their employees. This fact may cause considerable dissatisfaction and pressure to employees to identical working conditions which may not correspond to the standard in the local community.

3.3. Franchisees advantages

Franchising offers many advantages for licensee, the most common are being listed in this subchapter. Franchising is a considerable simplification while starting business. "Once the franchisees buy the franchise idea, its business plans, they receive training, operating manuals, marketing plans and procedures in written or electronic form."[31] License contract permits the purchaser to own and operate a private company, without had to come up with my business idea. Also, he doesn't have to build a brand name out of nothing, but can take advantage associated with an established name of franchisor and his reputation. Franchisee can run the business as he see fit as long as it does not break any of contractual issues.

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[30] Hesselink, Martijn W , Commercial agency, franchise and distribution contracts (PEL CAFDC), (cop. 2006, :[Munich]: Sellier), p. 243

[31] Audhesh K. Paswan, C. Michael Wittman , Industrial Marketing Management, Knowledge management and franchise systems, (Industrial marketing management vol. 38, 2009), http://www.sciencedirect.com/science/article/pii/S0019850108001685, p. 3

The cost of opening operations for the franchisee is often lower than they would be if it acted completely because of the cooperation with the franchisor. “The franchisee will invariably need less capital than he would if he was setting up a business independently because the franchisor, through the experience gained from pilot and other operations, should be able to advise on the most cost-effective use of resources.”[32] This cost reduction is achieved mainly due to the size of the organization standing behind the franchisor, which is then capable of supplying companies and can achieve better conditions, because he is an important trading partner.

Franchisor would also be able to provide for a franchisee a training that will allow control the company without previous specific knowledge of the field. Therefore, if someone wants to become an entrepreneur, franchising is not the case limited by the field in which he is known. “A franchiser provides an established product or service which may already enjoy widespread brand-name recognition what gives the franchisee the benefits of a pre-sold customer base which would ordinarily takes years to establish and chances of business success because you are associating with proven products and methods.”[33]

In addition, the franchisor will help him with many other matters, like the selection of location, preparation of plans for future furnishing of working space, obtaining the necessary financial means and purchase of equipment and raw materials.

Franchisor is also committed to the rule that the license will not provide a way which could evoke competition among franchisees. It is especially the geographical distribution of market. Franchisee which enters into the market can benefit from experience of the franchisor and its trained staff and can use franchisors patents and registered trademarks. “Franchising is also used more often when outlet managers’ local market knowledge is an important competitive input, the need for such knowledge makes centralized monitoring difficult and costly.”[34]

The biggest positive for the franchisee is that on one hand he can benefit from all these advantages belonging to rather large business, but also still maintain freedom of independent entrepreneur.

[32] Reference 13, p. 49
[33] Reference 17
[34] Reference 11, p. 8

3.4. Franchisees disadvantages

For the franchisee, however, in franchising are not only benefits. Most of the disadvantages rise from the relationship and strong interdependence between the parties. Although the franchisee is the owner of his company, the franchisor holds over him considerable control. “The franchisee is not an independent entrepreneur he must follow the franchisor's instructions.”[35]The lower risk is off-set by the lower return of accomplishment.

Franchisee on the one hand benefits from the experience of the franchisor, but must also comply with many rules and regulations set by headquarters. “If the franchisee’s contract is terminated due to noncompliance with the franchisor’s quality standards, the franchisee suffers the loss of anticipated quasi-rents.”[36] If the specified standards are not respected; it could undermine the reputation of the entire chain. Therefore, a provider of franchise retains the right to withdraw the license if the franchisee does deviate from the designated standards or stopped observe them completely.

Franchisee risks that if there is a deterioration of the reputation and prosperity of the entire chain he will be withdrawn down, without any fault. The negative impact may also have requirement to follow a strategy designed by headquarters. If headquarter makes a wrong decision and the license holder again without apparent fault of their own or suffer a loss that worsen the economic situation of the company. The disadvantage of a strong dependence of the franchisee on the franchisor can have negative impact when the franchisor is unable to meet its commitment, without which usually franchisee can not operate.[37]

Franchise agreement also generally regulates business opportunity of franchisee or work in the same field, which is subject to franchise. This limitation often applies not only during cooperation with the franchisor, but also for several years after the termination. Franchisor is trying to escape and prevent unauthorized use internal information.

The obvious negative aspect of purchasing a license is that the franchisee can not be free to sell, because the franchisor has a natural interest in ensuring that the license was owned by an appropriate person. The franchisee contract will contain some restrictions against the sale or transfer of the franchised business. Often oversees not only to whom the license is sold, but also to the fact at what amount. In practice there is usually there is

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[35] Reference 17
[36] Reference 11, p.5
[37] What are the disadvantages of franchising a business?, http://www.whichfranchise.com/franchiseyourbusiness/index.cfm?FeatureID=288

difficulty while sale or transfer of a franchised business. Some agreements even provide payment fee to be paid to franchisor for the cost of dealing with new applicant and his training.[38]

Downside of buying a license is also that with the right to use franchising there are often considerable fees associated with it. Franchisee has to pay to franchisor for the provided services and for the use of his business system from the initial fees through the continuing fees.[39]

3.5. Advantages and disadvantages for consumers

Customers in all branches of franchised companies get the same product range and variety. Single style branches do not mean restriction on diversity and creativity. “A consumer should benefit greatly from a franchised business because he will be dealing with an owner and not merely an employee. The service should, therefore, be personalized, effective and result in greater customer satisfaction.”[40] Franchising is then guarantor for the quality of its reputation and name. It is fully recognizes by the franchisor and he is therefore willing to spent even money for the examination of the quality.

Franchisee has the option to obtain information regarding the requirements and demands of customers easier and, thanks to the constant flow of information between franchisor and franchisee he is able to quickly and effectively respond to these requirements.

A very successful franchisee can reduce or even destroy the competition and thus also choice for the consumer. Monopolizing the market is associated with the franchising and the competition that constitutes is the dominant macro-economic disadvantage of franchising from the perspective of consumers and from the perspective of law. Possible monopoly on certain products or services can result in lower availability of these products and services and can even increase their prices.

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[38] Reference 13, p. 50

[39] Reference 13, p. 51

[40] Nicola Broadhurst, What are the advantages and disadvantages of a franchise business opportunity, April 11, 2012, http://sellingafranchise.co.uk/what-are-the-advantages-and-disadvantages-of-a-franchise-business-opportunity

3.6. Summarry:

In this chapter I described the main advantages and disadvantages for franchisor, franchisee and consumers. By describing them I also answered my first research question.

Advantages for franchisor:

1. Relatively lower demand for capital, because the increase of the network is reached by using a financial resources of franchisee, in addition to that he has to pay the initial franchising fee, franchisees must pay ongoing licensing and advertising fees,
2. Lower risk of business, franchisee is self motivated since he has invested his own time and money in the business, meaning that he will work harder to bring in better results,
3. Fewer personnel problems, franchisee has the responsibility for the day-to-day conduct of the business, and franchisor can have a smaller central organization which means uniformity of procedures
4. Rapid development of penetration through the new markets, because of franchisees empirical knowledge of local market.

Disadvantages for franchisor:

1. Franchisee failure risk; with a wrong partner it can have a negative impact on profits and reputation of the whole organization,
2. Training a future competitor in the recipient; franchisor also faces the risk that franchisee due to its good results will acquire the impression that the franchisor is no longer needed,
3. Risk disclosure of secrets franchisor; a prospective franchisee is usually obliged to sign a confidentiality agreement.
4. Franchisor's own role changes drastically; although the franchisor by licensing premises substantially free him from routine matters, he is still responsible for the entire network. He has to ensure the reputation of the business and the therefore he is forced to constantly check that licensees comply with all.

Advantages for franchisee

1. independence; The biggest positive for the franchisee is that on one hand he can benefit from all these advantages belonging to rather large business, but also still maintain freedom of independent entrepreneur.
2. Own initiative; franchisee can run the business as he see fit as long as it does not break any of contractual issues.

3. Safer, faster market entry; franchisee doesn’t have to build a brand name out of nothing, but can take advantage associated with an established name of franchisor and his reputation.
4. Lower risk of business; Franchisee which enters into the market can benefit from experience of the franchisor and its trained staff and can use franchisors patents and registered trademarks,
5. Assistance in starting, running; franchisor would also be able to offer for a franchisee a training that will allow control the company without previous specific knowledge of the field.
6. Access to credit; the cost of opening operations for the franchisee is often lower than they would be if it acted completely because of the cooperation with the franchisor,
7. Quickly establish contacts with other entrepreneurs; franchiser offers set up company, which may already enjoys extended brand-name recognition what provide the franchisee with the benefits of a pre-sold customer base that could normally take years to set up,
- Chances of commercial success associate with proven products and methods,

Disadvantages for franchisee:

1. Self-limiting - The franchisee is not an totally independent entrepreneur he govern by the franchisor's instructions,
- Franchisee on the one hand benefits from the experience of the franchisor, but must also comply with many rules and regulations set by headquarters
- Franchise agreement also generally regulates business opportunity of franchisee or work in the same field, which is subject to franchise. This limitation often applies not only during cooperation with the franchisor, but also for several years after the termination,
2. Subordination to the franchiser; franchisee risks that if there is a deterioration of the reputation and prosperity of the entire chain he will be withdrawn down, without any fault,
3. Dependence on the franchisor; the disadvantage of a strong dependence of the franchisee on the franchisor can have negative impact when the franchisor is unable to meet its commitment, without which usually franchisee can not operate,
4. Obligation to pay fees; franchisee has to pay to franchisor for the services he provided and for the use of his business system through the initial fees and continuing franchisee fees,

Advantages and disadvantages for consumers:

Main advantage is that franchise is a guarantor for the quality of its reputation and name; customers in all branches of franchised companies get the same product range and variety.

Main disadvantage for consumer is possible monopolization of the market and restriction of the competition on certain products or services which can result in lower availability of these products and services and can even increase their prices.

4. Contract – contractual issues

Franchise agreement is a legal expression of the franchisor and franchisee long term cooperation, where all the rules of cooperation between them should be embedded. The contractual relationship of franchise provides franchisee by supply of certain services done by franchiser, such are management consulting, and allows the franchisee to use franchisors name, join him and other franchisees in advertisement and secure other benefits.[41] It should be detailed description of the collaboration between a franchisor and franchisee. It is a free expression of will done by two economically and legally independent entities. „The grant of rights to use labels, names, trademarks, production procedures, prescriptions, etc., of the franchisor against payment by the franchisee can be regarded as constitutive features of franchising. "[42]

An essential part of every franchising contract has become the definition of mutual rights and obligations relating to intellectual property object especially the conditions for granting licenses, trademarks, know-how transfer. The franchise agreement also regularly contains provisions to ensure that the recipient has all relevant information available during the contract period. Franchiser has an obligation to train its franchise providers and beneficiaries throughout it provide adequate support. For contracts with a foreign franchisor it is also more suitable to directly set in the contract the rule of law, which manages the business relationship, and the proper jurisdiction or arbitration tribunal.

International perspective of franchise contract legislation is relatively sporadic. It is therefore necessary to modify all contract requirements that characterize franchise system of the cooperation. It is the only way to eliminate or at least limit any disputes between the parties and to achieve optimal balance between risks and prospects for franchising parties.

The franchise contract consists of two main parts, the purchase agreement and the license agreement. The Purchase Agreement describes the upfront transaction, detailing the terms of initial purchase. The License Agreement describes the terms and conditions of the franchise relationship. Purchase agreement should state the initial purchase price of franchise, include details about the franchise package and discuss the initial services that the franchisor will provide to franchisor. The License agreement contains information which pertains to the

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[41] Liuzzo, Anthony L , Essentials of business law, (6th [rev.] ed, 2007, Boston, MA [etc.]: McGraw-Hill/Irwin)
[42] Bernd Hempelmann , Optimal franchise contracts with private cost information, (2005, International journal of industrial organization vol. 24), http://www.sciencedirect.com/science/article/pii/S0167718705001062

ongoing operation of the franchise, like coverage of the rights included the purchase, obligations imposed on franchisor and franchisee and termination process of the contract.[43]

4.1. Structure of Franchise Agreement

In the franchise agreement are usually attached general business terms and conditions. Due to the nature and complexity of a franchise agreement, the intention is to only highlight a number of important clauses. Further, in this contract should be included the following points.

Franchise agreement usually contains a preamble in which it is made and the franchising definitions of basic concepts and interpretation of commonly used terms. Definitions should therefore include the trademarks, copyright, trade dress, know-how, trade secrets and other intellectual property.[44]

Secondly the subject of franchise agreement is described and it includes a precise characterization of the products or services that the franchisor provides to the franchisee. In the European Code of Ethics in 2.2 is stated "the obligations of the franchisor: The Franchisor shall have operated a business concept with success, for a reasonable time and in at least one pilot unit before starting its franchise network, be the owner, or have legal rights to the use, of its network's trade name, trade mark or other distinguishing identification and provide the Individual Franchisee with initial training and continuing commercial and /or technical assistance during the entire life of the agreement."[45] Furthermore, the obligations of the franchiser are set and can be divided into two groups. The first relates to the industrial property due to the fact that the use of trademarks, trade names, know-how and any other rights by concerns about the transmission system and method of business, the recipient takes over. The second group of rights and obligations of the provider's franchise includes the necessary information on the transmission system and method of implementation of the relevant economic activities. "As is the case with the initial obligations, the franchisor's ongoing commitments to the franchisee should be detailed in the agreement and the franchisor should be prepared to accept a legal obligation to provide them."[46] Franchisor provides the recipient area in which to carry out the franchising, while generally commits to a contract that

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43 See reference 13

44 Eugene Honey, The Franchise Agreement - what's included, http://www.whichfranchise.co.za/article.cfm?articleID=38

45 European Code of Ethics (http://www.eff-franchise.com/spip.php?rubrique13)

46 See reference 13, p. 193

he will not set out any other recipient of the recipient. It is an element of exclusivity, or exclusivity rights in the franchise contract. In this context, we can distinguish the territorial dimension, material and time.

The next important component of the agreement deals with the obligations of the franchisee and his compliance with the development plan, paying the agreed charges, to provide compliance with certain requirements aimed at controlling output quality and respect of confidentiality. The European Code of Ethics defines that: "The individual franchisee shall devote its best endeavors to the growth of the franchise business and to the maintenance of the common identity and reputation of the franchise network, supply the Franchisor with verifiable operating data to facilitate the determination of performance and the financial statements necessary for effective management guidance, and allow the Franchisor, and /or its agents, to have access to the individual Franchisee's premises and records at the Franchisor's request and at reasonable times, and not to disclose to third parties the know-how provided by the Franchisor, neither during nor after termination of the agreement."[47]

An important part of the contract provision is a comprehensive approach to advertising. International, regional and national advertising is done by franchisor. The recipient performs local advertising and marketing (market research) in their own catchments area. Franchisor must take reasonable efforts to promote and maintain the network and must take efforts to maintain good reputation of the franchise.[48] A complete statement of duties is however not possible. Franchise contracts are generally incomplete. This is especially true for those duties which concern marketing activities.

Furthermore, transfer of rights and obligations under the contract shall take place only with the consent of franchisor. Prices are determined according to the price list prepared by the franchisor.

The contract is concluded for a period of usually 2 to 15 years, but most time is 5 to 7 years. The aim of the franchise agreement is primarily a long-term cooperation between the Parties. Therefore, franchise agreement is usually concluded for a definite period with the possibility of further extension for example 15 years or more. In fact, should the duration of the contract fixed at a length that the recipient of a satisfactory profit to amortize their initial investment. It is normally defined as the possibility of further extension of the contract.

[47] See reference 45
[48] See reference 30

Also in contract should be set the franchisee payments. “The franchisor earns his revenue from income which he can generate principally from selling franchise packages, from continuing franchisee fees and/or mark/up on product sales.”[49]

Both contractors are entitled to withdraw from the contract. Such withdrawal may be proper, early or immediate, in which the franchisor must, however notice within a reasonable time prior notice. “The Agreement should also provide for an after termination clause in terms of which the franchisor will be entitled to after the termination of the contract to retrieve all materials, documents, programs and products bearing, reflecting or embodying the intellectual property of the franchisor or which is associated with the franchisor.”[50]

A substantial part of the contract is also the consequences of its termination. Franchise provider may be after the end of a stake in ensuring that the former recipient has not carried out on the same or similar activities. “Finally, there will be miscellaneous clauses, dealing with matters such as the right of the franchisee to sell the franchise, rights of heirs of the ceasing to be a franchisee.”[51]

4.2. Manual

As the main source of information for franchisee is in most cases is the manual, this document containing all relevant data, procedures and instructions. “Operational manual reinforces the terms and conditions of the franchise agreement, provide the franchisee with information about the working methods and practices, and sets out the way in which the franchise must be operated.″[52] Manual is usually attached to the contract. It contains information that belongs to the know-how of the franchisor. The conditions of its use should be in the contract clearly defined. In addition to developing custom text franchising agreements are legally relevant and significant negotiations leading to its closure. The franchiser is at this time provider of a partial disclosure of know-how. Due to the nature of the franchise package, however, is the franchisor of the effort to keep the package as much and as long as possible in secret. To protect confidential information obtained in this way, it is recommended that future advance franchise recipients pledged to secrecy, or that disclosure agreement is conclude. Franchisee is obliged in the contract to operate franchise business

[49] See reference 13, p. 132
[50] See reference 44
[51] See reference 15, p.19
[52] See reference 44

exactly as stated in the manual. Permission to change the products, services or technology is provided under the franchise (the "contract products") with respect to the common interests of both contractual partners is given only to the franchisor. Franchisor should also have an obligation by continually refine and improve the franchise concept as well as the range of contract products and receive input from the individual franchisees. It is appropriate to number the amendments, for a possibility of additional supplements to the original franchising agreement. [53]

4.3. Summary:

Franchise agreement is a legal expression of the franchisor and franchisee long term cooperation, where all the rules of cooperation between them should be embedded. The franchise contract is made up by two components, the purchase agreement and license agreement. Purchase agreement includes the original purchase price of the franchise, the franchise package and initial services that franchisor will provide. The license agreement should describe the conditions of the franchise relationship, which are the rights, included the purchase, obligations imposed on franchisor and franchisee, comprehensive approach to advertising, set of franchisee payments, period of the contract, termination process of the contract, after termination clauses and miscellaneous clauses dealing with issues such as the right of the franchisee to sell the franchise, rights heirs to be franchisee. The important part of the agreement is also the operational manual, which contains all relevant data, procedures and instructions for franchisee which he must use while operating the business.

[53] See reference 13, p. 201

5. Legal background of Franchising in Slovakia

The important question is whether the franchising is even an entrepreneurship? "The concepts of opportunity recognition, risk, organizational size, stage of organizational development, and organizational autonomy"[54] need to be taken into account when answering this question.

Pursuant to § 2 paragraph sec. 1 OBZ entrepreneurship is consistently considered a business activity carried out by entrepreneurs independently in their own name and on their own responsibility in order to achieve profit. All of the characteristics of entrepreneurship are cumulative. The conceptual character of entrepreneurship embodied in this Act states its independent conceptual character. This is missing in the franchising business, respectively it is narrowed to the significant extent. Franchise business is special business and can not but agree with the fact that the franchisee can decide according to his own reflections on the use of time and place of business or even the organization of work. Franchisee decides on business decisions only at the time of concluding the franchise agreement and has subsequently succumbed to the franchisor.

In the franchising franchisee incorporates the concept of entrepreneurship of franchisor including trademark and trade name, which is engaged in business under its own name. In franchising, each member, the franchisor and the franchisee are separate legal entities, they operate on their own account, but the entrepreneurial initiative and independence is oversees by the franchisee in overall by concept of franchisor.

Francoise chain performs at the market under the same trade name and trademark and together creates a joint business reputation and goodwill. Thus the franchisee is not satisfactory in two characters of entrepreneurship by not engaging in business under its own trade name and by not undertaking independently.

Character of independence differs significantly from other employment relationships. Independent is the one who alone decides and manages its business activities and who can be controlled only by law, also notes that independence does not relieve the operator to comply with legal obligations regulations and liabilities assumed. There are many opinions if the

[54] David J. Ketchen, Jr., Jeremy C. Short, James G. Combs , Is Franchising Entrepreneurship? Yes, No, and Maybe So,(2011, Baylor University) p. 1, http://onlinelibrary.wiley.com/doi/10.1111/j.1540-6520.2011.00442.x/abstract;jsessionid=576F7CDAA2B77F86B1F6EC63558F8045.d02t03

franchising is entrepreneurship, but as written bellow, it is type of entrepreneurship by the European /also Slovak/ Law.

5.1. Legal Form of Franchising

From a legal point of view franchising is defined as a relationship of two or more separate legal entities or persons, and is set up by franchising contract. Franchisor provides the franchisee the right to sell certain goods or services that bear his name, brand, goodwill and image. Franchisor transfers to franchisee also other industrial rights and helps him with the system of input and ongoing training and guidance supervision.[55]

Franchising is used in all countries of the world. It is based on close and constant cooperation of enterprises by franchisor and franchisees. Franchising is a way of spreading the scope of the business by franchisor with an established business concept. Franchisor gives opportunity to those applicants interested in entrepreneurship and as the consequence he needs them to follow his business concept. The base for cooperation in the franchise system is franchising contract.

After 1989 and especially starting in 1992, when Act No. 513/1991 /Slovakian Commercial Code/ went into force, entrepreneurs in Slovakia began to meet with a number of unknown terms. One of these concepts is also the concept of franchising.

Despite the fact that franchising is a widely known, so far it is not anchored to the legislation in Slovakia and other European Countries. It is a form of business, which currently represents the fastest way to the business expansion, particularly on the grounds that they are used in most personal commitment and investment of other people (such as business premises, insurance, equipment, staff, and so on).

The reason for franchisor and the franchisee to conclude a franchise agreement and make decisions to choose this form of business, of course, is the achievement of profit. Franchisee has a profit by selling goods or by provision of services, the franchisor gains profit as a reward that franchisee pays him for of complex of franchiser rights, such as licenses and know-how. [56]

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[55] Sudzina, Milan, The enforcement of intellectual property rights according to ammendement of O.s.p. [Vymožiteľnosť práv duševného vlastníctva podľa novely O.s.p.], (In:Právo a obchodovanie : zborník z vedeckej konferencie doktorandov konanej 7.6.2007 v Košiciach , 2008), http://www.upjs.sk/public/media/1084/zbornik_2.pdf, p. 219

[56] Mgr. Alexandra Vicová, Franchising, 2010, http://www.epi.sk/456/Franchising_18632.aspx,

Contracting parties of franchise agreement are undertakings and their contractual relationships are subject to § 261 paragraph 1 of the Slovak Commercial Code. This section of the Act governs contractual relationships between entrepreneurs, if at the time of their creation it is clear in all the circumstances that are relevant to their entrepreneurship.

Under the condition of a sufficient determination of the object of the parties the franchise contract will enter in a force under § 269 paragraph 2 of the Commercial Code, [57]which states that participants may also enter into such an agreement, not is recognized by the Slovak Commercial Code as a type of contract. However, if participants do not determine enough an object of its obligations, the contract is can not be concluded.[58]

For the reason that law does not address the form of a franchise agreement, for legal certainty, and for a wide range of content of the contract, it is almost a necessary requirement that a contract is in the written form.

Because of the absence of regulation of franchise, written franchise contract should be perfect and balanced so the parties can avoid any disputes that might arise due to absent or inadequate contractual arrangements.

Franchise Agreement as a contract type is not regulated by the Commercial Code or the Civil Code. It is atypical contracts "sui generis", a type of combined contract (includes primarily elements of the license agreement, lease, agency contract). In terms of legislation, the functioning of the Franchise relationship is based on terms in the contract and should be in line with the European Code of Ethics, respectively of Slovak Code of Ethics made by Slovak Franchise Association in a mirror image of the European Code of Ethics.

5.2. Franchise Associations

The European Franchise Federation EFF is a non-for-profit membership organization that federates the legally constituted, independent and representative national franchise associations from most of the countries in Europe. European legislation as one of the sources of law developed thru EFF/the European Franchising Code of Ethics for franchising in 1972.

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[57] JUDr. Tímea Kovácsová, Franchisingová zmluva (§ 269 ods. 2 Obchodného zákonníka), 2006, http://www.epi.sk/Main/Default.aspx?Template=~/Main/TArticles.ascx&MID=224&edllnkid=6701368&ArtType=3&phContent=~/EDL/ShowArticle.ascx&ArticleId=15483

[58] Slovak Commercial Code, http://www.szk.sk/files/legislativa/1991-513_znenie_20110630.pdf

The Code contains a summary of the essential rules of fair conduct and conduct in franchising practice in Europe. This Code is mandatory for those members of national associations which have adopted it.

In terms of legal liability the code is binding only for those members of the national franchise associations who participated in the process and committed to ensure its compliance.

"In order to allow prospective individual franchisees to enter into any binding document with full knowledge, they shall be given a copy of the present Code of Ethics as well as full and accurate written disclosure of all information material to the franchise relationship, within a reasonable time prior to the execution of these binding documents."[59]

The relevant provision is 3.3 of the Code under which franchisees enter into franchise agreement with a full knowledge and to this end they will be within a reasonable time before signing a franchise agreement given a valid copy of the Code together with a complete and exact wording of all written information and documents relevant to the franchise relationship. Although the franchise agreement is a contract not named under the Slovak law, the Code sets out mandatory rules for franchise contract. Since the Slovak Republic is not a member of the EFF, the Code can not apply on the franchise agreement entered under Slovak regulation.[60]

At present, in Slovakia only Slovak Franchise Association /SFA/ is formalized as operating entity, which is in a coherent whole issue of franchising provides qualified advice and service to franchisor, franchisees and prospective candidates for franchising - such as legal advice and service , selection of suppliers, production logistics, supply systems, cooperation and contacts at local, national and international organizations and structures operating in the affected areas, market analysis, purchase, marketing and advertising, advice on choosing franchisee and placement service, developing manuals, training and personnel management, and so on.

Slovak Franchise Association is the only official center for franchise business in Slovakia and in this sense are the only competent partner franchise associations around the world. It is bound to respect the Code of Ethics adopted by the European Franchise Federation, which is an important document regulating the franchising business ethics. SFA is therefore guarantees compliance with the ethics official business of franchising in Slovakia and it also imposes it on its members.[61]

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[59] European Code of Ethics
[60] See reference 45
[61] Slovak Franchise Association, http://www.sfa.sk

SFA is a non-profit organization whose members are Franchisor, franchisees and other business entities and individuals that promote franchising. One of its main current objectives is to promote and raise the level of credibility of franchisees and franchisors in Slovakia.

SFA is therefore preparing certification of franchise consultants, and then also of the franchise systems operating in Slovakia. Membership in the Slovak Franchise Association with the certified franchise system can officially mark the franchisors quality and seriousness, and guarantee the correctness of the franchisee.

In 2011, the membership of the SFA increased from six to nineteen full members. Slovak Franchise Association represents outside their tents under the SFA board, which also coordinates, organizes and implements its activities.[62]

Code of Ethics for franchising Slovak Franchise Association is prepared in accordance with the Code of Ethics for Franchising Franchise Federation.

5.4. European Competition law and franchising

It is necessary to mention the EC, notably Article 101(1)[63] of the Treaty on the Functioning of the European Union (TFEU) prohibits agreements that may affect trade between European Union countries and which prevent, restrict or distort competition have direct effect on member states of European Union. The evaluating under Article 101 TFEU composed of two parts. In the first step it is important to determine whether an agreement between businesses is may affect trade between EU countries and if it has an anti-competitive object or real or potential anti-competitive effects. Article 101(3) TFEU[64] becomes relevant only when an

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[62] See reference 60

[63] Article 101(1) TFEU: "The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which:
(a) directly or indirectly fix purchase or selling prices or any other trading conditions;
(b) limit or control production, markets, technical development, or investment;
(c) share markets or sources of supply;
(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts."

[64] Article 101(3) TFEU: „The provisions of paragraph 1 may, however, be declared inapplicable in the case of:
- any agreement or category of agreements between undertakings,
- any decision or category of decisions by associations of undertakings,
- any concerted practice or category of concerted practices,
which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

agreement between undertakings is restricting the competition. The second step, which becomes relevant only when an agreement is found to be restrictive to the competition, is to determine if the pro-competitive benefits and effects produced by that agreement outweigh the anti-competitive effects[65]

It is also important to mention the "Commission Regulation 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices and its Guidelines on vertical restraints."[66] This Regulation is entirely binding and directly applicable in all Member States /Slovakia is also a member state/. This regulation granted a block exemption to franchise agreements, if they are accordance with the conditions specified therein. Under this regulation, all companies using independent trading parties (including franchising business) for distribution in the EU are to fulfill the following: First Check your ownership interest in the EU, second in the event that their market share is below 30%, check whether their agreements are not on the list of exceptions to prevent the block exemption, third in the event that their market share is above 30%, re-evaluate what further action is necessary in order to ensure consistency in the competition.[67] Agreements that generate sufficient benefits to outweigh its anti-competitive effects will be exempted from prohibition under Article 101(3) TFEU. Whether a vertical agreement truly restricts competition and whether in that case the benefits outweigh the anti-competitive effect will frequently depend on the market structure in that case. In principle it needs an individual examination. However, the Commission Regulation 330/2010 provides a safe harbor for most vertical agreements

"The guidelines describe the approach taken towards vertical agreements not covered by the Commission Regulation (EC) No 2790/1999, 'the Block Exemption Regulation' (the BER). In particular, the BER does not apply if the market share of supplier and/or buyer exceeds 30 %. However, exceeding the market share threshold of 30 % does not create a presumption of illegality. This threshold serves only to distinguish those agreements which

(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;"
(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

[65] Guidelines on the application of Article 101(3) TFEU (formerly Article 81(3) TEC), http://europa.eu/legislation_summaries/competition/firms/l26114_en.htm

[66] Exemption for vertical supply and distribution agreements, http://europa.eu/legislation_summaries/competition/firms/cc0006_en.htm

[67] See reference 64

benefit from a presumption of legality from those which require individual examination. The guidelines assist firms in carrying out such an examination."[68]

5.4. Summary:

To summarize the legal aspects of franchising in Slovakia, firstly it is important to find out if franchising is even entrepreneurship. There were few discussions about it, but mostly they agreed that franchising is a type of entrepreneurship.

Franchising agreement is not regulated as a type of contract in the Slovakian Commercial Code. It is a combined type of contract and should base on terms of the Slovak Code of Ethics. The Slovak Code of Ethics was adopted by Slovak Franchise Association which is the only official center for franchise business in Slovakia as a mirror image of the European Code of Ethics made by European Franchise Federation

The legislative framework of European competition policy is provided by the EC Treaty mostly Article 101. Further rules are provided by Council and Commission Regulations as a Commission Regulation 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices and its Guidelines on vertical restraints.

To answer my research question, whether it is appropriate to create a new type of contract in the Slovak Commercial Code or whether the Slovak legislation is too complicated or incomplete? It is important to mention also the fact that the legislature must legally regulate those activities that reach certain intensity and thus affect the wider part of society and their legal regulation is socially desirable. In this regard, I consider that the incorporation the franchise agreement as a named contract in Slovak Commercial Law is desirable. It would prevent confusion and secure certainty for further development of the franchise in Slovakia.
It should also be noted that despite the fact that the franchise agreement is not presented as a named contract, this type of business practice, does not have that many practical problems while using in Slovakia.

[68] Guidelines on vertical restraints, http://europa.eu/legislation_summaries/competition/firms/cc0007_en.htm

6. Actual usage of franchise

The situation with the franchise system in the world, especially in Western countries and the USA is significantly different from the situation in the Eastern European countries especially in Slovakia. While in western countries there was free market economics, in the Slovak Republic was even in the late eighties the planned economy and new business including franchising began to develop only the beginning of the nineties. In developed countries franchising has a long tradition, especially in the United States, where in this way operates mainly businesses in the fast food industry and restaurants. Some of the best known global franchise entities are MacDonald, KFC, Burger King, etc.

6.1. USA

The U.S. Census Bureau released the 2007 Economic Census Franchise Report On September 14, 2010 at the International Franchise Association's Annual Public Affairs Conference. That report, the first census of franchising in the United States, that provides estimated franchise organizations, employment, annual sales, and payroll among businesses.

„The economic significance of franchising is greater than indicated by the activity in franchised businesses alone, for it stimulates still more activities in many non-franchised businesses. Counting economic results both inside and outside of franchising, franchised businesses in the United States were the cause of:

• 17.4 million private nonfarm jobs, or 11.8 percent of the total
• $707.6 billion of private nonfarm payroll, or 9.7 percent of the total
• $2.1 trillion of private nonfarm output, or 9.0 percent of the total
• $1.2 trillion of private nonfarm GDP, or 9.7 percent of the total

Overall, contribution to GDP made because of franchised business accounted for 8.4 percent of total U.S. GDP, including the government and farm sectors, in 2007. "[69] As we can see franchising in the USA plays a huge role in the economic market.

[69] PWC, The Economic Impact of Franchised Businesses: Volume III, Results for 2007, (2011), http://www.buildingopportunity.com/download/Part1.pdf

6.2. Europe

In official European Franchise Federation Website is only statistic, which is dated to year 2009. The difference is significant, since Slovakia, has in 2012 only 91 franchise concepts. The Czech Republic had in 2009, 150 of these concepts, which considerably more than Slovakia although they both are post communist countries and started entrepreneurship /also franchising/ considerably at the same timeframe.

Economic weight in figures2 in EU-173 Member States:

✓ **Average annual growth rate of number of brands is 8.1%**

Country	**# brands/systems**	**# brands**	**# brands**	**Δ growth over 2 yrs**	**% domestic brands**
17-EU States	**2007**	**2008**	**2009**	**2009/2007**	**2009**
AT-Austria	390	411	435	**11,5%**	55%
BE-Belgium	200	240	320	**60,0%**	60%
CZ-Czech Rep	131	137	150	**14,5%**	50%
DK-Denmark	180	185	188	**4,4%**	82%
FI-Finland	220	255	265	**20,4%**	75%
FR-France	1.137	1.229	1.369	**20,4%**	89%
DE-Germany	910	950	960	**5,5%**	80%
EL-Greece	544	560	563	**3,5%**	70%
HU-Hungary	320	350	341	**6,6%**	70%
IT-Italy	847	852	869	**2,6%**	96%
NL-Netherlands	676	669	679	**0,4%**	85%
PT-Portugal	501	521	524	**4,6%**	55%
PL-Poland	383	480	565	**47,5%**	73%
SI-Slovenia	103	106	107	**3,9%**	48%
ES-Spain	850	875	919	**8,1%**	81%
SE-Sweden	350	400	550	**57,1%**	67%
UK	809	835	842	**4,1%**	89%
TOTAL	**9.102**	**9.687**	**10.176**		Av.2009/2007 = 16.2%

Annual Av. = 8.1%

70

[70] European Franchise Federation, Franchising: a Vector for Economic Growth in Europe 2011, http://www.eff-franchise.com/IMG/pdf/Franchising_-_A_vector_for_Economic_Growth_in_Europe_-_2011_v472011.pdf

In 2009, these 17 European countries had over 10, 000 franchise brands, which compared to the number of the other franchise brands in major world markets is very significant.

(est.) :

China	2,800	**India**	1,800
South Korea	2,500	**Brazil**	1,643
USA	2,200	**Canada**	1,200
Turkey	1876	**Australia**	1,000

[71]

The Europe has the considerably the most franchise brands. As seen on the table above France is the leader in the amount of the brands in Europe, then Spain, UK and Netherlands. This doesn't mean that in Europe are more establishment as in USA, just that it has more diversity of the franchise brands.

Throughout Europe as stated on the official website of Slovakian Franchise Federation, to the year of 2012 we find 8,500 different brands using the franchise model of business, 2500 in USA, France 1141 and Germany 910 brands. In the Czech Republic are only 130 of these brands. Increase of franchising in Europe is 5% each year; in the UK it is as much as 44%.[72].

As we can see the different numbers which could not be both true are stated in the official franchise association websites, one on the European one and one on the Slovakian which to trust is hard to say. For sure there can be only stated that franchising is still popular and often used all over the world, the exact number of the brands is not known.

6.3. Slovakia

Franchising started to be used only when the global foreign chains started to entry the country. In Czechoslovakia the very first franchise operation was open in 1991, it was a natural cosmetics store Yves Rocher in Prague and then in a few days, also first operation of the Mc Donald's was open. In Slovakia, the first franchise operation to be open was Mc

[71] See reference 69

[72] Andrej Klokner, Franchising is the most succesfull [Franšíza je úspešnejšia] (2012) http://www.sfa.sk/novinky/fransiza-je-uspesnejsia.html

Donald's in Banska Bystrica in 1995. Afterwards other famous brands started to then we develop its networks and chains.[73]

In Slovakia there is not other formal subject except Slovak Franchise Association that could professionally be capable of provide advisory services, services to franchisor and franchisee. There is not actual official statistic of the franchise operations and solutions of their entrepreneurship in Slovakia. To write this subchapter I used mostly the Interim reports on the status and development of franchising in Slovakia in 2011, and 2012 made by Slovak Franchise Association, because of the lack of online information about current development of franchising in Slovakia.

Slovak Franchise Association has only information of its own participants, so it is not 100% accurate. Most concepts are foreign, but some are domestic, most famous one is probably Pizza Mizza, which is spreading now also to Czech Republic.[74]

To have successful franchise the franchisor has to choose franchisee which knows the local environment of the operation, the local market and can predict future development.

Some of the foreign franchisors have a tendency to think that what works in global market will work in our environment. This can take them to the bad decision making. In Slovakia, but also in other European countries, there is not formal legal definition of franchising. [75]

The reality is that success of franchising in Slovakia does not depend on their origin or the success of the global brands, but from experience of our local master franchisor, appropriate selection of franchisees and his local knowledge. Franchisor and franchisee must have a good knowledge of local market and have to correctly predict the future development. The concept to successful work abroad should be set at to our local conditions, options, purchasing power and so on.[76]

“Before the recent recession, many companies were targeting Eastern Europe where the demand for and popularity of U.S. products and services was very high. Although Poland

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[73] Ing. Jozef Šétaffy, Interim report on the status and development of franchising in Slovakia in 2012 [Priebežná správa o stave a rozvoji franchsingu na Slovensku 2012], http://www.msponline.sk/files/SFA_-_Spr__va_m__j_2012.pdf

[74] See reference 72

[75] Ing. Jozef Šétaffy, Interim report on the status and development of franchising in Slovakia in 2011 [Priebežná správa o stave a rozvoji franchsingu na Slovensku 2011], http://www.franchisa.sk/franchising-report-sfa-2011.html?PHPSESSID=e2d60a344a38aa0d803d57d36e850eba

[76] See reference 72

seems to have fared well in this economy, Hungary, Romania, Slovakia and the Czech Republic continue to battle with economic contraction and budget deficits."[77]

"Due to very high unemployment and overbuilding in most European countries up to 2008, there is little new investment happening right now. But franchise investment is starting to happen in Eastern Europe and could make a comeback as early as 2012 in areas such as Scandinavia, Spain and the United Kingdom."[78]

Franchising is a type of entrepreneurship, thus its existence depends on development of the quality in the whole business environment. The consequences of the crises are the purchase power of the people is low, the unemployment rate is high, and the uncertain outlook of the potential of the European and global economy does not create a suitable atmosphere for the growth of public consumption and consequently franchising. Slovakia has a lot to improve.[79]

Slovakia has significant differences in the regional purchasing power, the gastronomic and shopping habits of the consumers, which makes applying of the same standards of franchise concepts uniformly across the country impossible. Every local franchise has to set its own conditions.

Another barrier is the low knowledge of the principles, methods and benefits of the franchising. There is not enough information about franchising for starting entrepreneurs in Slovakia. Slovak Franchise Association is only one organization which is promoting franchise in Slovakia. A lot of entrepreneurs which are using the franchising do not join SFA. By doing so they do not help to develop the franchising practice and hence their business and help especially young entrepreneurs.

The global brands which are successful abroad will now have a problem to develop in Slovakia. This is due to the saturation of the market, the current sales potential and the problematic economic situation of the consumers and their purchasing power.

An interesting phenomenon is also persistence of the thinking and behavior of the people. People hold on to their habits and it is more and more difficult to adopt a new brand, especially if they are relatively satisfied with services, location, operation and brand of the old one. [80]

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[77] Wiliam Edwards, International Franchise Association, Where to Take Your Franchise, March 2011, http://franchise.org/Franchise-Industry-News-Detail.aspx?id=53437
[78] See reference 76
[79] See reference 74
[80] See reference 72

The slow development and spread of franchising in Slovak Republic is because of the imperfect legislation where franchising is not governed by special type of contract /foreign companies operating the franchise concept didn't have confidence in the Slovak legislation/, problems with its funding, limited offers off counseling services, underdeveloped business culture, lack of know how and experience of Slovak entrepreneurs /problems with location of enough suitable candidates for franchisee/.

In Slovakia, there is still no official statistics on the current franchise business. Some partial information has a SFA about its members. Most franchise concepts are from abroad but some are also originally local.

Currently, we register in the Slovakia 22 local and 69 foreign concepts. The structure of the franchise business has a general global trend, as most of them are in the field of gastronomy, trade and services. The success of the formats is possible to evaluate only approximately as to evaluate how they develop and operate on the market, because the official statistics and economic results are not available. [81]

6.4. Summary:

In the last part of my thesis, I described the recent development of franchising in USA, Europe and especially in Slovakia. I also answered the one of my research questions. Why is franchising not used in the same altitude in Eastern European Countries like it is used in US and other pro franchising countries? As explained in above, the history and development of entrepreneurship in the concrete country plays a big role. In Slovakia and in most of the Eastern European countries there was a national socialistic directive economy when franchising started to spread in USA and other countries. Only after Slovakia had free market environment and possible entrepreneurship franchising as a type of new entrepreneurship could occur.

There is more reasons why franchising is not spread in the same altitude than in other countries. First of all people in Slovakia have persistent thinking and behavior. They hold on to their traditions and habits and they are to rigid for a change in a form a new brand. Secondly, Slovakia has imperfect legislation where franchising is not governed by special type of contract, very high unemployment, saturation of the market, the current sales potential

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[81] See reference 72

and the problematic economic situation of the consumers and their purchasing power. Another barrier is the not sufficient knowledge of the franchising, its principles, methods and benefits. Slovak Franchise Association promotes franchising in Slovakia but doesn’t have much success. Due to these problems the global brands which are successful abroad will have a problem to develop in Slovakia.

7. Conclusion

In this chapter I will provide the summary of the thesis, but mostly the answers for my research questions. In second chapter I focused on the theoretical basics of the franchising. As are the different types of entry modes which are the joint ventures, wholly owned subsidiaries, contractual agreements and exports, the definition of franchising and its history. In fourth chapter I described the main contractual issues of the franchise agreement, as it is an essential requirement for the franchise business.

In the third, fifth and six chapters I focused on answering the researched questions, which I think I succeeded. My answer for the first research question / What are the advantages and disadvantages for entrepreneurs while using franchising form of distribution?/ is explained in greater detail in the third chapter. Entrepreneurs choose franchising for its many advantages. The main advantage for the franchisor is relatively lower demand for capital, lower risk of business, fewer personnel problems and rapid development of penetration through the new market. The main advantages for franchisee are his independence, his own initiative, safer, faster market entry, lower risk in business, assistance in starting and running the business, lower costs and quickly established contacts with other entrepreneurs. But franchising has also its disadvantages. For the franchiser it is mainly franchisees risk of failure, training a future competitor in the recipient, risk of franchisors secret disclosure and change of role for franchisor. The franchisees main disadvantages are self-limiting, subordination to the franchiser, dependence on the franchisor and obligation to pay fees. For the customers the main advantage is a expected guarantee of the same quality of the same product, because of the name and reputation of the brand. The main disadvantage is the monopolization of the market, which can result in lower availability of the certain products or services can even increase their prices.

The answer on my third question /Whether it is appropriate to create a new type of contract in the Slovak Commercial Code or whether the Slovak legislation is too complicated or incomplete?/ is in the fifth chapter. Franchise Agreement as a contract type is not regulated by the Commercial Code or the Civil Code in Slovakia. It is atypical contracts "sui generis", a type of combined contract which includes primarily elements of the license agreement, lease, and agency contract. It is a combined type of contract and should be base on terms of the Slovak Code of Ethics. The Slovak Code of Ethics was adopted by Slovak Franchise Association which is the only official center for franchise business in Slovakia as a mirror image of the European Code of Ethics made by European Franchise Federation. It is important to mention also the fact that the activity which reach certain intensity and thus affect the wider part of society and their legal regulation is socially desirable legislature should legally regulate. In this regard, I consider that the incorporation of the franchise agreement as a named contract in Slovak Commercial Law is desirable. It would prevent confusion and secure certainty for further development of the franchise in Slovakia. It should also be noted that despite the fact that the franchise agreement is not presented as a named contract, this type of business practice, does not have that many practical problems while using in Slovakia.

In the last part of my thesis I answered the second question / Why is franchising not used in the same altitude in Eastern European Countries like it is used in US and other pro franchising countries?/ As a history and development of the USA, Europe, and Slovakia as also most of the Eastern European Countries was different it influenced also the future. Only something more than 20 years ago in Slovakia was still national socialistic directive economy, while in USA and Western Europe was free market environment. The possibility of entrepreneurship opened up only after the free market was allowed in Eastern Europe. After that the franchising as also other possibilities of entrepreneurship started to spread also in Eastern Europe. Other reason is also the persistent thinking and behavior of the people in Slovakia. Their traditions and habits are rigid and they don't want a change. Also the imperfect legislation is confusing for new entrepreneurs. Slovakia and in general also Eastern Europe has very high unemployment, saturation of the market, the current sales potential and the problematic economic situation of the consumers and their purchasing power. Another barrier is not sufficient knowledge of the franchising, its principles, methods and benefits. Promoting of franchising in Slovakia is done only by Slovak Franchise Association. Due to these problems even the global brands which are successful abroad will have a problem to develop in Slovakia. There is not many information about current situation of franchising in Slovakia and its economical and legal prospective. This made my research harder, but because of it I think I choose a useful research topic which is not yet used up.

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