<http://www.franchiselawyers.net/reportindia.htm>

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| **Introduction**The franchising industry rightly deserves to be called the wave of future businessin India. The phenomenon of franchising developed at the end of Second WorldWar and the system has taken its roots in the United States of America, wherealmost 50% of all retail sales are through franchise outlets. Decades later, Indiahas begun to see the growth of both domestic and international franchisesbalancing the philosophy of the free market with the philosophy of swadeshi(indigenous) products.Franchising encourages spirit of entrepreneurship with its essence lying in anagreement between two independent undertakings, the franchisor and thefranchisee. The consideration is the payment of some fee or royalty to thefranchisor against the rights granted to the franchisee to market the goods andservices of the former with their brand names using the franchisor’s trade marksand business methodology for which the franchisor would also provide the knowhowand technology.**Emergence of the Indian market**One of the primary factors which control the success of a franchising business inan emerging economy like India is the ability of a foreign franchisor to identifyand seize the appropriate moment when the business environment is favorableand reap its rewards. Home to over a billion people, including a flourishing classof urban consumers possessing considerable amounts of disposable incometogether with the continued growth of the economy have strengthened India’sclaim to be a viable and beneficial destination for a foreign franchisor.India ranks as the fourth largest economy globally in terms of purchasing powerparity (PPP) with GNP of US $ 2.91 Trillion (2001-02). According to a recentreport by UNIDROIT, the foundation of a successful franchising industry in anycountry lies in the existence of a “healthy commercial law environment” whichhas been defined as one with a ‘general legislation on commercial contracts, withan adequate company law, where there are sufficient notions of joint ventures,where intellectual property rights are in place and enforced and wherecompanies can rely on ownership of trademarks and know-how as well as onconfidentiality agreements’. The Indian business and legal set up is characterizedby all these attributes, a fact which has been acknowledged as well as exploitedby numerous foreign companies.India offers vast openings for a franchisor to set up its business; createawareness for his products or services and exploit the enormous market offered.As a result, it comes as no surprise that India has recently been declared as thesecond most attractive destination for retailers among 30 emerging markets.Though current investment regulations of the Indian Government bar foreigninvestment in the retail sector, it hasn’t deterred foreign participation. Rather thanshying away from the enormous market that India offers, international companieslike Marks & Spencer, the global retail chain of stores have taken to entering intodifferent forms of franchising arrangements, ranging from just use of its trademark for a fee to the standard model of allowing its system to be used for afranchise fee.Seasoned franchisors such as McDonalds were one of the first to realize thewidespread prospects offered by India and extended its services into this market.The international recognition of its brand together with the adaptation of itsproducts to suit the preference of Indian consumers, which include offering morespicy items in its menu, has resulted in McDonalds becoming a household namein India.An important aspect which determines the feasibility of any franchising businessin a country relates to the class of consumers it caters to. India is a country withthe largest young population in the world; a staggering 870 million people arebelow the age of 45 years, a market that will suit the products and services ofmultinational franchising companies primarily dealing in Food &Beverages (F&B)and lifestyle products. Indian consumers have experienced the standard ofservices offered overseas and have sufficient exposure through media, whichhas further fuelled their expectations. They now want to avail of the benefits thata foreign franchisor can generate for them.However, to state that a franchisor can rely on the international recognition of hisbrand and proven business system to ensure a successful venture in India wouldbe nothing short of an oversight. Almost every product or service has a market inIndia but sometimes, innovative strategies like ‘indianisation’ of its products andmarketing techniques must be employed by a foreign franchisor to further accessthe sizable market of India. A notable example in this regard is the deliberateexclusion of beef by McDonalds giving due consideration to the religioussentiments of the Indian public. Majority of India’s population is follower of theHindu religion which preaches that the cow is considered sacred and is thereforeanti cow slaughter.**The Legal Framework in India**There is no specific legislation regulating franchise arrangements in India, butthere are various laws which affect the relationship between thefranchisors and franchisees, including intellectual property laws, taxation, laborregulations, competition laws, property and exchange control. A deepunderstanding of the laws related to the business of franchising is imperative fora foreign franchisor which is planning a foray into the India market.The Government permits foreign franchisors to charge royalties up to 1 % fordomestic sales and 2 % on exports for use of the foreign franchisor’s brand nameor trade mark, without transfer of technology. In effect, this means that by lendingjust their brand name or trade mark to an Indian company, a foreign companycan receive royalties. The laws in India also permit lump sum and royaltypayments to be made by Indian franchisees to their foreign counterparts for useof foreign techno logy, which includes manuals, systems etc. Lump sumpayments up to US$ 2 million are permitted and royalties of 5% on domesticsales and 8% on exports can be paid to the foreign franchisor. In addition, foreigncompanies can enter into consulting agreements and receive up to US$ 1 millionper project. Amounts in excess of these can also be received but with thepermission of the Indian Government. These rules allow a foreign franchisor tostructure its business in India in such a way so as to ensure that it can repatriatethe maximum amount from India.A foreign franchisor also needs to decide whether to appoint a master franchiseefor the entire country or appoint franchisees around the country independently orthrough its subsidiary which acts as a master franchise. The franchisee will notonly be responsible for developing and adapting the foreign prototype to a newand different market in which it has limited name recognition, but will also beresponsible for implementing the expansion plan of the franchisor for an entirecountry. It is important to recognize that a potential master franchisee in NorthernIndia may have an extremely strong network in that part of the country but maynot be able to provide similar resources in other parts of the country. India is ahuge market and demands, networks and languages vary from region to regionand state to state. It may be a better idea to appoint different franchisees fordifferent regions rather than trusting one master franchisee to control theappointment of suitable sub-franchisees around the country. Further, it is vital toconduct a thorough financial and legal due diligence or feasibility report on one’spotential partner, which includes a check on the owners, directors, financialstatus and its ability to invest and expand the business.Taxation is another issue which deserves due consideration. It is important toknow the local sales tax, property tax and withholding tax. Eventually, the localtax laws and the existence of treaties between the countries involved mayhave considerable influence on the structure adopted. Where the franchisorreceives royalties, service or franchise fees, tax has to be paid under theincome tax act (as income arising and accruing in India), whether thefranchisor is an Indian or foreign party. In a case where the foreign franchisorsends training personnel and supervisors to India, the salaries payable tothese persons may be subject to personal income tax, whether anarrangement is made to deduct the tax at source or they are taxed as selfemployedpersons (if they come as consultants).In calculating the amount of tax payable by the franchisor or the franchiseecompany, the deductions available in tax laws of India can be important for taxplanning purposes. Some of these relate to rent, repairs and insurance inrespect to premises used for business; depreciation and expenditure onresearch; and, expenditure of capital nature on acquisition of patent rights orcopyrights. However, the availability of tax advantages would depend on thetype of franchise, the product of the franchise and where the unit is to belocated.It must be noted that the above is subject to double taxation avoidanceagreements (DTA) involving India and any foreign country. The tax liabilitywould accordingly be reduced. The income tax law in India gives recognitionto this and double taxation agreements take precedence over the terms of theIncome tax act.A signatory to the international conventions on intellectual property rights,India offers adequate protection to trademarks or brand names as well ascopyright and designs of the foreign franchisor. A significant step takenrecently is the recognition and protection extended to service marks in Indiaenabling the foreign franchisor to license its mark to a franchisee in order toextend the services synonymous with him to the consumers in India.Enforcement mechanisms are becoming more reliable, which has previouslybeen a bone of contention for foreign corporations.The key issue to a beneficial relationship between any franchisor and itsfranchisee is related to the smooth transfer of technology and training ofpersonnel followed by regular assistance provided by the franchisor in therunning of the business. Like other developing countries, India had, tillrecently, a restrictive technology policy which attempted but didn’t succeed inattracting substantial foreign technology. Owing to this, franchisors initiallypreferred to spread their business in countries which were investment friendlyor culturally similar to the country of their origin.**India: New Opportunities**Post 1991, India has liberalized the economy and has also emerged as aninformation technology and outsourcing hub. These, coupled with theomnipresent knowledge of English language amongst Indians havesubstantially bridged the cultural divide between India and the westerncountries. Indian franchisees have successfully comprehended andimplemented technology which initially may have been alien to them and haveprovided the required impetus to the franchising industry. In addition tobringing down the costs for the franchisors, the increase in the level ofeducation amongst Indians has created a pool of talent and skill which can berelied on by the foreign franchisors for beneficial partnerships and its fruitfuloutcome.India offers a large and expanding consumer market with an increasingpurchasing power which amounts to almost 350 million, more than the entirepopulation of some European countries put together. World EconomicReform’s Global Competitiveness Report, 2002-03 has declared India ashaving the best technology licensing regime causing an upturn in the interestof foreign companies to invest in India.One of the most vital tools for the expansion of any business relates to itsadvertising, marketing and brand management. The competence of theadvertising and media sector in India is globally recognized. An extensive medianetwork is always at the disposal of the foreign franchisor to reach the populationof India of over a billion and create awareness of its services and products.Sponsorship of events and festivals by franchisor companies is a commonoccurrence in India.**Conclusion**Foreign franchisors should take time to understand the huge potential Indiaoffers to their business. Like any business expansion strategy, a foray into theIndian market would require a detailed feasibility study and calculation of risksattached to it. On the other hand, the Indian Government must be open toconfidence building measures in favor of the international franchisors includingpolicy amendments and adoption of a single focus approach to the promotionand regulation of the franchising industry in India.**Note about authors and firm:**Srijoy Das (sdas@archerangel.com, +91-11 26261302) is a Partner with the lawfirm of Archer & Angel, based in New Delhi, India with offices in Chennai andMumbai. 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