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

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| **Introduction**  The franchising industry rightly deserves to be called the wave of future business in India. The phenomenon of franchising developed at the end of Second World War and the system has taken its roots in the United States of America, where almost 50% of all retail sales are through franchise outlets. Decades later, India has begun to see the growth of both domestic and international franchises balancing the philosophy of the free market with the philosophy of swadeshi (indigenous) products. Franchising encourages spirit of entrepreneurship with its essence lying in an agreement between two independent undertakings, the franchisor and the franchisee. The consideration is the payment of some fee or royalty to the franchisor against the rights granted to the franchisee to market the goods and services of the former with their brand names using the franchisor’s trade marks and business methodology for which the franchisor would also provide the knowhow and technology.  **Emergence of the Indian market**  One of the primary factors which control the success of a franchising business in an emerging economy like India is the ability of a foreign franchisor to identify and seize the appropriate moment when the business environment is favorable and reap its rewards. Home to over a billion people, including a flourishing class of urban consumers possessing considerable amounts of disposable income together with the continued growth of the economy have strengthened India’s claim to be a viable and beneficial destination for a foreign franchisor. India ranks as the fourth largest economy globally in terms of purchasing power parity (PPP) with GNP of US $ 2.91 Trillion (2001-02). According to a recent report by UNIDROIT, the foundation of a successful franchising industry in any country lies in the existence of a “healthy commercial law environment” which has been defined as one with a ‘general legislation on commercial contracts, with an adequate company law, where there are sufficient notions of joint ventures, where intellectual property rights are in place and enforced and where companies can rely on ownership of trademarks and know-how as well as on confidentiality agreements’. The Indian business and legal set up is characterized by all these attributes, a fact which has been acknowledged as well as exploited by numerous foreign companies.  India offers vast openings for a franchisor to set up its business; create awareness 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 the second most attractive destination for retailers among 30 emerging markets. Though current investment regulations of the Indian Government bar foreign investment in the retail sector, it hasn’t deterred foreign participation. Rather than shying away from the enormous market that India offers, international companies like Marks & Spencer, the global retail chain of stores have taken to entering into different forms of franchising arrangements, ranging from just use of its trade mark for a fee to the standard model of allowing its system to be used for a franchise fee. Seasoned franchisors such as McDonalds were one of the first to realize the widespread prospects offered by India and extended its services into this market. The international recognition of its brand together with the adaptation of its products to suit the preference of Indian consumers, which include offering more spicy items in its menu, has resulted in McDonalds becoming a household name in India. An important aspect which determines the feasibility of any franchising business in a country relates to the class of consumers it caters to. India is a country with the largest young population in the world; a staggering 870 million people are below the age of 45 years, a market that will suit the products and services of multinational franchising companies primarily dealing in Food &Beverages (F&B) and lifestyle products. Indian consumers have experienced the standard of services offered overseas and have sufficient exposure through media, which has further fuelled their expectations. They now want to avail of the benefits that a foreign franchisor can generate for them. However, to state that a franchisor can rely on the international recognition of his brand and proven business system to ensure a successful venture in India would be nothing short of an oversight. Almost every product or service has a market in India but sometimes, innovative strategies like ‘indianisation’ of its products and marketing techniques must be employed by a foreign franchisor to further access the sizable market of India. A notable example in this regard is the deliberate exclusion of beef by McDonalds giving due consideration to the religious sentiments of the Indian public. Majority of India’s population is follower of the Hindu religion which preaches that the cow is considered sacred and is therefore anti cow slaughter.  **The Legal Framework in India**  There is no specific legislation regulating franchise arrangements in India, but there are various laws which affect the relationship between the franchisors and franchisees, including intellectual property laws, taxation, labor regulations, competition laws, property and exchange control. A deep understanding of the laws related to the business of franchising is imperative for a foreign franchisor which is planning a foray into the India market. The Government permits foreign franchisors to charge royalties up to 1 % for domestic sales and 2 % on exports for use of the foreign franchisor’s brand name or trade mark, without transfer of technology. In effect, this means that by lending just their brand name or trade mark to an Indian company, a foreign company can receive royalties. The laws in India also permit lump sum and royalty payments to be made by Indian franchisees to their foreign counterparts for use of foreign techno logy, which includes manuals, systems etc. Lump sum payments up to US$ 2 million are permitted and royalties of 5% on domestic sales and 8% on exports can be paid to the foreign franchisor. In addition, foreign companies can enter into consulting agreements and receive up to US$ 1 million per project. Amounts in excess of these can also be received but with the permission of the Indian Government. These rules allow a foreign franchisor to structure its business in India in such a way so as to ensure that it can repatriate the maximum amount from India.  A foreign franchisor also needs to decide whether to appoint a master franchisee for the entire country or appoint franchisees around the country independently or through its subsidiary which acts as a master franchise. The franchisee will not only be responsible for developing and adapting the foreign prototype to a new and different market in which it has limited name recognition, but will also be responsible for implementing the expansion plan of the franchisor for an entire country. It is important to recognize that a potential master franchisee in Northern India may have an extremely strong network in that part of the country but may not be able to provide similar resources in other parts of the country. India is a huge market and demands, networks and languages vary from region to region and state to state. It may be a better idea to appoint different franchisees for different regions rather than trusting one master franchisee to control the appointment of suitable sub-franchisees around the country. Further, it is vital to conduct a thorough financial and legal due diligence or feasibility report on one’s potential partner, which includes a check on the owners, directors, financial status and its ability to invest and expand the business.  Taxation is another issue which deserves due consideration. It is important to know the local sales tax, property tax and withholding tax. Eventually, the local tax laws and the existence of treaties between the countries involved may have considerable influence on the structure adopted. Where the franchisor receives royalties, service or franchise fees, tax has to be paid under the income tax act (as income arising and accruing in India), whether the franchisor is an Indian or foreign party. In a case where the foreign franchisor sends training personnel and supervisors to India, the salaries payable to these persons may be subject to personal income tax, whether an arrangement is made to deduct the tax at source or they are taxed as selfemployed persons (if they come as consultants).  In calculating the amount of tax payable by the franchisor or the franchisee company, the deductions available in tax laws of India can be important for tax planning purposes. Some of these relate to rent, repairs and insurance in respect to premises used for business; depreciation and expenditure on research; and, expenditure of capital nature on acquisition of patent rights or copyrights. However, the availability of tax advantages would depend on the type of franchise, the product of the franchise and where the unit is to be located. It must be noted that the above is subject to double taxation avoidance agreements (DTA) involving India and any foreign country. The tax liability would accordingly be reduced. The income tax law in India gives recognition to this and double taxation agreements take precedence over the terms of the Income tax act. A signatory to the international conventions on intellectual property rights, India offers adequate protection to trademarks or brand names as well as copyright and designs of the foreign franchisor. A significant step taken recently is the recognition and protection extended to service marks in India enabling the foreign franchisor to license its mark to a franchisee in order to extend the services synonymous with him to the consumers in India. Enforcement mechanisms are becoming more reliable, which has previously been a bone of contention for foreign corporations. The key issue to a beneficial relationship between any franchisor and its franchisee is related to the smooth transfer of technology and training of personnel followed by regular assistance provided by the franchisor in the running of the business. Like other developing countries, India had, till recently, a restrictive technology policy which attempted but didn’t succeed in attracting substantial foreign technology. Owing to this, franchisors initially preferred to spread their business in countries which were investment friendly or culturally similar to the country of their origin.  **India: New Opportunities**  Post 1991, India has liberalized the economy and has also emerged as an information technology and outsourcing hub. These, coupled with the omnipresent knowledge of English language amongst Indians have substantially bridged the cultural divide between India and the western countries. Indian franchisees have successfully comprehended and implemented technology which initially may have been alien to them and have provided the required impetus to the franchising industry. In addition to bringing down the costs for the franchisors, the increase in the level of education amongst Indians has created a pool of talent and skill which can be relied on by the foreign franchisors for beneficial partnerships and its fruitful outcome.  India offers a large and expanding consumer market with an increasing purchasing power which amounts to almost 350 million, more than the entire population of some European countries put together. World Economic Reform’s Global Competitiveness Report, 2002-03 has declared India as having the best technology licensing regime causing an upturn in the interest of foreign companies to invest in India. One of the most vital tools for the expansion of any business relates to its advertising, marketing and brand management. The competence of the advertising and media sector in India is globally recognized. An extensive media network is always at the disposal of the foreign franchisor to reach the population of India of over a billion and create awareness of its services and products. Sponsorship of events and festivals by franchisor companies is a common occurrence in India.  **Conclusion**  Foreign franchisors should take time to understand the huge potential India offers to their business. Like any business expansion strategy, a foray into the Indian market would require a detailed feasibility study and calculation of risks attached to it. On the other hand, the Indian Government must be open to confidence building measures in favor of the international franchisors including policy amendments and adoption of a single focus approach to the promotion and 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 law firm of Archer & Angel, based in New Delhi, India with offices in Chennai and Mumbai. The firm advises on franchising, intellectual property, foreign investment, technology and corporate law. Kartik Srivastava (ksrivastava@archerangel.com +91 -11 51641302) is an associate in the Corporate and IP department. |
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