Running head: International Trade: Licensing and Franchising

The Advantages and Disadvantages of Licensing & Franchising in Canada

Presented by:
Mamah S. Borbor
Of Team McWorld

University of Maryland University College

AMAB 606 Fall 2005

November 6, 2005

Executive Summary:

Over the past couple of decades, franchising has blown up internationally. One of the most significant decisions faced by big companies such as McDonald's is what mode of entry to use when entering a foreign market. Franchising is a common entry mode for many establishments. Buckley & Casson (1998) suggest that licensing and franchising are great starting strategies as measures to gain entry into a foreign market. Licensing is referred to as permission to use intellectual property rights such as trademarks, patents, or technology under defined conditions (Buckley & Casson, 1998). Where as, franchising can be referred to as a method of doing business wherein a franchisor licenses trademarks and methods of doing business to a franchisee in exchange for a royalty fee (Hill, 2005).

Consequently, both licensing and franchising come with advantages and disadvantages. The underlying advantages and disadvantages can both be presented on a domestic and international level. In Canada franchising is common method of doing business and has been credited for boosting their economy (Gray, 2005). Therefore, Canada highly encourages individuals to fully research and plan prior to opening a franchise in Canada. The McDonald's corporation is quite familiar with the standards and procedures on franchising in Canada as over half of the companies restaurants are franchise operated.

Introduction:

When a company decides to expand their market on a global level there are several underlying factors that they must take into consideration. These options include what foreign market to enter, costs, risks involved, attitudes, the ability to achieve objectives in the target markets and the degree of entry mode (Hill, 2005). Although all the associated options mentioned above are equally important, however the choice of entry mode is a significant factor.

There are numerous market entry strategies that a business can adapt to when setting up offshore. Each factor has differing levels of risk, legal obligation, advantages and disadvantages. The simplest form of entry mode strategy is exporting using a direct or indirect method. Other entry modes such as export processing zones and joint ventures are a bit more complex (Buckley & Casson, 1998). For the purposes of this paper it will primarily focus on licensing and franchising as an entry mode. The paper specifically has as its goal to discuss franchising as a method of expansion for McDonald's corporation in Canada.

Definition of Licensing:

The term licensing can be defined as an understanding between two parities where one person has proprietary rights over some information, patent, inventions, formulas, process, technology, trademarks, designs, inventions or copy right (Wikipedia.org). This agreement that is specified in a mutual contract requires the licensee to pay a royalty fee or some other specified sum to the licensor in exchange for authorization to copy the patent, trademark or copyright (Wikipedia.org).

There are several types of license agreements. A patent license agreement details how the licensee would have access to the patent. For example, under the agreement the licensor is able to continue to produce their product but, the licensor grants the licensee permission to market the product under the licensors label in a noncompetitive market (Wikipedia.org). In another case the licensee may actually produce and market the patented product under there own label. However, this arrangement must be clearly stated and should involve a lawyer to avoid future legal actions (http://www.nmpa.org/hfa/licensing.html).

Licensing agreements under copy rights are also quite well known. These agreements involve permission to use of copy books, music, software, photographs, computer games, movies and television shows for board games. For example, a television show will often give a licensee the rights to copy right a show into a board game of computer game (http://www.nmpa.org/hfa/licensing.html).

The most recognizable licensing ventures include measures in the sports merchandising and entertainment industries. The National Basketball Association (NBA) is a good example. The association makes millions of dollars yearly in licensing agreements made with clothing and toy companies (http://www.nmpa.org/hfa/licensing.html).

Like any other agreement there will always be advantages and disadvantages. There a few underlying advantages and disadvantages to licensing.

Licensing Advantages:

The following are the advantages to licensing:

-Profitability with little investment
-Good way to begin in a foreign operation & open the door to low risk manufacturing relationships
-Capital is not tied up in foreign operation
-Opportunity to form an initial relationship with a potential joint venture partner
-Few long term obligations unless separately called for in a contract
-Circumvent tariffs' & quotas
(http://www.wipo.int/sme/en/documents/pdf/licensing.pdf#search='advantages%20of%20licensing).

Disadvantages of Licensing:
-Limited form of participation – to length of agreement specific product process of trademark
-Lack of control of marketing programs sacrifices long term returns
-Partner develops know how and so license is short
-Licensees become future competitors
-Requires considerable fact finding, planning, investigation and interpretation
-Possible antitrust problems in developed country markets
-Possible damage to reputation, trademarks if quality control becomes a problem
-Can prevent direct entry into market if circumstances later dictate that approach
(http://www.wipo.int/sme/en/documents/pdf/licensing.pdf#search='advantages%20of%20licensing).

Licensing agreements have significant values as marketing strategies especially to holders of patents, trademarks or copyrights to grow their business in new markets where they are short of supplies and experience. Many believe that licensing is a great strategy for business minded individuals who would like to begin a new business but by virtue of permission by the licensor. On the other hand, in the case of a company like McDonald's licensing agreements probably are not the best means of running the establishment. As most of the operations are ran by way of franchise.

Definition of Franchising:

Closely related to licensing is the term franchising. Franchising is widely defined as a comprehensive contract in which one party (the franchisor) grants another party (the franchisee) the right to operate a business selling products and or services produced or developed by the franchisor under the franchisors business formats policies and practices in return for a royalty fee (Gilman, 2000).

A franchise agreement will usually state the given territory the franchisee can use as the extent to which the franchisee can use as the extent to which the franchisee will be supported by the franchisor in terms of marketing and territory (Lafontaine & Shaw, 1998).

Again like licensing there are some advantages and disadvantages of franchising. The following are the associated advantages of franchising

Franchising Advantages:
-Franchising offers franchisees the advantage of starting up a new business quickly based on proven trademark & formula for doing business
-Collective purchasing power on products, supply, equipment, advertising etc. can easily offset any ongoing royalty paid by the franchisee
-Franchised business can sell faster and for a higher value than an independent business
-Easier access to financing as financial institutions prefer to lend to an established business because of their assumed higher success rate
-Franchisors can help provide site selection assistance based on demographic knowledge
-The advertising system is spread over many units (Lafontaine & Shaw, 1998).

Disadvantages to Franchising:
-On an international level firm is unable to take profits out of the country
-Loss of independence can not freely make changes

-Payment of fees franchisees are required to invest a minimum amount on local advertising
-Misrepresentation by the franchisor this can be intentional or unintentional
-Underestimate of the associated expenses (Lafontaine & Shaw, 1998).

Franchising in Canada:

In Canada franchise operations play a pivotal role in the economy and it continues to grow. Also it is a great method to enter Canada on a global level to conduct business. Today many entrepreneurs are interested in franchising in Canada because it is perceived as a better chance of success than an independent business owner (Gray, 2005).

Canada is comprised of ten provinces and three territories. Therefore, franchisors that operate in Canada are required to adhere to both federal and provincial laws which fluctuate from province to province. The province that has the most distinguished differences is Quebec. This is because Quebec is mainly a French speaking territory. As a result all contractual agreements in Quebec are governed by Civil Code (Gray, 2005).

On the other hand, Alberta and Ontario are the only two provinces that require a franchisor to deliver a written disclosure document to a potential franchisee before it can implement a franchise agreement (Gray, 2005).

Generally, a foreign franchisor desiring to expand into Canada can do so through a number of ways which include; franchising directly from the foreign-based franchisor corporation to franchisees in Canada, establishment by the franchisor, of a branch or subsidiary in Canada, joint venture partner in Canada, master franchise agreement and development agreement. It is vital that the foreign franchisor consider all taxes and business implications along with commercial considerations of income tax, withholding tax, and repatriation funds that are associated with franchising (Gray, 2005).

In closing franchising offers several advantages in Canada however, success is not necessarily guaranteed to everyone. Success in franchising is based on a mutual dependence (Gray, 2005). As a result, it is strongly recommended that proper research and planning is done first prior to operating a franchise in Canada.

McDonalds in Canada & Franchising:

McDonald’s is a global company that is currently located in 119 countries operating 31,000 restaurants (McDonalds.com). As a result, McDonald’s has to choose the best entry mode in each country to run their business. In reference to Canada the best entry mode is by way of franchising. Approximately 65% of McDonald’s Canadian restaurants are franchised operations. McDonald’s proudly admits to relying on their franchisees to play a main role in the success of the corporation. McDonald’s take great pride in their business and places a premium on quality operations globally (McDonalds.com). Therefore, franchise opportunities are only available threw new restaurants or the sale of existing restaurants. Each country has different franchise requirements. In Canada, McDonald’s has a very selective recruiting process for individuals seeking to franchise McDonald’s. New restaurants are franchised to current owners who have revealed exceptional track records, to new franchisees and company employees. However, prior to finalizing franchising agreements, prospective franchisees have to undergo an inclusive operation training program to fully integrate them for McDonald’s refined management and operational system and strictly enforced standards of quality, service, cleanliness and value (McDonalds.com)

Despite the strict polices and standards established in Canada for franchising McDonald’s has proven to be successful. McDonald’s franchising policies and procedures are also note worthy of the success they have today in Canada and why they have been able to expand as much as they have across Canada with numerous operating franchised restaurants.

Conclusion:

In closing both licensing and franchising are great methods of business practices especially as a measurement to gain entry into a country on a global level. In general they both come with advantages and disadvantages. Determining what measure is suitable depends on the nature of the business and the individual seeking to do business. The McDonald’s corporation runs their business by both measures. Although McDonald’s takes credit for the success they have today as a result of franchise operations that they have both in the US and in foreign countries. In Canada McDonald’s operates over half of their establishments by franchising and has been quite successful with their current operations and counting.

References:

Buckley, P. & Casson, M. (1998). Analyzing foreign market entry strategies: Extending the international approach, *Journal of International Business Studies*, 29 (3), 539-561.

Gilman, A. (2000). What do we know about entry, *International Journal of Industrial Organization,* 13, 421-440.

Gray, D. (2005). Expanding your franchise system into Canada, *Franchise*.

Hall, C.W.L. (2005). International business: Competing in the global marketplace (5th ed.). New York: McGraw Hill.

Lafontaine, F. & Shaw, K. (1998). Franchising growth and franchisor entry and exit: Myth and Reality, *Journal of Business Venturing*, 13, 95-112.

Licensing information (2005). Licensing. Retrieved November 3, 2005 from http://www.nmpa.org/hfa/licensing.html

Licensing Advantages & Disadvantages (2005). Licensing. Retrieved November 3, 2005 from http://www.wipo.int/sme/en/documents/pdf/licensing.pdf#search='advantages%20of%20licensing

Wikipedia.org (2005). Licensing.

www.mcdonalds.com (2005). McDonald's.