



HOW TO EXPAND TO GERMANY



The Franchise Specialist

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Is your franchise-license system or simple your business model, ready for the market entry in Germany?

Franchisors outside and within Europe who run a successful franchise system on their home market will eventually think about the question to expand their system to the markets and here especially to the very profitable German one. They will then face the problem of how to enter the new market successfully. In principle, they have the choice between:

Searching for a master-licensee

or

to penetrate the market as the franchisor

Obviously both ways allow for a range of variations. But it is clear that they represent one fundamental decision: Either to invest as the franchisor or to shift the responsibility onto a third party. Both ways are possible but decisions must be taken, which are to be discussed in the sections below. In the following we have our experience from the German market in mind but the most statements are true for other continental European markets too.

1.

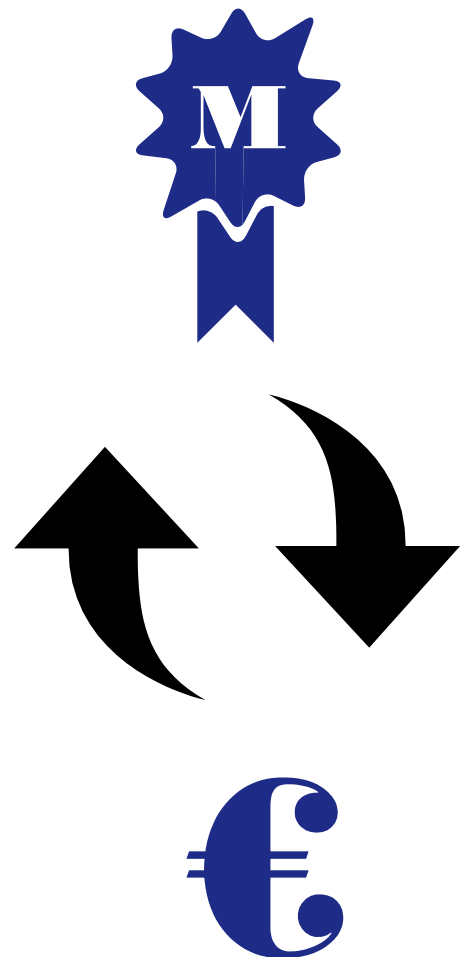
Master-Licensee Approach

The expansion to a new market by selling a territory (e.g. a whole country like Germany or parts of it) to a master-licensee/master-partner is the most popular way of franchise-system expansion in the USA and markets with a comparable business mentality – foremost the UK. To say it right from the beginning it is not in the most continental European countries – Germany included.

So, is the master-partner expansion dead for most European countries?

Not necessarily if some preconditions are fulfilled. Expanding by simply selling a territory without providing further support and leaving the whole build-up to the master will in most cases not be viable. Because in this case the master-licensee would have to agree to pay a high price just for the brand name and the know-how from the franchisor's home country.

This is possible in the case of global mega franchise-brands but not for relatively small franchise systems. Especially in Germany potential investors will investigate intensely in new business opportunities and will not invest huge sums in a business that has not yet proofed to be successful on this market.



But the master-partner approach has certainly advantages and will be effective if certain conditions are fulfilled. The fact that a franchisor will find a partner who comes from the same country and is aware of all its peculiarities is not to be hoped for. Furthermore the franchisor can rely on someone who has the motivation to make the business successful and invest the earned money to accelerate the growth of the System.

If a franchisor decides to go this way it will be necessary for him to present to a candidate who is interested in buying a license two important things: a professional local market analysis for the territory and a support package at least for the first two years. The analysis will be important when having the first conversation with candidates – showing them the market potential for the license-territory in a consistent document. Such a document – more or less a feasibility study – will deal with all the important aspects, which will affect the market entry.

These are primarily: legal aspects (e.g. trade register, probable tariffs – if non-EU territory is involved – and export restrictions, labour market regulations, statutory law etc.) tax aspects, as well as market aspects such as competition, target group, market size, pricing etc.

During conversations with candidates the franchisor should emphasize that he believes in the successful expansion to new countries. The best way is always to take money in your hand - for example in a joint venture concept - and present a clearly defined support package to the candidate dealing with know-how adaptations and marketing support in the start-up phase.

Sure it is possible for a franchisor to try to sell the “American way” but this will tremendously slow down the process of finding partners. We know of the systems that search in vain for years now to find their first partners.

2.

Expansion by Franchisor



The above section has shown the certain investments will have to be done by the franchisor to convince a potential master-licensee of the business opportunity. When the franchisor realizes – while conducting a market analysis – that the market potential is actually very lucrative he/she may think about starting the expansion by himself without selling the territory.

A good thumb rule for Germany is that if the market potential for the expansion is more than 50 franchisees in a clearly predictable period (that is a ROI – in this case total return/investment – higher than one calculated on a two year planning horizon) the franchisor should really think about not selling the territory and penetrate the market by himself.

There is also the option to start a joint venture with a financially solidly partner who runs the pilot business and is granted incentives and profit shares but without getting the right to sell sub-franchises. Such a partner could start the pilot business and will help the franchisor actively to develop the system – but the franchisor remains in charge.

Thus the following procedure will show all the most important tasks for the implementation of a foreign franchise system by the franchisor on the German market, after a feasibility study has been drafted.



The first step should be to adapt the business model onto the conditions of the German market. The second step will be the adaption and drafting of all absolute necessary documents for the German market: These are primarily a good business plan and a franchise contract.

The business plan for a normal franchisee should include the financial projection of the business as well as the description of the local market situation, the market potential and the organisation of the business.

It will be necessary if the franchisee needs to apply for bank loans and during the recruiting process to present the business to candidates.



Furthermore the franchise-agreement has to be drafted. A one-to-one translation would not suffice because EU law sets a completely different legal framework.

As business consultants we always accompany this process for our clients and can recommend an international specialist solicitor to the system. The consulting of the process is necessary to get a contract, which will later be "sellable" to potential candidates and allows for a good workflow in the signing-phase of the contract.

Furthermore manuals, business plan and contract should be of one piece.

Finally, to act professionally on the German market a franchisor should have a legal entity, which will be a GmbH (the German equivalent of an Ltd.) in most cases. Basically there exist of course the opportunity to establish and to generate your business model to the German market without founding a domestic legal entity.

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In this case it should be on your mind, that there could be additional requirements and liabilities for prospective franchisees derived from the german taxation laws (§§ 49-50a EStG) flat rate tax under the circumstances of franchise fees.

To have a company in Germany does not mean that a franchisor has to employ staff; a resident service can take care of all tasks, which occur in a franchise headquarter.

The organisation of the support within the system will have to be planned carefully at the beginning.

Taking the size of Germany we recommend to think about an area developer solution. The developers should accompany during the recruiting process and help the existing franchise step by step during their daily business. Area developer simply means that those franchisees conduct certain tasks for the franchisor e.g. field training. That means that a territory size has to be estimated which can be supported by a regional developer as well as the compensation for him.

After those preliminary tasks have been accomplished the roll out can start. Founding the first franchisee means running a pilot. A franchisor now has different options to start. We definitely recommend offering special conditions to the first partner(s) because they will test the market.

Having at least one pilot very early will accelerate the system expansion. The pilot phase lasts generally between 6 months to one year. After that phase a fast and sustainable countrywide roll out is possible. The bottom line is that a franchisor can have a considerable nationwide expansion after 3-4 years' time in Germany.

The first question which has to be considered is whether your business model has got the essential sustainability for a franchise or a license system? The success of a franchise-concept can be seen primarily in the product or the service as a product, the USP and finally in the know-how behind the whole business model that is intended to be offered on the new market.

Business models that combine services with products still have huge opportunities to grow in Germany. But the most important questions to be asked before a market entry can be planned are:

- Is our product and service concept accepted by local customers?
- How intense is competition?
- What are the price structures in the respective country of expansion?
- Does my marketing conception fit with the mentality and consumer attitude?

Eventually the growth of the system will show how happy the franchisees and how satisfied the customers are. But only with the help of a market research the above questions can be answered in advance.

3.

Our proposal for your business process in 9 steps

1. *Familiarization with your business model*

The first step will always be a familiarization with the details and workflows of the company. This step will qualify us to give you a detailed proposal to penetrate the German market as franchisor/licensor.

Familiarization means that we have to study relevant materials in more detail. These are primarily:

- 1) **Company structure and introduction of persons in charge for this project**
- 2) **Business planning, pricing, cost effectiveness study, intended fee structure**
- 3) **Market evaluation, market analysis, competition analysis**
- 4) **Manuals or comparable documentations**
- 5) **Information about an already existing pilot company**
- 6) **General description of workflows (e.g. supply chain)**
- 7) **Contractual framework/conditions**
- 8) **Marketing material**
- 9) **Further material you deem is necessary to understand your concept**

Belonging to the first step is also the development of a rough concept as a basis for further discussions.

Having studied all company documents we will start to do some research regarding the German market (target groups, relevant market size, pricing etc.) to estimate the market outlook. Based upon the research we will draft a feasibility study in order to show under which circumstances a successful expansion into the German market can prove to be successful.

Two variants of market analysis will lead to the aspired aim:

a) **Field Research**

Example: A franchise-system based in the food industry wanted to know, how often per month consumers are willing to buy take-away and delivery food. The exact questions were:

- How many persons does an average order comprise?
- Are they willing to test the described offer?
- Are the customers willing to pick up the food or do they prefer delivery service?
- Are the given price categories 1, 2, and 3 adequate or too low or too high?

These data was gathered in a field research that questioned minimum of 200 selected persons of the main target group. The result was positive and the Board of Director decided to start the adaption of their system for the market entry in Germany.

b) **Secondary Research**

Example: A franchise-system based in the non-food industry wanted to know:

- Which suppliers deliver certain stone-products in Germany?
- Which distribution channels are used?
- Which machine suppliers for stone processing are adequate?
- Which companies with which market prices in the B-to-B and the B-to-C operate within the market?
- How large can the maximum target group of end customers B-to-C be on the German market?

All this data could be gathered from Bureaus of Statistic, relevant organizations, chamber of commerce, scientific research papers, exhibition catalogues and industry reports.

The step that enables us to find out more about your market in future is the familiarization with your business model.

2. Business planning Franchisor, pricing, cost effectiveness study, intended fee structure

The capital budgeting has to be issued in form of a calculation model concerning the financial requirements of the possible growth of your company German Franchise-System central. Before you start to search for franchisees you should know how much money will be needed. Showing this in a standard business plan under the rules of the German Ministry of Economics you even could apply for German subsidies.

3. Business planning Franchisees incl. Market evaluation, analyses and competition analysis

As a third step a business plan for future franchisees has to be drafted, including the following thoughts: Is the business model attractive enough? Is it necessary to adjust the cost structures (fees) for the start-up of new franchisees, in order to ensure they have enough liquidity at their disposal during the first months/year? When is the invest amortization scheduled? Are the costs of living included?

4. Manuals or comparable documentations

The fourth step will be adapting or writing new franchise-manuals. At this point all individual specifications will be put to test once more. All departments and participants have to be part of the discussion. In addition, the headquarters services will be scrutinized regarding all legal, economic and fiscal aspects. We know the normally two types of franchise-manuals will be necessary

- a) the business administration one and
- b) the technical documentation for daily business.

5. German Headquarter

To become active on the German market it is advisable to have a German headquarter and preferably as legal entity a German Ltd. (in Germany this is a GmbH; a subscribed capital stock of 25.000 Euro is mandatory, but the money can be spend for the expansion). The preparation of the company's articles, registration of the business under town council, notary act and notification in the trade register will be part of this step.

The German headquarter will also later be necessary for the bank finance of the franchisees and the reputation of the system. Therefore, a German GmbH has to be registered in the German Chamber of Commerce.

You have to decide whether the German headquarter will initially be externally sourced out or if you start your German office right away on your own. The planned workflows within the headquarters have to be structured and documented in advance. The franchisor-services that are explicitly required in order to assist and provide support to the future franchisees have to be defined.

We are in the position to offer foreign franchisors a seat-service, fully equipped with personnel and office space in order to lower the administration costs for at least the first years.

6. Information about an already existing pilot company

The build-up of the pilot or rather the introduction of the pilot phase. Within the pilot phase the business model will be tested under real-life conditions. Within that phase from all experience ample adaptations will have to be made.

After a period of at least 6 months the documentations for the franchise can be finalised. Before the first franchisees can be found in Germany, the final manuals will have to be drafted. Furthermore, it is advisable to have a business plan under the rules of the German Ministry of Economics.

This business plan is necessary firstly during the recruitment process so that you can show the development of the franchisee's business and secondly to help the partner to get a bank finance and subsidies from the state bank and employment office. Beside you fulfill the obligation of disclosure with the business plan.

This business plan will be the basis for all franchisee foundations and has to obey the German spoken law. It will rely on the data of the pilot business and the already created financial framework for the pilot businesses.

7. Recruiting of franchisees

With the seventh step the recruiting phase starts. It is important to issue a marketing and budget plan for the recruiting of franchisees in advance. Eventually we have to organize the nationwide roll-out.

Generally, we can divide into two parts: The passive search and the active search. Under the passive search, you have to understand that your system will be presented in different franchiseportals, specialized platforms for recruiting, social media etc. That means that someone has to become aware of your system. The active way is to find qualified persons within your target group and contact them directly.

To generate leads of interested candidates it will be necessary to draft a marketing plan for the recruitment. The competition between franchise systems for good partners has become fiercer within the last years as more and more systems are active in Germany. Hence we will need to start an ongoing marketing and recruitment process for the German market that primarily consist of:

- Placing of presentations in relevant franchise-portals (absolute essential)
- Internet franchise recruitment via a specialized platform (highly recommended)
- Bi-monthly press releases (essential)
- Placing of adverts in relevant magazines of the industry (optional)
- Direct contact of multipliers if they can be identified (recommended)
- Direct contract to companies or target groups (person) of relevant economic sector

The search process can be outsourced to us as business consultants. It will be the same for all franchisees. It includes:

- a) Marketing plan for the franchisee search (see above) and starting the marketing campaign
- b) Pre-selection of candidates

- c) Interviews; only applicants who fulfil all requirements are invited to the interviews. During the interview, we go through the business plan in detail and answer all further questions.
- d) Live-Presentation; the applicant now has 7 days' time to make a decision.
- e) Help during the establishment of the franchisee company.

We as a Consulting company could later do the whole selection process when interested partners investigate deeper in your franchise business.

The pre-selection process includes a first selection of candidates that match the requirements of the profile and is part of the pre-contractual clarification, in order to comply with the legal provisions of the franchisor.

The pre-selection process guarantees a first telephone-contact to the interested person within 24h of his initial contacting. We collect all necessary personal data from the candidate, compare his profile to what is needed, check his financial situation and only pass the candidate on to the franchisor if we consider him a promising future franchisee.

8. Franchisee foundation

Surely, it will depend on where the oncoming partner comes from? Has he/she been unemployed before or did he/she have a long contract with their former employer? Anyhow, most of them need a helping hand during all aspects of foundation. Questions of how to quit the former job, how to prepare their first business plan under the rules of the German Ministry of Economics, to get a bank finance and subsidies from the employment office have to be handled. Either you as the franchisor will help the new partner or you have to organize the help from third parties national wide.

9. Signing the franchise contract

As mentioned above an international specialist with whom we are interdisciplinary working has drafted a sellable franchise contract exist under applicable German law. This contract needs to be worked through with the onboarding franchisee because there is no existing law's the Civil Code law (BGB), Commercial Code Law (HGB), trademark-competition law and numberless judgment's.

All this abundance by the law have to be considered. If the franchisee can require subsidies under the rules of the German Ministry of Economics the contract should not be signed before the business plan has been presented to a bank, otherwise the founder will lose the right of government funding.

4.

Summing up - What has to be done?

It should have become clear that no matter if the franchisor decides to expand by master or by himself the following tasks **will always have to be done by the franchisor:**

- A market analysis
- The drafting of an internal document, which shows the market potential including at least a profit & loss projection

The results may let the franchisor rethink his intention to sell a master licence and start selling franchises himself. Not to have these tasks accomplished will slow down the recruiting process in any case. A franchisor should not think that an investor/master is doing that work for him.

Furthermore, the franchisor should present a clearly defined support package to all candidates showing them that they will not be left alone while penetrating a new market.

The work to be done should be seen as an investment for a respectable franchisor who shares risk and profit with his partners.

The authors



Andreas Langner
Eckhold Consultants GmbH
Qualified Economist
Managing Partner

Wilhelmshofallee 75
47800 Krefeld
Germany
Phone: +49 (0) 21 51/60 47-10
E-Mail.: andreas.langner@eckhold-consultants.de



Jörg T. Eckhold
Eckhold Consultants GmbH
Senior Consultants
Managing Partner

Wilhelmshofallee 75
47800 Krefeld
Germany
Phone: +49 (0) 21 51/60 47-10
E-Mail.: joerg.eckhold@eckhold-consultants.de

www.eckhold-consultants.de
Eckhold Consultants GmbH