

*In Business Program*  
International Labour Organisation

Legal Research Paper

Magan Goh, Ryan Halverson and Victoria Taylor-Philip

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## Table of Contents

PART I – INTRODUCTION .....	3
1. Background to the Program .....	3
2. Overview of the <i>In Business</i> Training Suite .....	4
3. Goals of the <i>In Business</i> Program .....	5
3.1 Target Clients .....	6
3.2 Implementation of the <i>In Business</i> Program .....	6
3.3 The <i>In Business</i> BMO sub-license agreement .....	6
4. Role of the ILO .....	7
PART II - LEGAL AND REGULATORY FRAMEWORK .....	8
5. Introduction .....	8
6. Definition of franchising .....	8
7. Master franchise agreements .....	8
8. Benefits of franchising .....	8
9. International franchising .....	9
9.1 External Variables affecting international franchising .....	10
10. Use of franchising in developing countries – Case Examples .....	11
10.1 Philippines .....	11
10.2 Cambodia .....	14
PART III - CHALLENGES AND BARRIERS TO ROLLING OUT <i>In Business</i> .....	16
11. Intellectual Property Rights .....	16
12. Differing Labour Standards .....	16
12.2 The enforcement of minimum labour standards .....	17
12.3 Child labour concerns .....	18
12.4 Elimination of unfair labour practices .....	19
13. Choice of Law & Jurisdiction .....	20
14. Termination and revocation .....	21
14.1 Grounds for termination .....	21
14.2 Termination by licensee / sub-licensee .....	22
14.3 Termination by Franchisor .....	22
15. Consequences of termination .....	23
15.1 Consequences for the Sub-Franchisee .....	25
16. Assignment of the Franchisee’s Rights in the Sub-Franchises .....	25
PART IV - RECOMMENDATIONS .....	27
17. ILO Ensuring Compliance with the Franchise Agreement .....	27

## PART I – INTRODUCTION

Developed by the International Labour Organisation (ILO), the *In Business* (Enterprise development, growth and enhancement program for micro, small and medium-enterprises) program is an innovative, peer-to-peer training program designed to help enterprises develop the necessary skills to improve productivity, competitiveness and working conditions.

To assist the ILO in its implementation of the *In Business* program, this research paper is split into four parts: Part 1 introduces the *In Business* program concept; Part 2 summarises the general principles of franchise law and describes the legal and regulatory framework within which the *In Business* program will likely operate, noting the impact of local in-country laws; Part 3 identifies potential challenges and barriers to rolling out the *In Business* program; and Part 4 makes recommendations to the ILO and provides an alternate means for operationalizing the program to facilitate various stakeholders who might otherwise be resistant to such a product.

### **1. Background to the Program**

Pursuant to Outcome 3 of the Director-General's 2014-15 Programme and Budget Proposal<sup>1</sup> the *In Business* program forms part of ILO's strategy to promote sustainable enterprises as well as improve productivity and working conditions in small and medium-sized enterprises (SMEs). With the initial focus on SMEs in the Asia-Pacific region, the ILO has developed the *In Business* program to tackle major structural issues inhibiting the growth of SMEs. These include: (i) limited access to finance leading to undercapitalisation; (ii) unfavourable governmental policies accompanied by lack of transparency; and (iii) minimal entrepreneurial experience with limited access to business advisory resources; and (iv) low levels of technological advancement.<sup>2</sup>

Enterprises play a key role in creating productive and decent work that helps meet the economic and social aspirations of people and their communities. Whether small, medium or large, enterprises including cooperatives are a major source of growth and employment in all countries. Enterprises and the entrepreneurs who run them play a crucial role in creating jobs and reducing poverty.<sup>3</sup>

Employers' organizations represent a key asset in any society and help to create the conditions for

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<sup>1</sup> [http://www.ilo.org/wcmsp5/groups/public/ed\\_norm/-relconf/documents/meetingdocument/wcms\\_203480.pdf](http://www.ilo.org/wcmsp5/groups/public/ed_norm/-relconf/documents/meetingdocument/wcms_203480.pdf)

<sup>2</sup> Comparative Study on Impact of Internal and External CFFs on SMEs, Hussain, Iftikhar; Si, Steven; Xie, X M; Wang, Lixia. *Journal of Small Business and Entrepreneurship* 23.4 (2010): 637-650.

<sup>3</sup> <http://www.ilo.org/empent/lang--en/index.htm>

enterprise success by influencing the environment in which they do business and by providing services that improve their individual performance. As one of the three constituents of the ILO, employers' organizations have a special relationship with the Organization.<sup>4</sup>

The Partnerships and Field Support Department (PARDEV) is responsible for resource mobilization and the management and administration of technical cooperation activities and public-private partnerships, as well as providing support to ILO field structures and managing day-to-day relations with other international and regional organizations, UN system-wide coherence issues, South-South and triangular cooperation, and relations with civil society and other external partners such as parliamentarians, NGOs, faith-based organizations and academic institutions.

## **2. Overview of the *In Business Training Suite***

The *In Business* training suite includes distinct, stand-alone modules designed to meet the needs of different groups. Each module sets out techniques, methods and worksheets that guide participants through the practical steps.

For new start-ups and underdeveloped enterprises:

- The modules focus on key areas of business planning that strengthen SMEs' bottom line and deliver long-term value.
- The main skills that new start-ups and underdeveloped enterprises will learn are: marketing principles for success, better bookkeeping for micro enterprises, pricing and profitability, investment capital and microfinance.

For established SMEs with enterprise-specific human resources and expertise:

- The modules focus on competencies designed to improve and expand business operations.
- The main skills that established SMEs will learn are: strategic analysis, growing productivity through safety and health, competitiveness and quality improvement, cash flow forecasting.

For SMEs with task-oriented expertise and human resources:

- The modules focus on competencies related to value-added investments that increase competitiveness.

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<sup>4</sup> <http://www.ilo.org/public/english/dialogue/actemp/>

- The main skills that these SMEs will learn are: business continuity for natural disasters and safety and health, supply chain management and logistics, preparing importers and exporters or the AEC, e-commerce and social media for small business.

How to use the training modules:

- Training is divided into various sessions: case study, networking, review of key principles, addressing the bottom-line and action-planning. Since there is no external trainer or specialist to lead the training, all group members need to participate actively in group work and discussions. At the end of the training participants will have mastered the skills needed to increase productivity, improve working conditions and strengthen business networks.
- Participants only pay a small amount of money to join the training. Groups of five to seven participants with similar profiles work together through modules, to jointly solve problems and consider issues. If you are a business owner and have the literacy level to read the instructions, you are eligible to join the training.

### 3. *Goals of the In Business Program*

The ILO intends to make the *In Business* Program available through licensing and sub-licensing of peak national EOs and business membership organizations (BMOs) in their membership under a franchising framework. An Operations Manual has been developed to facilitate the deployment of *In Business* to Employers Organizations (EOs), and is a step-by-step practical guide on how EOs can successfully engage BMOs and build their capacity to effectively deliver the *In Business* Program in a sustainable manner.

Operating through peer-to-peer training, the *In Business* Program comprises of a series of modules focusing on allowing SMEs of similar profiles to share experiences and knowledge regarding the various stages of business development commencing from the initial planning and human resource planning through to the growth and enhancement of their investment.

Building on the benefits of public private partnerships, ILO seeks to establish partnerships with Employer Organizations (EOs) through licensing agreements whereby EOs, as licence holders, will sublicense to third parties within their membership who, as *In Business* service providers, will deliver the program as a training service to SME member and non-members. As *In Business* Service Providers, licensed BMOs will be responsible for the delivery of the training as well as reporting SME client profiles and progress/outcome data back to the EO franchise holder.

### ***3.1 Target Clients***

The target clients for the *In Business* Program are micro, small and medium-sized enterprises. The *In Business* program is designed for business owners (and in some cases line managers) who need to develop their business management skills and have an interest in networking with other firms.

### ***3.2 Implementation of the "In Business" Program***

The Management and Governance Structure contained within the Operations Manual describes how *In Business* will be managed to conform to the procedure of the ILO's Franchising Agreement and also provides the optional models under which both EO and BMOs can run *In Business*.

The *In Business* program will be provided to EOs and BMOs under a franchise framework. The ILO will license one national EO per country as the Franchise Holder of *In Business*. As the Franchise Holder, the EO will have the right to grant sub-licenses to third parties within their membership to expand their business with minimal investment and risk. The License Holders will have authority to provide *In Business* as a service to SME – both members and non-members – within designated geographical areas. The EOs receiving the Franchise will compensate the ILO by its commitment to implement and sustain *In Business* Program in the long run as well as facilitate its scaling up. The Franchise Agreement does not transfer ownership of the intellectual property rights. The License Holders will compensate the Franchise Holder for technical assistance and support to be provided through an annual fee and profit-sharing percentage from fees collected through training provided.

### ***3.3 The In Business BMO sub-license agreement***

The License Agreement provides BMOs with the right to use and deliver the *In Business* Program in a specific region, defined by geographic area or economics sector/s. The BMO delivers *In Business* to SMEs and will receive technical support and performance monitoring by the EO throughout the validity of the license to ensure that *In Business* remains a viable business proposition for their organizations and clientele. The BMO, however, is not allowed to issue sub-licenses to any third party.

The sub-license is valid from the issue date for a period of two years. The sub-license holders should file an application for renewal one month prior to the expiration date in order to ensure the continuity of service. Approval for renewal will be based on joint performance evaluation in review of data and reports submitted throughout the license period. The BMO must begin the implementation

of *In Business* within two months after the license has been issued or the Licensing Agreement may be terminated.

The *In Business* Package for License Holders will consist of the following: *In Business* Program materials; Program orientation and capacity building of project manager and *In Business* Partnership Coordinator; Implementation manual; *In Business* Evaluation tools and system; Branding and marketing of *In Business* materials and promotional campaigns; Marketing support; and *In Business* SME Certification and Recognition System.

The EO has a responsibility to consolidate the *In Business* Franchise System and provide contextualization, tailoring, and translation of the core training suite. The EO must update and ensure augmentation of modules as per feedback gathered and BMO needs. It is also the responsibility of the EO to promote and market *In Business* to BMOs, provide approval and issuance of License to BMOs and collect license fees. The EO ensures orientation of BMOs in the use, delivery, and marketing of *In Business* including provision of Implementation Manual and marketing support to BMOs. The EO must provide assistance to BMOs in complying with the sub-license terms and setup of simple performance monitoring system. The EO has a role in the issuance of *In Business* SME certification in collaboration with BMO providers and must provide an annual report to the ILO on the status of the program, tools and revenues. Following the pilot phase or first round of introduction, EO support will be scaled back and BMO will be responsible for sustained rollout and management of the program.

#### **4. *Role of the ILO***

The ILO has a role and responsibility to consolidate the *In Business* licensing system. The ILO is responsible for the design, development and translation of the core training suite of the *In Business* Program. The ILO is also responsible for the issuing of Franchise rights to the selected EOs, the orientation of licensed EOS to the use, delivery and marketing of *In Business* supported with Operations and Implementation Manuals. The ILO has a responsibility to provide quality assurance and monitoring of EO performance and compliance to the terms of the Franchise Agreement.

## PART II - LEGAL AND REGULATORY FRAMEWORK

### 5. *Introduction*

This part describes the legal and regulatory framework within which the *In Business* program will likely operate, noting the impact of local in-country laws. This section begins by summarising the general law within the area of franchise law and explains key legal concepts of franchise law as well as the benefits of franchising.

### 6. *Definition of franchising*

Franchising refers to a system involving an independent business entity, the franchisee, being granted the right to market and distribute the products of another, the franchisor, in return for a fee payable to the franchisor.<sup>5</sup> As a versatile licensing tool, the franchising structure allows the ILO to expand into the territories of developing nations through local corporations that act as a reservoir of local knowledge and a tool for local adaptation.<sup>6</sup> Corresponding with the ILO and *In Business* program's aims, franchisees will not be charged any fee.

### 7. *Master franchise agreements*

The arrangement implemented through the *In Business* program is that of a master franchise agreement with ILO assuming the role of a master franchisor; EOs assuming the role of the master franchisee; and the licenses are granted to the BMOs as sub franchisees. Master franchising refers to a system whereby the master franchisee undertakes to be a 'franchisor' in the exclusive territory and will assume the obligations of a franchisor. Such duties include attracting and training sub-franchisees; supervising the use of the franchisor's intellectual property rights and franchise system; and adapting the franchise system to local conditions amongst other things.<sup>7</sup>

### 8. *Benefits of franchising*

Franchisor:

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<sup>5</sup> Robert W. Emerson, 'Franchisees as consumers: The South African Example' (2014) 37 *Fordham International Law Journal* 455.

<sup>6</sup> Mark Abell, 'International expansion through franchising' (1997) 35 *Managing Intellectual Property* 35.

<sup>7</sup> Alex Konisberg Q.C. and Lapointe Rosenstein, 'Critical Issues in Acquiring a Master Franchise from a Foreign Franchisor' (2005) 3 *International Journal of Franchising Law* 23.



One benefit to the franchisor is the possibility of expanding the franchisor's network without investing as much as would usually be required if it were setting up the foreign operation itself. Also, the ability of the franchisor to rely on a licensor which is familiar with the domestic territory it operates within – i.e. understands the territories culture, customs, legislation, language, religion etc. Furthermore, the geographical distance between the country of the franchisor and that in which it intends to expand its network might be such that it would be difficult for the franchisor to control the performance of the unit operators.

Franchising allows franchisors to reduce transaction costs arising not only from the conduct of buyers who engage in opportunistic behaviour; but also from uncertainty about the future of the environment.<sup>8</sup> Franchising therefore allows franchisors to involve franchisees in the marketing process whereby local knowledge can be used to modify elements of the marketing mix to suit local conditions and maximise the value of product offerings.<sup>9</sup>

#### Franchisee:

The Franchisee receives the benefit of investing in a well-known and tested business concept. Consumers will rely on past experiences, brand name and reputation to reduce the costs of estimating the value of a product and having to select from a range of competing products.<sup>10</sup>

### **9. *International franchising***

Having explained the brief concepts behind franchising and the benefits of franchising, Amos (2001)<sup>11</sup> confirms that the franchising mechanism and its benefits is a 'translatable' concept. This indicates that it is a model that is malleable to different cultures and business regulations but the additional complexities with operating on an international scale means that a different set of capabilities are necessary to manage the key operational issues and challenges facing international franchisors (Hoffman and Preble 2004).<sup>12</sup>

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<sup>8</sup> C.M. Sashi Devi Prasad Karuppur, (2002), "Franchising in global markets: towards a conceptual framework", *International Marketing Review*, Vol. 19 Issue 5 pp. 499 – 524.

<sup>9</sup> C.M. Sashi Devi Prasad Karuppur, (2002), "Franchising in global markets: towards a conceptual framework", *International Marketing Review*, Vol. 19 Issue 5 pp. 499 – 524.

<sup>10</sup> C.M. Sashi Devi Prasad Karuppur, (2002), "Franchising in global markets: towards a conceptual framework", *International Marketing Review*, Vol. 19 Issue 5 pp. 499 - 524.

<sup>11</sup> Amos, J.H. Jr (2001), "Franchising, more than any act of government, will strengthen the global economy", *Franchising World*, Vol. 33 No. 4, p. 8.

<sup>12</sup> Richard C. Hoffman John F. Preble, (2004), "Global franchising: current status and future challenges", *Journal of Services Marketing*, Vol. 18 Issue 2 pp. 101 - 113.

### ***9.1 External Variables affecting international franchising***

As with any mode of entry, the external environment influences the viability of franchising in a country and comprises of the political, economic and currency dimensions of the country (Karuppur 2002).<sup>13</sup>

***Political uncertainty*** exists when industrial laws and policies are subject to frequent change which subsequently increases the risk of businesses operating in the country (Karuppur 2002).<sup>14</sup> This affects franchising in the sense that royalty payments, as negotiated between EOs and BMOS (being franchisor and franchisee respectively), can be affected by political uncertainty (Karuppur 2002).<sup>15</sup> Karuppur (2002) further suggests that certain countries may have regulations restricting the use of foreign brand names which would therefore be of concern to ILO if ILO branding and certification is to be attached to all *In Business* materials.

***Economic uncertainty*** refers to characteristics such as higher interest rates; inflation and fluctuations in market demand (Karuppur 2002). Higher interest rates will affect business operational costs and, whilst no financial liability exists between the ILO and EOs, transaction costs are nonetheless incurred through quality control / monitoring processes conducted by the ILO to ensure compliance with the Franchise Agreement and other responsibilities imposed on the licensees, as well as further expenses involved in troubleshooting the program or resolving potential unforeseen issues and remaining responsive to feedback from the various stakeholders. It is hoped however that the use of franchising will enable the local BMOs to be able to modify their membership / training price to be responsive to the demand and availability in the market from SMEs for such business development resources. BMOs are able to also then select a price that covers the costs involved in maintaining their obligations under the *In Business* program in terms of communicating back to the EO through annual reports or maintaining the quality of their services as *In Business* providers.

***Cultural distance*** manifests in the degree of differences between home country and local market values, customs and methods (Karuppur 2002). This has implications for performance measurement as cultural intricacies can affect BMOS' perceptions of different measures and affect the standards of evaluation when performing the quality assurance processes as required by the ILO. Relatedly,

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<sup>13</sup> C.M. Sashi Devi Prasad Karuppur, (2002), "Franchising in global markets: towards a conceptual framework", *International Marketing Review*, Vol. 19 Issue 5 pp. 499 - 524.

<sup>14</sup> C.M. Sashi Devi Prasad Karuppur, (2002), "Franchising in global markets: towards a conceptual framework", *International Marketing Review*, Vol. 19 Issue 5 pp. 499 - 524.

<sup>15</sup> C.M. Sashi Devi Prasad Karuppur, (2002), "Franchising in global markets: towards a conceptual framework", *International Marketing Review*, Vol. 19 Issue 5 pp. 499 - 524.

*geographic distance* can also increase the cost of monitoring the franchisees -- the *In Business* licence holders -- in spite of technological advancements in communication technologies (Karuppur 2002). Geographical decentralisation increases uncertainty and informational gaps between the franchisee and license holders (Alon 2006)<sup>16</sup> and whilst this means minimal monitoring costs between BMOs and SME clients, it impedes on EOs' ability to monitor the actual delivery of the *In Business* modules and gather direct and honest feedback from first-hand consumers, the SMEs.

The prevalence of *agency theory* should be of concern to ILO as it refers to the possibility for a participant to maximise their own objectives at the expense of the principal (Karuppur 2002). The Franchise Agreement expressly excludes an agency relationship between ILO and EOs but agency theory is not confined to the legal definition of the term but to any situation where there is delegation of work from one party to another. A potential impediment to the effectiveness of the *In Business* program is that both EOs and BMOs may prioritise their individual pursuit of profit-maximising to the detriment of ILO as the quality of the *In Business* program may suffer as a result of their self-serving pursuits. The introduction of specific criteria in the selection of BMOs (such as having the appropriate management skills, dedication and marketing acumen) assists in minimising the risk of illegitimate *In Business* providers that cannot effectively achieve the goals of ILO in relation to improving the capabilities of SMEs. However, EOs nonetheless retain a degree of discretion in selection procedures and may not necessarily select BMOs that are capable of performing the *In Business* procedures - thus presenting problem of adverse selection (Karuppur 2002). Whilst self-serving BMOs that violate their obligations under the *In Business* agreement may be subject to contractual penalties, ILO should be aware that country-specific laws may be deficient in providing adequate sanctions for such opportunistic behaviours (Terpstra and Sarathy 1999).<sup>17</sup>

## ***10. Use of franchising in developing countries – Case Examples***

### ***10.1 Philippines***

Philippines has been chosen as the target country for the initial distribution of *In Business* suite of services. Key considerations that arise in operating a business in Philippines (including ILO's potential involvement as a master franchisor) include cultural factors; political corruption; lack of infrastructure and relatively laggard law-enforcement processes.

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<sup>16</sup> Ilan Alon, (2006), "Market Conditions Favoring Master International Franchising", *Multinational Business Review*, Vol. 14 Issue 2 pp. 67 – 82.

<sup>17</sup> Terpstra, V. and Sarathy, R. (1999), *International Marketing*, Dryden Press, Hinsdale, IL.

### ***Cultural considerations***

Multiple culture-specific factors exist when operating a business in Philippines. Firstly, Filipino businesses operate according to a hierarchical management style where vertical decision-making occurs and information must be passed through various levels within the hierarchy before the final decision is made.<sup>18</sup> Secondly, Filipino businessmen are accustomed to a more relaxed concept of time where punctuality is perceived as less important than the personal relationships formed through face-to-face interaction.<sup>19</sup> These cultural differences are significant for the reason that they should be understood in order to avoid any unnecessary misunderstandings between the ILO representatives and parties involved in delivering the *In Business* program.

### ***Contract Enforcement***

Effective contract enforcement processes and procedures encourage business relationships between foreign investors, and local businessmen as parties can be confident that effective commercial dispute resolution processes are in place to make the other party accountable for losses arising from contractual breaches or failure to meet legal obligations. In *Doing Business 2015*, an annual survey conducted by the World Bank, Philippines was ranked as 124 of the 189 economies that were surveyed on the ease in which contractual rights may be enforced. It was found that the average number of days for enforcing a contract through the courts was 554 in East Asia and Pacific but that in Philippines, the average number of days for an aggrieved to seek contractual remedies was 842. This indicates that any form of commercial litigation is likely to be costly and disruptive to the implementation of the *In Business* program. It therefore suggests that alternative dispute resolution processes should be clearly defined at the outset of all commercial relationships formed both between ILO and its stakeholders; as well as between the license-holders and the sub-licensees who are contracted to provide *In Business* services.

### ***Institutional factors***

Researchers have found that Philippine exports tend to lag behind its neighbours, China and Thailand, in their level of technological competence (Wignaraja et al 2009) and reflects the lack of technological and logistical infrastructure that is a product of the country's poor state of public finance and low wage levels (Wignaraja et al 2009).<sup>20</sup> However, a more significant deterrence in foreign

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<sup>18</sup> <https://www.austrade.gov.au/Australian/Export/Export-markets/Countries/Philippines/Doing-business>

<sup>19</sup> <https://www.austrade.gov.au/Australian/Export/Export-markets/Countries/Philippines/Doing-business>

<sup>20</sup> Wignaraja, G., Lazaro, D. & De Guzman, G. 2009, "Factors Affecting Use or Nonuse of Free Trade Agreements in the Philippines", *Philippine Journal of Development*, vol. 36, no. 2, pp. 69-95.

investment is that low-wages has created an environment that promotes rampant corruption within the country as workers resort to acceptance of bribes in order to survive on their low income (Jon 2015).<sup>21</sup>

The political system of Philippines has been marked by instability and frequent changes in leadership means that there is a lack of strong political will to punish and enact policy changes that seek to improve detection and punishment for corrupt practices (Jon 2015). Additionally, the bureaucratic red tape which causes inefficiency in the Philippine Civil Service has meant that businessmen are more inclined to engage in corrupt practices by paying bribes to expedite the application process for the relevant permits or government issued licenses (Jon 2015).

The Filipino value of *utang na loob* strengthens the opportunities for corrupt practices because the term describes the Philippine's value of strong inter-family groups which reinforces nepotism as public officials will seek to return favours for their relatives or for their superiors / subordinates who have assisted them in the past (Jon 2015). Therefore, whilst the country has liberalised its market by removing most of its non-tariff barriers and removing restrictions on employment of foreign personnel (Tongzon 2005),<sup>22</sup> ILO representatives should be made aware of the existence and potential use of "expediency payments" whilst not abandoning the Anti-Corruption Principle (Principle 10 of the Ten Principles of the United Nations Global Compact (2010)) which encourages businesses to eradicate all forms of corruption including bribery and extortion.

### ***Philippine Franchise Association ("PFA")***

ILO should be aware that particular rules are imposed by the Philippine Franchise Association as well as regulating the franchising industry through the *Fair Franchising Standards* as introduced in 2003 and given effect on 24 February 2005 (Schwartz and Zylberman 2008).<sup>23</sup> The franchisor is required under section V of the *Standards* to provide the prospective franchisee with thirty days' grace period to review the Franchise Circular (FOC) disclosing various information to the franchisee. Following that, a fourteen day period must be provided to the franchisee to review the proposed Franchise Agreement between the parties (section V(2) *Fair Franchising Standards*).

Where disputes arise between franchisor and franchisees, there is a requirement under section VIII of

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<sup>21</sup> Jon S.T. Quah. "Chapter 4 The Philippines" *In* Curbing Corruption in Asian Countries: An Impossible Dream? Published online: 09 Mar 2015; 111-152.

<sup>22</sup> Tongzon, J.L. 2005, "Trade Policy in the Philippines: Treading a Cautious Path", *ASEAN Economic Bulletin*, vol. 22, no. 1, pp. 35-48.

<sup>23</sup> Bryan Schwartz & Leandro Zylberman 2008, 'International Franchise Regulation', *Asper Review of International Business and Trade Law*, vol. 8, pp. 318-358.

the *Fair Franchising Standards* to exhaust all means of dispute resolution and utilise non-judicial remedies. There is a requirement to, as far as practicable, provide for these dispute resolution processes within the Franchise Agreement (s VIII *Fair Franchising Standards*).

## **10.2 Cambodia**

With CAMFBA being a key partner in the *In Business* program, the *In Business* has potential of improving the limited entrepreneurial skills and access to training resources available for Cambodian businessmen (Lin et al 2004).<sup>24</sup> A variety of institutional problems remain that are likely to affect the efficacy of *In Business* services.

### ***Lack of Infrastructure***

Relative to its neighbours, the education levels and per capita income in Cambodia remain low and issues with informational transfer from ILO representatives, to EOs and SMEs will persist with the country's lack of technological infrastructure (Lin et al 2004). For every 1,000 people in the country, there is a mean number of 1.4 computer units and 0.03 units that possess the capability of accessing the Internet. These have significant implications on *In Business* processes as it may greatly restrict informational transfer between the stakeholders - resulting in limited feedback and evaluation of the efficacy of *In Business* within the country.

### ***Weak legal system***

Whilst the 1994 Law on Investment has improved international trade for the country, Cambodia's minimal investment regulations and tax system does not account for the unreliability of its legal institutions which are seen from both the prevalence of widespread corruption as well as being relatively weak (Lin et al 2004). This is evidenced by the ability for companies to remove any unfavourable restrictions on their operations through lobbying and paying top government officials (Lin et al 2004).

Corruption is a significant deterrent for foreign direct investment into the country but the persistence of the problem is a result of Cambodian society's acceptance of bribery to the extent of engaging in open discussions of such illegal payments. The lack of confidence by foreign investors in

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<sup>24</sup> Lin, C., Hsieh, H., Yuok, N., Savary, C. and Sum, V. (2004) 'Evaluating the Competitiveness of Least-Developed Countries - the Example of Cambodia', *Asia Pacific Management Review*, vol. 9, no. 2, pp. 205-227.

the legal system is exacerbated by the appointment of judges who have limited training and who have minimal access to published Cambodian law (Lin et al 2004). The natural result is the delivery of decisions in a haphazard manner without reference to previous case law and judicial rulings. The implication for ILO is that where trademark laws are infringed and *In Business* material is illegally disseminated in breach of the MOU, legal remedies are unlikely to be effective in compensating for the losses of the aggrieved parties.

### ***Sweatshops and labour practices***

The result of liberal investment regulations, low level of incomes and limited access of education for the population is that labour standards are frequently exploited by companies seeking to exploit the advantage of low labour costs.<sup>25</sup> The ILO must therefore seek a way to effectively encourage entrepreneurial activity through the *In Business* program without however losing its focus on improving the working conditions of the country's labour force - a number comprising of approximately 51% of the total nation's population (Lin et al 2004).

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<sup>25</sup> <http://asiancorrespondent.com/135800/struggle-for-a-decent-wage-leaves-cambodias-garment-workers-in-limbo/>.

## PART III - CHALLENGES AND BARRIERS TO ROLLING OUT *In Business*

### ***11. Intellectual Property Rights***

Intellectual property (IP) rights may be a potential concern to the success of the *In Business* program. IP rights are necessary to ensure that BMOs are able to maintain confidence that they can generate a profit without third parties taking that material as their own and thereby removing the incentive for BMOs to participate and source SMEs for the program.

The ILO retains all IP rights of *In Business*. Any changes, alterations or customization of modules based on feedback and evaluations should be reviewed and endorsed by the *In Business* Help Desk and Advisory Panel for final approval by the ILO. The License Holder is required to expressly acknowledge that the ILO is the owner of all rights, titles, and interest in the trademark and associated goodwill. *In Business* materials will bear a trademark compliant with ILO's branding and marketing guidelines unless they have been adapted or customized - in which case, prior written approval from the ILO would have to be sought and obtained in advance of publication or distribution. This would appeal to license holders as it demonstrates association with the *In Business* Program and the ILO.

Karuppur (2002)<sup>26</sup> highlights the risk that upon gaining access to technical knowledge, franchisees may make minor alterations to the product in order to escape payment of royalties to the patent-owner. The issue ILO may face therefore is that after attaining access to the contents of the *In Business* services and modules, there is a risk that third parties may engage in such opportunistic behaviour by attempting to circumvent patent infringement laws and regulations and on-selling modified products that have not been endorsed by the ILO. If trademark laws are not properly observed, it may impede the effectiveness of *In Business* program as SMEs inaccurately attribute the quality of the counterfeit products as those related to and endorsed by the ILO and may therefore lose confidence in ILO's business offerings.

### ***12. Differing Labour Standards***

#### ***12.1 International labour standards***

International labour standards are legal instruments agreed upon by international actors that set out

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<sup>26</sup> C.M. Sashi Devi Prasad Karuppur, (2002), "Franchising in global markets: towards a conceptual framework", *International Marketing Review*, Vol. 19 Issue 5 pp. 499 – 524.



the basic principles and rights at work. These standards are a result of discussions among governments, employers and workers. Since 1919, the ILO has maintained and developed an international legal framework of labour standards aimed at promoting opportunities for women and men to obtain decent and productive work, in conditions of freedom, equity, security and dignity. The ILO's unique tripartite structure ensures that these standards are backed by governments, employers and workers.

## **12.2      *The enforcement of minimum labour standards***

International labour standards are either conventions, legally binding international treaties that may be ratified by member states, or recommendations, which serve as non-binding guidelines. Ratifying countries commit themselves to applying the convention in national law and practice and reporting on its application at regular intervals. There is also representation and complaint procedures that can be initiated against countries for violations of a convention they have ratified. By ratifying ILO Conventions, countries come within the ILO standards supervision system.

There are eight fundamental conventions that have been identified by the ILO's Governing Body: Freedom of Association and Protection of the Right to Organize Convention (No. 87); Right to Organize and Collective Bargaining Convention (No. 98); Forced Labour Convention (No. 29); Abolition of Forced Labour Convention (No. 105); Minimum Age Convention (No.138); Worst Forms of Child Labour Convention (No. 182); Equal Remuneration Convention (No. 100); and Discrimination (Employment and Occupation) Convention (No. 111).

A growing body of research indicates that compliance with international labour standards often accompanies improvements in productivity and economic performance.<sup>27</sup>

- a. Higher wage and working time standards, and respect for equality can translate into better and more satisfied workers and lower turnover of staff.
- b. Investment in vocational training can result in a better trained workforce and higher employment levels.
- c. Safety standards can reduce costly accidents and health care fees.
- d. Employment protection can encourage workers to take risks and to innovate.

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<sup>27</sup> A fair globalization - Creating opportunities for all - Report of the World Commission on the Social Dimension of Globalization 2004.

The beneficial effects of labour standards do not go unnoticed by foreign investors. Studies have shown that in their criteria for choosing countries in which to invest, foreign investors rank workforce quality and political and social stability above low labour costs. At the same time, there is little evidence that countries which do not respect labour standards are more competitive in the global economy.<sup>28</sup>

Representative employers' and workers' organizations play an essential role in the international labour standards system.

### **12.3 *Child labour concerns***

Child labour is work that deprives children of their childhood, their potential and their dignity, and that is harmful to physical and mental development.<sup>29</sup> It refers to work undertaken by children below the appropriate legal minimum working age, based on ILO Minimum Age Convention, 1973 (No. 138), as well as the worst forms of child labour defined by the Worst Forms of Child Labour Convention, 1999 (No. 182).<sup>30</sup> Both Conventions Nos. 138 and 182 are fundamental Conventions, however, under the ILO Declaration, even the member States that have not yet ratified these conventions should respect, promote and realize the principles. The ILO supports businesses' efforts to reduce child labour and to increase compliance with the ILO's child labour standards.

The most recent issue of the ILO's report series: Global Estimates on Child Labour provides new global and regional estimates on child labour for the year 2012 and compares them with the previous estimates for 2000, 2004 and 2008. The report, Marking Progress Against Child Labour, shows that the global number of child labourers has declined by one third since 2000, from 246 million to 168 million.<sup>31</sup> The report also found that the largest absolute number of child labourers is found in the Asia-Pacific region at almost 78 million.

There is also available to businesses, the Child Labour Platform, a membership-based exchange forum

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<sup>28</sup> Working out of Poverty - Report of the Director-General to the 91st Session of the International Labour Conference June 2003.

<sup>29</sup> International Labour Organisation, 2012, "What is child labour?" < <http://www.ilo.org/ipec/facts/lang--en/index.htm> >

<sup>30</sup> ILO New Report, 23 September 2013, ILO says global number of child labourers down by a third since 2000.

<sup>31</sup> ILO News Report, 23 September 2013, ILO says global number of child labourers down by a third since 2000.

was launched in 2010 at The Hague Global Child Labour Conference as a way for businesses to share and learn from others' approaches to tackling child labour in the supply chain. In June 2011, following the UN Human Rights Council's endorsement of the "Guiding Principles on Business and Human Rights", the ILO and the International Organisation of Employers (IOE) launched the project "Guidance Tool on How to do Business with Respect for Children's Rights to be Free from Child Labour". This project provides guidance on how companies can prevent child labour and contribute to child labour remediation, whether in their own operations or in their supply chains, through appropriate policies, due diligence and remediation processes.

#### **12.4 *Elimination of unfair labour practices***

To achieve the effective abolition of unfair child labour practices, governments should fix and enforce a minimum age or ages at which children can enter into different kinds of work. Within limits, these ages may vary according to national social and economic circumstances. The general minimum age for admission to employment should not be less than the age of completion of compulsory schooling and never be less than 15 years. Developing countries may make certain exceptions to this, and a minimum age of 14 years may be applied where the economy and educational facilities are insufficiently developed. However, types of work dubbed "the worst forms of child labour" are totally unacceptable for all children under the age of 18 years, and their abolition is a matter for urgent and immediate action. Forms of dangerous work that can harm the health, safety or morals of children are subject to national determination, by government in consultation with workers' and employers' organisations.<sup>32</sup>

In any effective strategy to abolish child labour, provision of relevant and accessible basic education is central. But education must be embedded in a whole range of other measures, aiming at combating the many factors, such as poverty, lack of awareness of children's right and inadequate systems of social protection that give rise to child labour and allow it to persist.<sup>33</sup>

The ILO's role in leading the fight against child labour, through its standards and supervisory system, advice, capacity building and direct action has had a positive effect in driving the progress in the fight against child labour. In conjunction with the ILO, the political commitment of governments, the increasing number of ratifications of the two ILO child labour Conventions, sound policy

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<sup>32</sup> <http://www.ilo.org/declaration/principles/abolitionofchildlabour/lang--en/index.htm>

<sup>33</sup> <http://www.ilo.org/declaration/principles/abolitionofchildlabour/lang--en/index.htm>

choices and solid legislative frameworks will all contribute to ensuring the continuing decline in child labour.

If there is a particularly “bad” problem of child labour in certain countries with which the ILO will be implementing *In Business*, this may be accounted for during the contract stages. Otherwise, there could be a standard condition included which will set the ILO standard on child labour.

### ***13. Choice of Law & Jurisdiction***

To achieve a degree of certainty in the enforceability of an international master franchise agreement, at the outset, the parties should choose the law that is to apply to their relationship and agree on the approach to be adopted to resolve any dispute that may arise between them.<sup>34</sup> When the parties negotiate the traditional choice of forum and choice of law clauses, other matters considered include: agreeing on the forum in which disputes might be resolved, the possibility of having recourse to arbitration as opposed to litigation, and the use of mediation, negotiation or conciliation.<sup>35</sup>

To ensure the overall workability and enforceability of the master franchise agreement, there are a range of legal considerations that the parties need to take into account. The choice of law that is to apply to an international agreement within a master franchise agreement and the preferred forum for the settlement of disputes are both important considerations in negotiating international master franchise agreements, such as the *In Business* Memorandum of Agreement. Indicating the legal regime that is to apply helps clarify at the outset the interpretation that the parties intend should be given to the principal terms of their agreement.<sup>36</sup> The law of a particular jurisdiction chosen to apply to the franchise agreement is important. If the parties do not choose the law that is to apply to their agreement, the determination of the laws of which State should govern it will be left to the applicable conflict of laws rules.<sup>37</sup> In the context of the *In Business* Program, the applicable law will most likely be the law of the country in which the sub-franchisor operates the

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<sup>34</sup> Guide to International Master Franchise Arrangements (second edition), Published by the International Institute for the Unification of Private Law (UNIDROIT), Rome Italy, 2007 p198.

<sup>35</sup> Guide to International Master Franchise Arrangements (second edition), Published by the International Institute for the Unification of Private Law (UNIDROIT), Rome Italy, 2007 p198.

<sup>36</sup> Guide to International Master Franchise Arrangements (second edition), Published by the International Institute for the Unification of Private Law (UNIDROIT), Rome Italy, 2007 p198.

<sup>37</sup> Guide to International Master Franchise Arrangements (second edition), Published by the International Institute for the Unification of Private Law (UNIDROIT), Rome Italy, 2007 p198.

franchised business with applicable international treaties and conventions taken into account.<sup>38</sup> International uniform law will often be considered in addition to domestic law unless expressly excluded by the terms of the contract.<sup>39</sup> An alternative of seeking to have the same legal principles apply to all the agreements in the master franchise arrangement is that the parties could provide that the provisions of their agreement should be interpreted in accordance with the UNIDROIT *Principles of International Commercial Contracts*.<sup>40</sup>

## ***14. Termination and revocation***

### ***14.1 Grounds for termination***

Termination provisions in master franchise agreements are ones that permit a franchisor to terminate in the event of a “material” or “substantial” breach. Expressions such as “material” or “substantial” breach are difficult to define. What a franchisor regards as a “material or substantial” breach may not be regarded as so by a franchisee or the sub-franchisee. All parties should agree on what is material or substantial before reaching a final agreement. If the parties do not, a court may decide and how the court will determine such a dispute may be open to question. It is important for the parties to know where they stand. Thus, terms such as “material” and “substantial” should be clearly defined at the beginning of the contract.

Failure by a franchisee to ensure that the sub-franchisee complies with the terms of the agreement is a serious issue for the franchisor. However, the franchisor may have to accept that compliance requires reasonable time and careful handling to be achieved. Breaches of agreement are not necessarily best resolved by requiring the franchisee to undertake legal proceedings against the sub-franchisee and/or terminating the agreement. A solution can often be achieved by engaging in direct discussion, persuasion, retraining and support. The parties must acknowledge that there are a wide range of methods available to deal with issues and the agreement should recognise the need to be flexible.

Ultimately, the franchisor must be able to bring matters to a head to protect its interests and the integrity of its brand etc. The franchisor and franchisee must ascertain whether the law applicable to

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<sup>38</sup> Guide to International Master Franchise Arrangements (second edition), Published by the International Institute for the Unification of Private Law (UNIDROIT), Rome Italy, 2007 p199.

<sup>39</sup> Guide to International Master Franchise Arrangements (second edition), Published by the International Institute for the Unification of Private Law (UNIDROIT), Rome Italy, 2007 p203.

<sup>40</sup> Guide to International Master Franchise Arrangements (second edition), Published by the International Institute for the Unification of Private Law (UNIDROIT), Rome Italy, 2007 p203.

the agreement (which may be the law of the host country as a matter of public policy) provides special procedures, restrictions of direct or indirect penalties in some form or other which may inhibit the exercise of a contractual right to terminate the contract.

Before termination is resorted to, the franchisee will normally be given a certain period of time to remedy the breach. The period of time allocated must be appropriate given the nature of the breach.

#### **14.2      *Termination by licensee / sub-licensee***

In practice, it is rare to find provisions that entitle a franchisee to terminate for default on the part of the franchisor. The view usually adopted by franchisors to justify this difference between the rights granted to franchisors and franchisees is that, while it is sufficient for the franchisee to rely on the remedies available at law for non-performance on the part of the franchisor, the franchisor needs the specific termination provision to enable it to act swiftly to pursue the remedies necessary to preserve its trade name, trademarks, etc. The franchisor will also consider that it needs to be able to swiftly decide what to do with the network of sub- franchisees and to act upon its decision without delay.

If the franchisee considers the franchisor to be failing to provide the services or products it is under an obligation to provide and considers this failure to have adverse consequences for itself and its sub-franchisees, then the remedy of damages for non-performance is available. The franchisee is entitled to terminate the franchise agreement when the franchisor is in “material” breach of its obligations.

Similarly, it is rare to find a provision in a master franchise agreement permitting termination by the franchisee for breach by the franchisor. It is uncommon to find a provision in an agreement giving the franchisee a right contractually to terminate the agreement. The franchisee may find it difficult to choose between when a franchisor is in default, terminating and losing their right to continue to trade as before or permitting the franchisor’s breach.

#### **14.3      *Termination by Franchisor***

Where there is a lawful termination in accordance with the provisions of the master franchise agreement that deal with termination, the franchisor would expect the full range of consequences stated below. A franchisee dissatisfied with any of those consequences must negotiate alternative solutions prior to the franchise agreement.

A related issue is whether the franchisor should be required to make a payment to the franchisee for the transfer of the sub-franchise. The following problems arise:

- The sub-franchise agreements may be regarded as having come to an end automatically when the master franchise agreement terminates. It is therefore necessary to make provision in both the master franchise and the sub-franchise agreements for an extension of the term of the sub-franchise agreements beyond the end of the master franchise agreement, so as to provide the franchisor with sufficient time to make the correct informed decision about which approach it wishes to adopt vis-a-vis the sub-franchise network;
- a sub-franchisor who wishes to terminate for any reason, or who wishes to sell but cannot find a purchaser, may deliberately breach the contract to force the franchisor to terminate and “buy” the network;
- sub-franchisees who may be unhappy with the franchisee and could lead to rebellious sub-franchisees who wish to break away from the franchise;
- whether the franchisor in any event will be obliged, or whether it will merely have the option to take over the sub-franchised network, or whether it should be able to select the sub-franchisees it wants to deal with and to terminate the others;
- in view of the issues that the franchisor may perceive as possible with a sub-franchised network in these circumstances, whether the franchisor should be able to require the terminated franchisee to compensate it for the additional expenses will incur and for the likely losses of dissatisfied sub-franchisees.

Local laws may have an impact on what happens to sub-franchised networks. The issues therefore require careful consideration within the framework of legal and ethical norms particular to the host country.

### ***15. Consequences of termination***

When the master franchise relationship comes to an end, the following consequences for the franchisee will likely arise:

- It will lose future development rights;
- it will have to cease operating as the “franchisor” of the sub-franchisees in the

development area;

- it will be required to discontinue the use of the franchisor's:
  - trademarks, trade names and other branding, copyright material (including the operations manuals); and
  - systems, know-how and confidential information
- it will have to de-identify any premises it may have;
- at the franchisor's option, it will be required to transfer all sub-franchise agreements to the franchisor.

Provisions of local laws may well affect a number of these consequences. For example;

- Intellectual property laws will have to be complied with to ensure that the rights that have been exercised are correctly terminated;
- restraints on the use of systems, know-how and confidential information will be affected by the law applicable to such property rights, but also by competition laws in some countries;
- the transfer of sub-franchise agreements may be affected by:
  - local laws regulating who can carry on business in a territory; and
  - the possibility that if the master franchise agreement is terminated sub- franchise agreements also terminate, unless the agreements deal with this issue;
- local laws may confer a right on the franchisee to claim compensation; and
- it is possible that, if the agreement is sought to be terminated for insolvency or other related reasons, there may be laws under which administrators are appointed to preserve assets for creditors and which affect the right to terminate

An effective operation of the sub-franchise units requires adequate serving and assistance on the part of the franchisee. In cases of termination or expiration of the term of the master franchise agreement, the risk is that sub-franchisees with agreements expiring after expiration of the master franchise agreement may be left without proper assistance. In order to avoid this problem, the franchisee may choose not to establish units (i.e. franchise the *In Business* program) as the agreement draws to a close. Nonetheless, it is not recommended that the development schedule remain inoperative during the latter part of the term of the master agreement, as franchisors will wish to



encourage the establishment of franchise units throughout the term. It would be fair and equitable to provide that, notwithstanding the expiration of the term, certain portions of the master agreement should remain in force solely with respect to franchise units for which sub-franchise agreements have been entered into prior to such expiration and that the franchisee should lose its right to develop additional franchise units under the master agreement. This would permit the franchisor to itself establish, or to franchise others to establish, new units within the territory concerned.

Each franchise unit existing at the date of expiration of the term of the master franchise agreement would in other words continue to be serviced by the franchisee for the remainder of the term of the sub-franchise agreement. The franchisee would continue to receive the royalties and other payments due to it until the expiration of the term of each sub-franchise agreement.

### ***15.1 Consequences for the Sub-Franchisee***

In most jurisdictions, each individual sub-franchise agreement would automatically terminate if the effect of the expiration of the term of the master franchise agreement or of its termination on the sub-franchise agreements is not dealt with in the master franchise agreement and the sub-franchise agreements. In this case, each sub-franchisee would be required:

- to cease using the franchise system and trademarks; and
- to remove any decorations or indications identifying the franchise unit as belonging to the franchise network.

The repercussions of the failure to deal with the effects of termination of the master franchise agreement on the sub-franchise agreements would be extremely serious, not only for the franchisor, but also for each sub-franchisee. The drafting of the provisions of the master franchise agreement that relate to the effects of the expiration of its term thus requires careful consideration by both franchisor and sub-franchisor. The impact of such provisions should also be dealt with in each sub-franchise agreement.

### ***16. Assignment of the Franchisee's Rights in the Sub-Franchises***

In consideration of the consequences discussed above, one practical alternative in dealing with the effects of termination of master agreements on sub-franchise agreements would be to provide for the assignment by the franchisee to the franchisor of all of the franchisee's rights, title and interest in and

to each sub-franchise agreement.

The parties should address such questions as whether the franchisor's option to take over the network should refer to the network in its entirety, whether the franchisor should be obliged to accept the assignment of the sub-franchisor's rights under each sub-franchise agreement, whether the franchisor should be allowed to choose the units to be assigned to it and to select the appropriate financial arrangements (if any), or whether it should merely be granted an option to obtain such assignments.

To the extent that the franchisor is obliged to accept assignments following the expiration of the term of the master franchise agreement, it will be required to assume a role that it may not be equipped to assume, namely, that of franchisor in a foreign country in which it will not have the benefit of an established organisation to support its activities.

The practical difficulties associated with the enforcement of assignment provisions have made it necessary to put appropriate mechanisms in place. It is common to include in the master agreement an obligation on the part of the franchisee to provide the franchisor with a power of attorney authorising it to execute all such assignments of sub-franchise agreements, for and on behalf of, the franchisee, should the franchisee fail to do so. In addition to the master agreement containing an assignment provision, each individual sub-franchise agreement should contain an acknowledgement by the sub-franchisee that when the term of the master franchise agreement has expired, the right, title and interest of the franchisee in the sub-franchise agreement will be assigned to the franchisor. The sub-franchise agreement could include an acknowledgement by the sub-franchisee that the franchisor is a third party beneficiary of such rights.

## PART IV - RECOMMENDATIONS

### 17. *ILO Ensuring Compliance with the Franchise Agreement*

There is a potential divergence in interests between the ILO and franchisees. Whilst the ILO strives to promote sustainable business development services that improve productivity, working conditions and competitiveness among micro, small and medium size enterprises, franchisees aim to grow their membership and collect sufficient revenue to sustain their organization (including activities other than *In Business*).

Maintaining a tightly controlled and integrated system that supports the *In Business* program is essential to ensuring its success. The ILO is faced with the challenge of maintaining uniformity across the franchise system to protect the *In Business* brand whilst providing benefits for franchisees to undertake the program. Consequently, the ILO must implement strategies to maintain control over its franchise agreement.

There are three identified different types of control in franchise systems; legal, economic, and administrative.<sup>41</sup> The extent to which a contract is the main source of control in franchising has been the subject of a number of investigations. There are limitations to its effectiveness in franchising. Some studies suggest that contractual controls are only used when there are serious breaches of agreement or when the franchisor wishes to establish structural system changes. In international franchising, contracts are tricky to standardise and are more difficult to enforce due to the geographic distances involved. Nonetheless, franchisees' fear of losing their investment and their willingness to engage in opportunistic behaviour is based on the threat of potential expulsion from the system and the associated economic risks. Therefore, the franchisor's willingness and ability to enforce the contract is of great significance. Studies conducted vis-à-vis master franchise agreements suggest that economic control may be a more effective tool. For example, it is suggested that by raising investment return expectations on the behalf of franchisees (as a result of their investment in *In Business*), control of the agreement is increased as benefits provided by opportunistic behaviour reduce. In other words, as franchisees expect their returns to increase from their investment in *In Business*, the opportunity cost of deviating from the agreement will reduce.

Administrative controls comprise the operational processes used to achieve goal alignment and

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<sup>41</sup> Hoffman, R. and Preble, J. (1991), "Franchising: selecting a strategy for rapid growth", Long Range Planning, Vol. 24 No. 4, pp. 74-85.

monitor adherence. These control mechanisms include decision-making processes and the mechanisms used to monitor *In Business* and quality targets. Training manuals are frequently used to support franchisees and maintain quality control. Inter-organisational processes for communication and information sharing are also important to the control of international franchise systems. However, the effectiveness of administrative control is related to the geographical distances involved and the different environments of the host countries and is therefore potentially more limited in international franchising. There are further limitations identified in master franchise agreements where responsibility for quality control may be devolved to franchisees who are also reported to filter franchisor communication. The evidence from research is mixed however, with some studies suggesting franchisees are more likely to behave opportunistically given their unique status; and others suggesting they are more likely to conform to franchisor practice than franchisees operating single units. However, many studies have addressed the issue of control superficially and report the need for further research to determine the mechanisms used to control international franchise systems, master or otherwise.