Franchises in Colombia, legal regulations and features

Franquicias en Colombia, características y regulación legal

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Abstract

This article will strive to reflect on the issue of Franchise in Colombia and its development over the years.

It will also analyze how lawyers have handled franchise contracts using different ways, for example, without having the Central Bank, the Andean decision 24 and 83, in which dispersed manner gives information about franchises.

For the purpose of these analyses, we will focus on the relationship with North American franchises, given the fact that the United States is the country that has the biggest influence in the development of franchises in Colombia.

We will part from an analysis of the figure in Colombia, its main characteristics and elements, practical examples and the risks that come with owning a franchise in the country.

Keywords: franchise, elements and features, Colombia, franchise agreement.

Resumen

Este artículo es una reflexión sobre el estudio de la franquicia en Colombia y su desarrollo a través de los años. También analiza cómo los abogados sin tener ninguna regulación expresa han podido manejar esta figura, en particular con los Estados Unidos, que ha sido el país que ha tenido más injerencia en la evolución de este contrato en la economía colombiana.

Se parte de un análisis de la figura en Colombia, de sus principales características y elementos, ejemplos prácticos de franquicias en el país y riesgos que puede presentar la figura.

Palabras claves: franquicia, elementos y características, contrato de franquicia en Colombia.
INTRODUCTION

Franchising is a marketing system in which, in exchange for a payment, an employer gives to another the privilege of using a business model that enjoys some pre market acceptance (Ruiz, 2006, p. 15).

The franchise agreement has boomed in recent times due to the fact that it helps businesses to expand and at the same time, produces a level of consumer confidence, which in turn is the main generator of success.

In both Colombia and the United States the franchise has been a model contract that has grown sharply with the passing of time. In Colombia, there is no doctrinal definition; many authors define the contract in accordance with the practices and customs.

The origin of the franchise model as we know it today was born in the United States with the Singer Corporation, a company that manufactured sewing machines. To avoid very high costs by hiring direct marketers, the Singer Corporation established sellers who were charged to have the right to distribute its products. (Park & Agudelo, 2010).

“The use of the word Franchise in the field of marketing, and specifically in commercial distribution, was born in the United States, where companies were looking for a new way to sell products to buyers” (Gonzalez, 1998, p. 3).

In this line of thought, this article seeks to describe the characteristics of the franchise agreement under the Colombian legal system, in order to understand how they have implemented many American franchises in Colombia, given the fact that our country does not have an expressed regulation for this type of contract.

The number of business that settled franchises, as well as the number of existing franchisees and total sales for these concepts are a proof of the success of this modern way of doing business which started in the United States of America and has expanded across the globe. (Gargollo, 2009, p. 4).
The lack of legal regulation has not been a problem for the creation of franchises in Colombia. It’s no secret that the franchise has become a growing phenomenon in our country.

Law 1480 of 2011, which provides regulation for all consumer rights and obligations, does not provide any regulation on this issue regarding the franchise agreement, not even for when the consumers’ rights have been violated by a franchise.

Furthermore, for entrepreneurs it is an easy way to start their own business, taking advantage of the experience and structure that have been tried by others. One of the main advantages of starting a franchise is the ability to jump into the market knowing how it works, how the brand is established, how the product is sold and how it is accepted by the general public.

On the other side, “The rise of the franchise can be qualified as wild, since there is no specific regulation to this trade, thus, it is not strange that franchisor and franchisee enter into abusive contracts that benefit the franchisor” (Gonzalez, 1998, p. 11).

The lack of legal regulation often leads the brand owners to make demands that can be very hard to accomplish on the side of the franchisee. It is a figure that may give a lot of power to the franchisor and puts the franchisee in disadvantage in terms of their negotiation power. Such an uneven contract can have devastating consequences on the success of the business and it can determine if the franchise contract succeeds or fails.

THE FRANCHISE AGREEMENT

The contract is based on the voluntary agreement of the parties; the franchise is an agreement between the franchisor and the franchisee, in which one is granting the other permission to use the name and likeness of an established business, transmit expertise or provide technical assistance.
The general rule, is that an investor makes an initial investment, which grants him/her the rights to trade under the business name, benefit from the name and likeness of the brand, and get access to the training and support required to run the business on a daily basis.

According to Marcela Castro,

The franchisor must ensure the franchisee the existence and title over such rights, be the owner of them or have permission from the owner to grant licenses to third parties. At the same time, the franchisor must guarantee the peaceful use of the licensed logos and do everything in its power to oversee that third parties do not use them in detriment of the franchisee. (Ruiz, 2006, p. 10).

Franchises minimize the risk for investors because there are specific results and procedures from which they can benefit. These procedures decrease operating costs, as well as provide a good return on investment and easy advertisement and promotion of the product. Some of the other benefits are the membership to a group or network of franchises, which makes it easier to sell and distribute the product or service, the access to a pool of free innovation and first-hand information about an established business.

On the other hand, franchises even help in the field of costs and organization; they are also ways to limit the potential of other items and ideas of the producer, which could at the same time, seek a balance in the economy and create opportunities to others who do not have the money to invest in a franchise.

This article will deal with the franchise in Colombia and it will try to answer possible concerns that an entrepreneur might have when buying a franchise in Colombia. It will also analyze the procedures, regulations and cases of successful and unsuccessful franchises in the country.
FRANCHISE IN COLOMBIA

The Latin American economy, despite having so many inequalities, has grown substantially in the last decade, which has led to the market demanding products and services that exist in developed countries.

With this expansion, franchises arrived in the region. In Colombia, franchises have spread widely these years. According to the director of the board of Colfranquicias, Luis Felipe Jaramillo Lema, Colombia went from 110 networks in late 2003 to about 530 in December 2013, with about 8,000 establishments under this figure, which generate between 35,000 and 40,000 jobs. Each year 40 new franchises open in the country.

Franchising is a multinational phenomenon; many companies have opted for it in their own countries and have slowly ventured into foreign markets driven by economic globalization phenomena. (Ruiz, 2006, p. 25)

According to Scott Murphy, senior president of Dunkin’ Brands, Dunkin’ Donuts, “We are a global company that sells 8 billion dollars, with 2 billion cups of coffee daily, making us the number one selling coffee cups daily. Colombia has been the basis for our growth in Latin America” (Gomez, 2014).

The case of Dunkin donuts shows how the Colombian economy has been the basis for the evolution of this contract in Latin America, in addition to the relationship of the representative in Colombia with the owner of the chain, who has allowed the Colombian coffee to be sold by Dunkin Donuts in the United States.

The result of a successful relationship with an American franchise like Dunkin Donuts has brought different benefits to our country, and has benefited other parties like the coffee makers, who are now exporting directly to Dunkin Donuts in the USA.
The brand intends to begin the renovation of the 175 points on 9 Colombian cities, with an investment of five million dollars over the next five years. For the next 10 years, it intends to open 70 more stores. Cartagena and Santa Marta are cities where they are interested to venture. (Gomez, 2014).

Another case of great importance to the Colombian economy, and for the recognition of its coffee, is Starbucks, “this chain has more than 19,000 stores in 62 countries. Some people say that the world of coffee owes much of its development to this company, which employs 160,000 people and generates annual revenues of approximately 14,000 million” (Revista Semana, 2013).

Cases like Dunkin and Starbucks put Colombian coffee on the map. Both companies are aggressively advertising our coffee and millions of people around the world are recognizing the true value of the drink.

For example, Starbucks CEO not only came to officialize the opening of the franchise into the Colombian market, he also came to discuss a strategy with the National Federation of Coffeemakers to give more visibility to Colombian coffee in its stores around the world. The idea is for a consumer in New York City, Hong Kong or any place that has a Starbucks store, to be able to identify the origin of the Colombian coffee grain” (Revista Semana, 2013).

Another good example is Century 21, this company ventured in Colombian Market with its first franchise in 2008 (Moloney, 2011). Since then, it has grown to 24 franchises in Colombia; other newcomers to the Colombian market in that moment were Calvin Klein, Swarovski and Mango.

In Colombia it is clear that the legislators have not covered in depth one of the most urgent issues to regulate today, regarding the franchise agreement, which has to do with the responsibility derived from the breach in the contract, creating multiple dangers for the parties (Otero, 2013).
The way the franchise agreement is seen by lawyers and jurisprudence is by analogy; there are other laws that are applicable in this situation on the commerce code. Under our legal system, every particular case has to be analyzed separately and carefully by all the parties involved.

Some Colombian regulations

There are some regulations in Colombia applicable to the franchise figure, for example, the commerce code (because the relationship in the franchise agreement is essentially commercial). Therefore, we directly apply the following books of the Commerce Code: (i) General Provisions, (ii) Of the merchants and Trade Affairs, (iii) commercial property, and (iv) commercial contracts and obligations.

Some of the regulations that can be found in the commerce code and international treaties that regulate the figure of franchise by analogy are the following (Código de Comercio, 2013):

i) Commerce Code

i. General provisions

Article 10: this title is about the applicability of the commercial law, the provisions of commercial law govern traders and business matters, and cases expressly unregulated will be decided by analogy with its rules. On trade issues that are unable to be regulated under the previous rule, the provisions of the civil law.

Article 30: Commercial practice shall have the same authority as commercial law, if not overtly or tacitly runs counter to the facts constituting the same are public, uniform and reiterated in the location where they met the performance or relationships emerged to be regulated by it. In the absence of local custom will take into account the overall country, provided it meets the requirements of the preceding paragraph.

ii. Of the merchants and trade affairs
Article 21: Other mercantile acts; It will be also all acts as commercial traders or companies related to trading activities, and executed by anyone to ensure compliance with trade obligations.

Article 22: Application of Commerce law acts. If the merchant acts regardless of the parties, the provisions of commercial law shall govern it.

Article 23: There are commercial:

1) Procurement of goods destined for domestic consumption or use of the purchaser, and the sale thereof or leftovers;

2) The procurement of goods to produce artistic works and disposal of these by its author;

3) Purchases made by officials or employees for public service purposes;

4) Disposals directly made by farmers and ranchers of the fruits of their crops or livestock in their natural state. Nor will the processing merchant of such fruits that made farmers or ranchers, provided that such transformation is itself a company, and

5) The provision of services relating to the professions.

iii. Commercial property

iv. Commercial contracts and obligations

Article 19: It is the obligation of every merchant to:

1) Enroll in the commercial register.

2) Enroll in the commercial register all events, books and documents on which the law requires that formality.

3) Keep accounts of its business in accordance with legal requirements.

4) Preserve, under the law, correspondence and other documents relating to its business or activities.
5) Report to the competent judge cessation at the current price of its commercial obligations, and

6) Refrain from acts of unfair competition.

b) Decision 486 of the Cartagena Agreement Commission (CAN):

As the franchise contract award carries a trademark, it is necessary to consider the regulations governing this procedure. Therefore, this decision applies, especially on article 162 on the trademark license.

**Article 162**: - The owner of a registered or pending registration may license one or more parties to use the mark.

Any license to use the mark shall be registered with the competent national office. Failure to register will cause the license to be unenforceable against third parties.

For the purposes of registration, the license shall be in writing.

Any interested person may apply for registration of a license (Decisión 486 de Cartagena, Régimen Común sobre propiedad Industrial, 2000).

It is important to remember that according to the hierarchy of the Colombian legal system, international treaties are beneath the Constitution and the Laws, which is why lawyers and investors have to be overly careful when entering into such contracts. Every issue that may come out must be analyzed with great concern, and the parties should be overly explicit in the contracts in order to avoid conflict and litigation.

**Important steps to acquiring a franchise in Colombia**

There are some important steps to acquire a franchise in Colombia. It is important to choose the franchise and the area of interests, the entrepreneur and the business for which he/she wants to bet.

Having a first contact is good for the franchisor and the franchisee to start knowing each other, evaluate each other and create a first impres-
sion. Therefore, most companies propose that the investor interested in joining the network visits its headquarters to objectively discover how it is and how the business works.

If at this time the two parties are still interested in the relationship, it is common to sign a preliminary agreement, which is a contract by which the franchisor grants the franchisee the reservation of an area until they find the right place. Upon signing the preliminary contract, the franchisee must pay an amount (which will vary depending on the brand) as advance payment or fee, to be paid when they sign the final contract.

After signing the preliminary contract, the hard work of finding the ideal venue for the activity begins. Normally, the center advises the franchisee on the type of establishment and the place to locate for success in managing the activity. Some companies are responsible for seeking the establishment to its partners and therefore, the franchisee does not have to search alone.

It is very important to consider the economic requirements that will be needed to acquire the franchise. Before signing the franchise agreement, the franchisee must ensure that they have the necessary funds to start the business. In addition to the initial investment required, they must have a financial cushion to develop the activity during the first few months. Most companies usually help their franchisees to reach agreements with banks or facilitate access to various funding sources.

Several authors such as Marcela Castro Ruiz (2006), have been responsible for defining certain elements that can explain the process in order to define the method to own a Franchise in the country.

It is important to say that these contracts are established by the Colombian Civil Code as an atypical contract, this means, “the effects have not been disciplinary regulated by the law”. Although there are also those who think that this contract is collaborative in which, instead of opposite interests, there is a common purpose for both parties, which is to sell merchandise or provide services (Marzorati, 2008)
Castro Ruiz said that these are the elements necessary for a franchise agreement to come to light: first, “the granting of a license to use property rights”, second, “the transmission of know-how from franchisor” and third, “the remuneration by the franchisee” (Ruiz, 2006, p. 18).

1. The granting of a license to use property rights: The franchise agreement grants the franchisee a license to use the logos of the chain. Through the contract the franchisee is authorized to use the marks, names, emblems, labels, appellation, slogans, logos and packaging.

2. The transmission of know-how by franchisor: This means that the franchisor literally knows how to do something; it is the set of technical, administrative, business and financial management skills. This may be the most important element because it is where the franchisor is committed to transfer the expertise of entrepreneurship.

3. The remuneration by the franchisee: Franchising is essentially an onerous contract, and the payment for the franchisee to enter and remain in the franchise, is an essential element for the existence of this contractual figure.

Knowing the legal framework of a contract is essential when one has succeeded in developing a business. Knowing the rights and obligations, meeting the most important clauses of the contract and staying within current legislation to make it more transparent and attractive to the potential customer brand (Park & Agudelo, 2010).

According to Marcela Castro (2006),

Essential elements that individualize those that allow a contract and distinguish it from other legal transactions (ART. 1501 CC.), It means that for the franchise agreement to exist, these elements must be present concurrently and full agreement is required Contracting with respect thereto. (p. 18)
Article 1501 says: Three things can be identified in each contract. The things that of its essence, the things that are of its nature and the things that are purely incidental.

The things that are of its essence cannot be missing in the contract and if they are, it degenerates into a different contract.

The things that are of its nature are the ones that not being essential to it, are inherent without the need of a special clause. The things that are purely incidental are the ones that not being of its essence or of its nature do not belong to it and are added by means of special clauses.

The custom has been the way to regulate the franchise agreement in Colombia. It has become usual to follow the essential elements previously mentioned for the formation of the franchise.

Given the vagueness of the Colombian regulation with regards to the franchise, it is important to stress the responsibility that falls on the franchisor’s shoulders, since he/she will be in charge of giving advice, providing the expertise and the knowledge to make the business work and keep the good name of the Company.

Economic Role

Osvaldo Marzorati gives a great idea of the importance of the franchise in terms of economic development. In 1960, franchises represented $60 Million dollars of annual revenue, fifteen years later the annual revenue was close to $ 240 Billion dollars, which represents 20% of the Gross Domestic Product and 31% of all retail sells (Marzorati, 2008, p. 236).

Dinero.com Magazine, in its August 2011 issue, says that only 3 of the 20 most important franchises have presence in Colombia, Dunkin Donuts, Burger King and McDonalds. In Bogotá, between July 12th and 13th, the sixth edition of the Andean Fair of Business and Franchises (Fanyf) took place, which stated that there were about 110 Franchise networks in late 2002, while in 2011 there were 430. Despite this exponential growth, it is estimated that over 77 % of Colombians do not know what a franchise is (revista Dinero.com, 2012).
Examples of franchises in Colombia

McDonald’s is one of the largest and the most recognized franchise of fast food around the world. “Nowhere in the world McDonald’s had grown as fast as in Colombia. The record held in Saudi Arabia, to open five stores in 12 months of operation, was overruled when the same amount of stores opened in the first five months in our country” (Revista Semana, 1996).

Over 58 million customers are served at McDonald’s every day in more than 100 countries. Approximately 85% of the restaurants are independently acquired and operated through franchise agreements and joint ventures. Every franchise owner pays markets rates, and the monthly rent to the parent corporation.

McDonald’s requires that any owner/operators possess adequate business experience, an excellent credit history, entrepreneurial spirit, a strong work ethic, and sufficient liquid assets (McDonald’s, s. f.).

In Colombia, McDonald’s is the most popular American franchise: they have opened 11 commercial points in the last year, creating 1,700 jobs, double-digit growth in sales and the brand’s foray into two new cities in the country are some of the achievements that allow Colombia to be one of the most important markets in the region for McDonald’s.

As of now, McDonald’s has 61 restaurants and 21 McCafes, which are stores smaller than restaurants, focusing in desserts and coffee, because McDonalds found that these are the main products that the general public demands.

Despite its recent economic growth, Colombia is not yet a fully developed market for a company like McDonalds. Colombia has 4 big cities and the rest of the country are mainly rural areas and small towns and villages, which is why McDonalds is not offering more franchises at the moment.
McDonalds requires that only people and not corporations buy their franchise, mainly because it requires full-time attention to the business and they are concerned that corporations may disregard the needs of the franchise. McDonald’s investors must enter into a process of evaluation that ranges from six months to one year, after which the franchise may be granted or denied. This is done with the objective of avoiding future conflicts, but it doesn’t assure the company that they won’t exist.

Last year, McDonalds closed its entire operation in the city of Cali, which is the third most important market in the country.

Due to differences between the brand owner and franchisee, the multinational McDonalds closed all its outlets in the city. The decision is costing millions and threatens 130 jobs. The company says it expects to reopen its operation in the capital of Valle. In Colombia the multinational has twelve years of operations, but has not achieved the expected result. (Diario El País, 2014)

The closure was prompted by an ongoing conflict for more than two years; the U.S. Company and the company Vallecaucana Alinco S.A, owner of the McDonald’s franchise in the capital of Valle, failed to reach an agreement and decided to close the business (McDonald’s cierra sus puertas , 2014).

McDonald’s Cali never became profitable for neither one of the parties, and McDonald’s Corporation started pushing the Colombian franchisee to repay the debt of the initial investment. The Colombian franchisee tried to delay the payments arguing that this is a long-term business and that eventually they would start making profits, but they were not able to reach an agreement and the McDonald’s corporation decided to end all of the contracts in that city.

Another important example of franchise in Colombia is Dunkin Donuts; it was created in Quincy (Massachusetts), and has been a successful food business around the world. As founder William Rosenberg
says “Make and serve the freshest, most delicious coffee and donuts quickly and courteously in modern, well-merchandised stores”.

Founded in 1950, Dunkin Donuts is America’s favorite all-day, every day stop for coffee and baked goods. Dunkin Donuts is a market leader in the hot regular/decaf/flavored coffee, iced coffee, donuts, bagel and muffin categories. The company has more than 9,700 restaurants in 31 countries worldwide. In 2010, Dunkin’ Donuts’ global system-wide sales totaled $6 billion. Based in Canton, Massachusetts, Dunkin’ Donuts is a subsidiary of Dunkin’ Brands, Inc.

The Colombian franchisee is Donucol Ltda., which last year reported sells of over 50.500 million pesos (USD$ 27.5 million). Dunkin Donuts recently subscribed an agreement with Donucol to open 70 new stores over a period of ten years in the country.

It is very interesting that these international companies have to adjust to the local markets in order to be successful and profitable. In the case of Colombia, they will incorporate flavors from the local cuisine into their restaurants in order to appeal to the local’s tastes. The reason for this is that in many of these places they have to compete with local food that is produced at very low costs and that appeals to the local tastes.

Another great example of a successful franchise in Colombia is KFC. Since 2012, the firm Investment INT is the owner of the KFC Franchise in Colombia. KFC has presence in every major city of the country and also in the Caribbean coast, which they opened recently. In about four to five months Investments INT Colombia will acquire two Colombian chicken chains in order to expand their operation in the country. They recently opened a new venue with an investment of 1.100 million pesos (USD$ 604,400) in funding and equipment.

The idea is that over the next years the KFC franchise in Colombia can open 6 more places before 2014 ends, and close the year with 35 places around the country (Portafolio, 2014)
RISKS OF HAVING A FRANCHISE

When opening a franchise, companies have to consider the culture and tastes of the local markets very carefully. Usually, franchises sell exactly the same product everywhere in the world, but not every market is prepared to consume the same types of products.

In 2011, McDonalds had to close its entire operation in Bolivia because the public did simply not accept their product. Even though McDonalds tried to adapt to the people’s tastes by incorporating local ingredients, people would just not trade their famous empanadas and slow cooked meals for the famous hamburgers.

Another disadvantage is the loss of autonomy in the business and preservation of possibility for the implementation of new ideas. Usually these franchises have very standardized procedures and they require that everything be done according to their parameters.

Despite these risks, if done correctly, acquiring a franchise may have more pros than cons, for example for small investors who do not have much knowledge in running a business, franchising offers continuous monitoring by the brand.

The idea is to help to have good financial results and to continue the reputation that the brand has brought over time.

CONCLUSION

After studying the characteristics of the franchise and the risks that they entail in Colombia, it is important to note that investing in a franchise might have a lot of potential due to the recent growth of the Colombian economy and the people’s demand for American products.

As it has been said before, lawyers have to be overly careful when advising an investor on a franchising purchase, due to the lack of regulation in this matter. Every time a new franchise opens, lawyers and
investors are a creating legal precedent that is helping to establish our franchise regulation.

For many years, people avoided investing in Colombia because of many issues like lack of security or political and economic instability. For the past ten years, Colombia has experienced an impressive expansion of its economy and many of the security issues that it had are now in the past.

Its economy has remained almost untouched by the international economic crisis and it is one of the only countries in the region that has always had political stability, making it a wonderful country for international companies to enter into franchising agreements with Colombian investors.

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