



# Bird & Bird & Internationalising your Franchise

Webinar Series Part 4: Middle East & India

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# Introduction



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Lourdes is head of the corporate and M&A team in the Madrid office and has combined expertise in franchising/corporate and commercial matters having assisted many clients in their internationalization.

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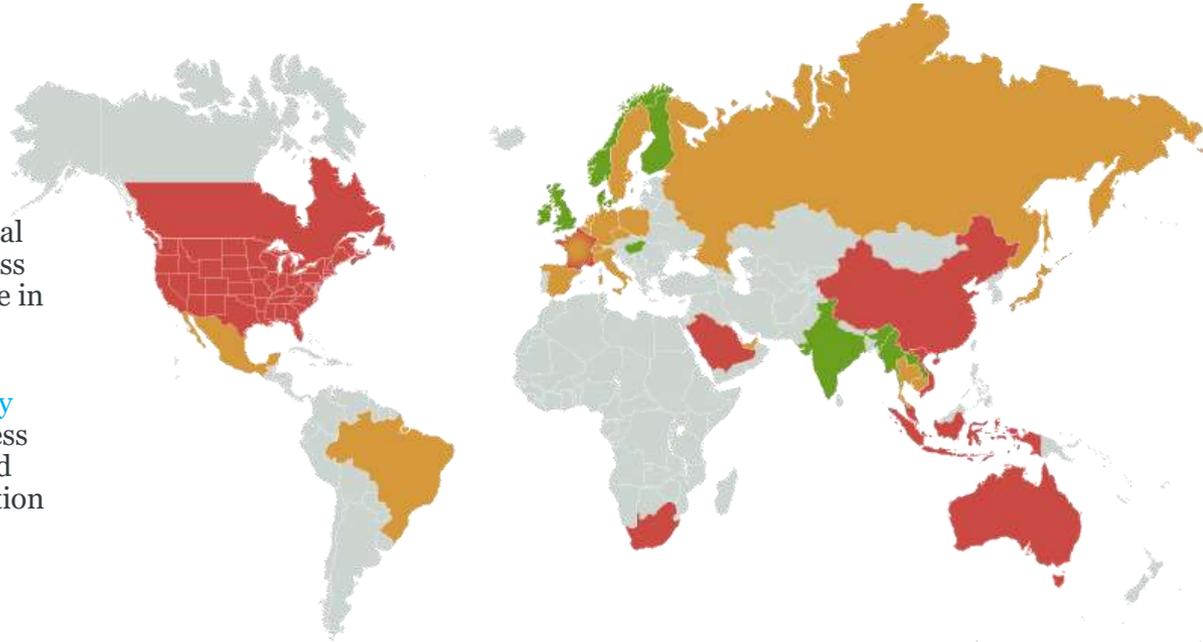
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Diana is part of the corporate and M&A team in the Madrid office and has extensive experience in advising franchisors and franchisees in their local and international expansion.

# Bird&Bird & International Franchising

- With more than 1,300 lawyers across a network of [29 offices in Europe, the Middle East and Asia Pacific](#), Bird & Bird is able to provide growing businesses with on the ground support through our international offices.
- With [franchise experts in each of our international offices](#), together with our global network of specialist franchise counsel across the Americas and Africa, we can you operate in a range of sectors to achieve their growth objectives via franchising or distribution.
- We also work with Bird & Bird's [consultancy arm, OXYGY](#), to support clients with business projects that require a range of skills beyond pure legal issues including internationalisation support.
- You can access our [online international franchise laws tracker](#), which provides a comparison of franchise laws across the jurisdictions in which we have offices or work with local franchising experts.



[Access online our International Franchise Laws Tracker](#)

# What you need to consider

- How to structure your franchise or distribution model
- Whether you may need a sophisticated hybrid strategies to support your global expansion
- Whether you may need the drafting and negotiation of core franchise, distribution and legal documentation
- What are the international franchise market entry regulations applicable
- Whether you may need support with ongoing franchise and distribution network management
- Whether you need exit planning as well as strategic acquisitions and disposals
- How to implement risk management including how to avoid and handle disputes

You may also need to take into consideration other key related areas such as:

- Brand management
- Advertising and social media
- Use of technology and data
- Corporate structures
- Competition
- E-commerce and m-commerce
- Employment and immigration
- Real estate
- Tax matters

# Our webinar series

Welcome to our webinar series in partnership with the Spanish Association of Franchisors:

**UK, The Netherlands & Poland:** Wednesday 15 September

**Australia & China:** Wednesday 13 October

**Italy, France & Morocco:** Wednesday 27 October

**India & Middle East:** Thursday 16 November



# Today's speakers

## Melissa Murray

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Melissa specialises in acting for international franchisors and master franchisees on their operations in the Middle East, and specifically the UAE and Saudi Arabia.

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Nipun advises international businesses on inbound and outbound mergers, acquisitions and disposals, with a particular focus on emerging markets.

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Sudipta is a cross-border specialist on matters relating to corporate & commercial advisory, mergers & acquisitions, insolvency & bankruptcy and banking & finance. He has advised and represented several prominent international brands on their entry and franchising strategies in India.

*Franchising in Middle East*



# Franchising in Middle East

## *What Countries*



# Franchising in Middle East *Regulations*



## 1. Agency Law Considerations

- a. Differs from country to country
- b. Gives protection to nationals of that country from termination, expiry; watch for compensation on termination consequences

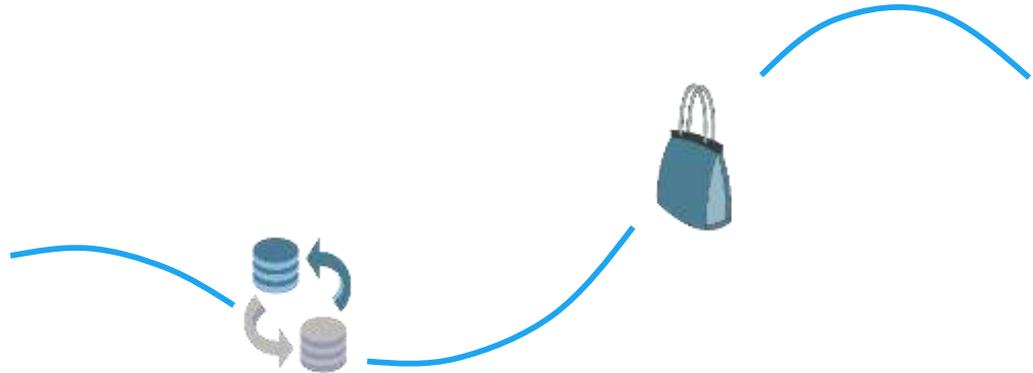
## 2. Saudi Franchise Law

- a. Disclosure document – Arabic language requirements, cooling off period,
- b. Registration requirements

# Franchising in Middle East

## *Other relevant laws*

- Consumer Protection
- Competition
- Trade Marks
  - First to file
  - Franchisees try to file
  - Arabic
  - Signage considerations
- VAT/Withholding taxes
- Strict food regulations
- Local Shareholding requirements for company owned outlets



# Franchising in Middle East

## *Common Commercial Considerations*

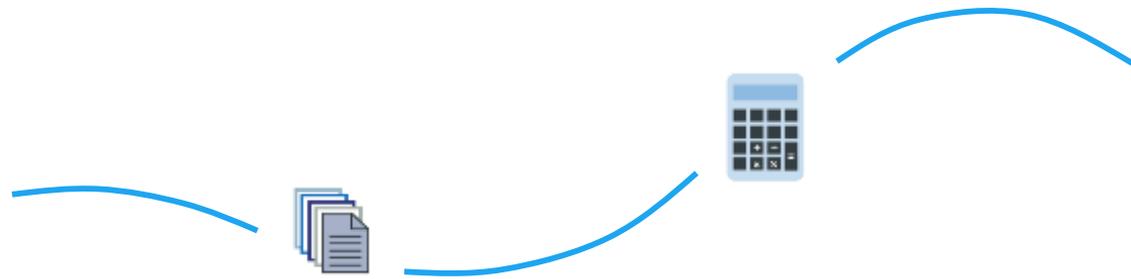
- Franchisees
  - Family groups
  - Funds/corporates
  - Individuals/smaller companies
- Locations: Mega malls vs. Strip malls vs. stand along sites
- Comparatively high rent + fit-out issues
- Alcohol + pork
- Logistics i.e. staff accommodation, buses



# Franchising in Middle East

## *Further Tips*

- Choosing the right partner
- Partner due diligence
- Negotiating sensible development schedule
- Territory fees & store opening fees
- Benchmarking of royalties & commercial terms
- If need Franchisor "head office" – set up in a freezone to avoid local partner ownership of business



# *Franchising in India*



# Franchising in India – Regulatory mosaic..



FDI POLICY AND EXCHANGE CONTROL

TAX

INTELLECTUAL PROPERTY RIGHTS

ANTI-TRUST / COMPETITION ACT

# Franchising in India

## How to structure your franchise or distribution model?

- *Constrained* by **ENTRY ROUTES** and **ENTRY CONDITIONS** which restrict retailing foreign brands in India.
- Imposed by the *Indian FDI Policy* and *Foreign Exchange Management laws*
- Your brand's Indian go-to-market strategy is inevitably impacted by the available choice of these Entry Routes and Entry Conditions
- *Indian strategy may not necessarily coincide with your global model / strategy*

# Franchising in India: FDI Policy

## OPTIONS

## CONDITIONS

Manufacturing in India

- Unrestricted B2C / retail, except food products (which requires govt. approval),
- no tobacco

Multi-brand Retail Trading

- Foreign investment capped at 51%,
- govt. approval,
- not all States, and select cities,
- *30% local sourcing requirement from MSMEs,*
- minimum investment USD100m,
- no e-commerce retail (inventory or marketplace)

Single Brand Retail Trading (SBRT)

- If FDI >51%, *30% local sourcing requirement,*
- B2C e-commerce conditional on opening brick and mortar stores.

Cash & Carry Wholesale /  
Wholesale Trading

- Only B2C permitted
- 25% turnover supply restriction to group companies

Offshore, local distributor /  
franchisee or customer as importer

- No entry conditions, only trade / tariff barriers
- Cannot own / lease real estate

# Franchising in India - Structure options: a closer look..

1. **ENTRY ROUTE 1: SINGLE BRAND RETAIL TRADE (SBRT) ENTITY. - 30% LOCAL SOURCING (AND / OR LOCAL MANUFACTURING)**
2. **ENTRY ROUTE 2: JOINT VENTURE (JV) ENTITY.**
3. **ENTRY ROUTE 3: "CASH AND CARRY WHOLESALE TRADING" (C&C / WT) (No Retail) - RETAIL ONLY THROUGH 3<sup>RD</sup> PARTY / INDIAN B2B FRANCHISEES, RETAILERS.**
4. **ENTRY ROUTE 4: OFFSHORE -- THROUGH 3<sup>RD</sup> PARTY / INDIAN CHANNEL PARTNER(S) - FRANCHISEES, DISTRIBUTORSHIPS, RETAILERS - THEY ACT AS IMPORTER-STOCKISTS.**
5. **ENTRY ROUTE 5: OFFSHORE - INDIAN B2C CUSTOMERS BUY AND IMPORT DIRECTLY.**

To disapply 30% local sourcing, JV route **ENTRY CONDITION** requires Indian partner to hold at least 51% in Indian JV entity. E.g., *Tata – Starbucks, Tata Zara, Tata Massimo Dutti*

Does not contemplate "Foreign Direct Investment" (FDI) for setting up entity in India. No **ENTRY CONDITIONS**.

## ENTRY CONDITIONS – SBRT (ENTRY ROUTE No.1)

- o **local sourcing norms** – 30% by value of goods procured by Indian SBRT entity must be sourced from India. Can follow **two-company** model or **two-segment in same company** model.
- o In the first instance, these **local sourcing norms** are relaxed – can be met as an "average" **in a block of 5 years** – thereafter, annual basis. Can be set-off by Indian SBRT entity against **global procurement for Group**.
- o Can undertake e-commerce PROVIDED a brick-and-mortar presence is established by Indian SBRT entity within 2 years.

## ENTRY CONDITIONS – C&C / WT (ENTRY ROUTE No.3)

- o **Strictly "wholesale" B2B operations only** – ideally, only Supply Agreements "*per normal business practice*".
- o Should **not be seen** to assist retail – e.g., marketing spends, granting franchise with retail incentives. Must maintain day to day register of all transactions.
- o In case of another Indian affiliate (for e.g., an SBRT entity), **cannot supply more than 25% of total turnover of C&C /WT entity**.

## Franchising in India - Structure options: a few “strategy” takeaways..

Each **ENTRY ROUTE** offers *differing balances* of :

1. costs / benefits;
2. market penetration advantage;
3. revenue growth / profit extraction potential; and
4. control over franchise.

*These factors also impact revenue extraction, ability to provide warranty support and repair services.*

**ENTRY CONDITIONS** are progressively more burdensome:

1. ENTRY ROUTE 5 (Offshore, direct B2C is easiest – customers import directly)
2. As the brand moves up the “value chain”, things becomes more difficult
3. Most burdensome in the case of establishing multi-brand “Retail” operations in India.

**Important:** A brand can adopt a multi-pronged strategy, i.e., can use more than one Entry Route simultaneously.

# Franchising in India - Structure options, more “strategy” takeaways..

- Many Brands have entered Indian markets through ENTRY ROUTE 4 and / or 5 (Offshore) or ENTRY ROUTE 3 (*Cash & Carry / Wholesale Trading (C&C/WT)*).
- Quite a few have successfully transitioned to *Single Brand Retail Trading (SBRT)* through Local Sourcing / Manufacturing / Contract Manufacturing.
- Some have achieved these transitions over a 15-year period.
- Others have used **structuring innovations** and **technology** to **blur** regulatory restrictions / divide between *Offshore, C&C/WT* and *SBRT* – which in turn causes frequent regulatory responses.
- ...and some others of course continue to experiment with extensive restructuring (with significant year-on-year losses).

**You can use the ENTRY ROUTES and ENTRY CONDITIONS in COMBINATION to achieve omnichannel distribution...**

**.....and sync closer to your global retail strategy model.**

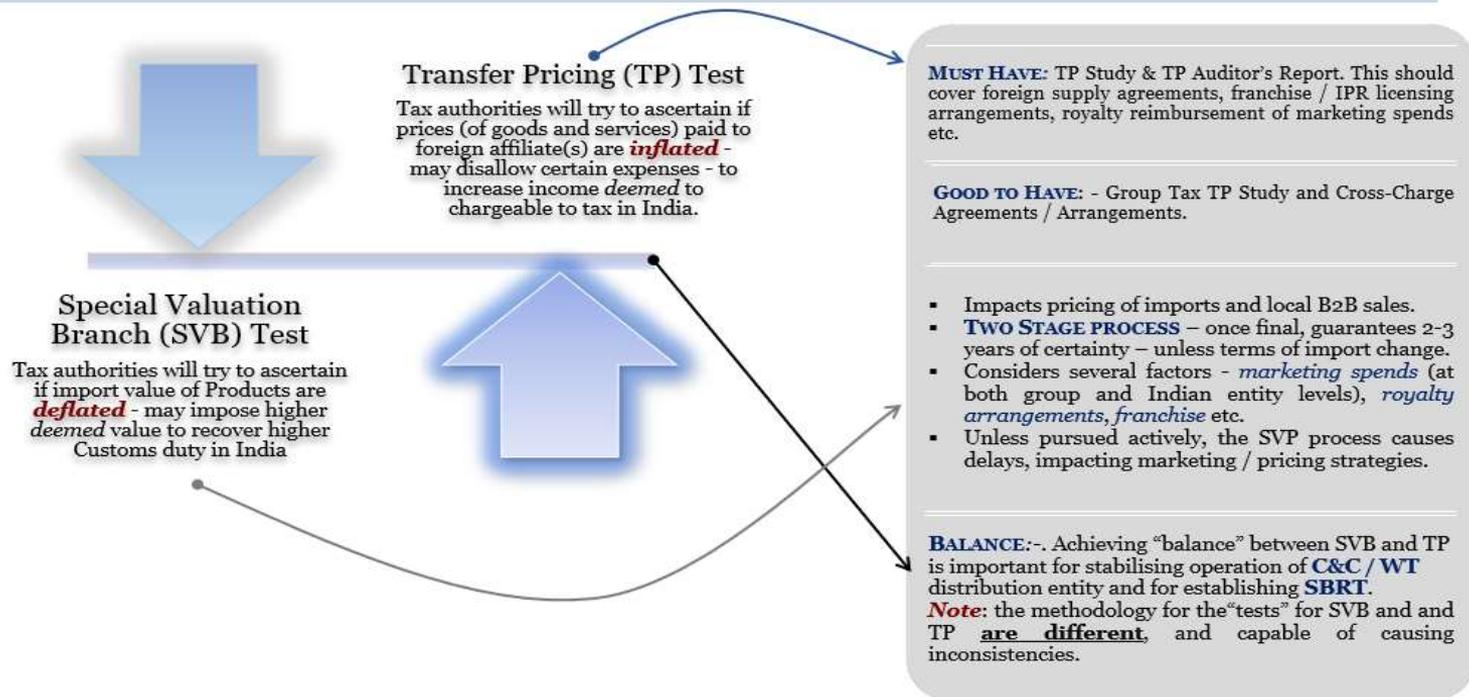
# Franchising in India - Tax

1. In offshore models (ENTRY ROUTE 4 & 5) – no or low impact, mostly centring around withholding taxes, customs duty and “Permanent Establishment”
2. Onshore models must consider Indian complexities and idiosyncrasies including ability to repatriate (exchange control regulations may also play a part here)
3. The complexities arise from a combination of income tax, transfer pricing, customs duty, GST (akin to VAT), treatment of royalties and withholding tax on repatriation
4. Traditionally, revenue extractions (or payments to foreign shareholders / affiliates) have been by way of *royalty payments, buying commissions, license fees, expenses or reimbursements through cross-charges* – which are more efficient when compared to dividends

**Tax is a “Balancing Act” –  
it will impact your pricing  
strategy, revenue extraction,  
and perhaps even your choice of  
Entry Route(s).**

# Franchising in India – Tax (the “Balancing Act”)

- **TRANSFER PRICING (TP)** – “ARM’S LENGTH PRICE” test for Payments and Supply of goods and services to and from foreign affiliates.
- **SPECIAL VALUATION BRANCH (SVB)** – “ARM’S LENGTH PRICE” test for imports from Foreign Affiliates for assessment of Customs duty.
- “**BALANCING**” SVB AND TP tests need to be balanced – because the tests are different and potentially oppose each other.



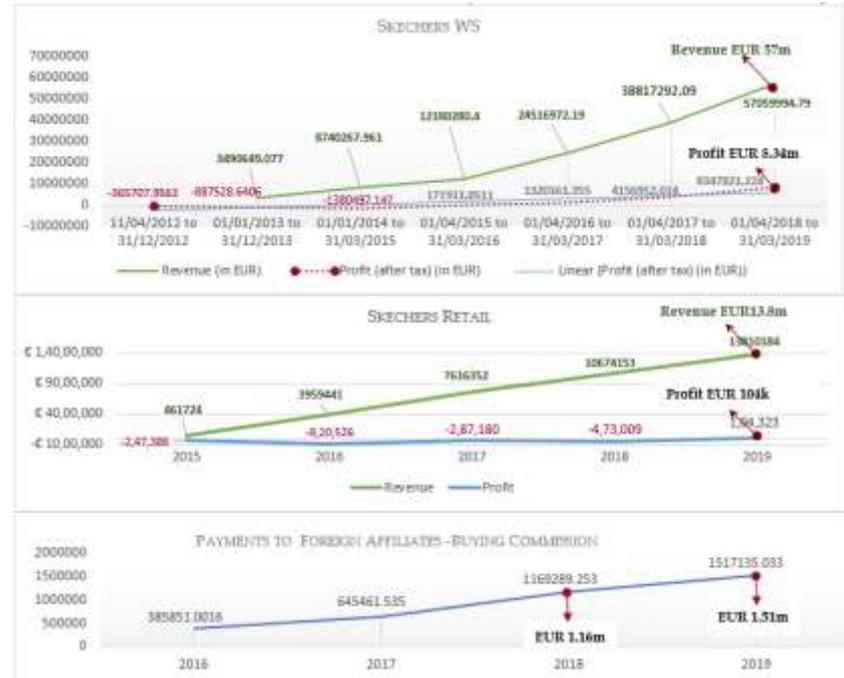
# Franchising in India - Structure options, transition strategies (Swatch)

- *Swatch* transitioned from ENTRY ROUTE 4 (offshore with independent distribution / Franchise), to ENTRY ROUTE 3 (C&C / WT) and then to ENTRY ROUTE 1 (SBRT).
- Today, *Swatch* uses all 3 routes in combination, but is principally focussed on C&C / WT.
- **Pre-2000** - ENTRY ROUTE 4 – Indian franchisees / importer stockists
- **April 2000** – ENTRY ROUTE 3 – Swatch C&C / WT entity for distribution of *Rado*, *Tissot*, *Omega*, *Breguet*, *Longines*, *Swatch*
- **January 2015** – ENTRY ROUTE 1 – separate company established for SBRT (Swatch Retail) – **two-company route**
- **Local sourcing norms** apply to 30% of value of procurement by Swatch Retail – Swatch Retail procured Rs. 11,488,239 [EUR 129,285] last year from Swatch C&C / WT.
- **Regulatory Restriction:** Value of C&C / WT entity supply to SBRT entity cannot exceed 25% of C&C / WT entity's turnover.



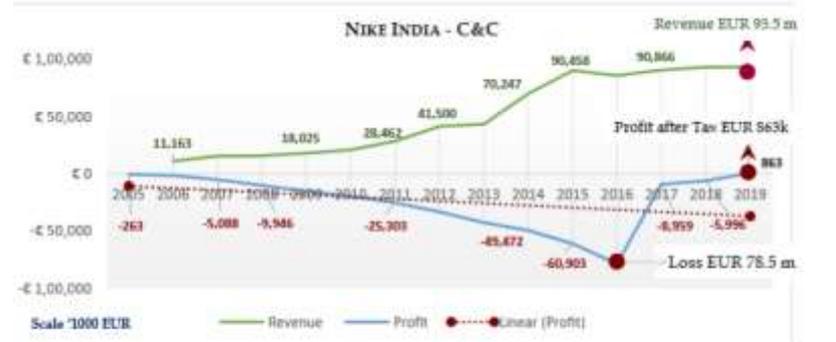
# Franchising in India - Structure options, transition strategies (Skechers)

- **April 2012** - Skechers C&C / WT (“Skechers WS”) set up under **ENTRY ROUTE 2 – 51:49 JV with Future Group**. (now 100% after buying out Future)
- **March 2014** – **ENTRY ROUTE 2 (Joint Venture)** –51:49 JV with Future Group (“Skechers Retail”). On liberalisation, **ENTRY ROUTE 1 (SBRT)**
- **January 24, 2019** – Skechers bought out Future – EUR5.2m for Skechers WS and EUR64m for Skechers Retail
- **Local sourcing norms** apply to 30% of value of procurement by SBRT segment.
- **Regulatory Restriction:** Value of C&C / WT segment supply to SBRT segment cannot exceed 25% of C&C / WT segment’s turnover.
- Skechers in India sells through its own stores, Indian franchisees and its proprietary webshop. Also placed in *Amazon, Tata Cliq, Flipkart, Myntra* etc.
- Revenue extraction is primarily through the Skechers WS entity by payments made to *Skechers Sarl* for purchase of products and *buying commission*.



## Franchising in India - Structure options, transition strategies (when things don't always go to plan..)

- **August 2004** – Nike C&C / WT set up under ENTRY ROUTE 3 – Wholesale Cash & Carry.
- **2015-16** – ENTRY ROUTE 1 (SBRT) – Nike received SBRT approval – BUT Nike has put approval in suspension. Nike sourcing from India from at least 2006.
- **2019** Nike withdrew from most of its franchise agreements. Nike operates physical retail outlets through Indian franchisees and a single distributor. Sports Station India Private Limited (SSIPL) - associated with Nike since 1995 and is Nike's largest franchise.
- Nike's operates its proprietary global digital platform under Entry Route 5 (direct sale to B2C customers in India) - <https://www.nike.com/in/> is owned by Nike Retail BV, operated by eShopWorld. Nike products are also placed on Myntra, Flipkart by SSIPL.
- Revenue extraction is by way of a combination of *royalty*, *buying commission*, *interest payments*, *cross charged expenses*, and *reimbursements*.



# Franchising in India – Bonus slide...

- In the last decade, Technology has had the most profound impact on franchising in India– the pandemic has only accelerated the pace.
- E-commerce combined with global digital marketing often neutralises the intended market penetration gradient across the different Entry Routes with proliferation of franchised “webshops”.
- For example: the “webshops” of *Birkenstock*, *Hummel*, *Onitsuka Tiger* have the same look and feel of proprietary “webshops” globally.
- Indian *FDI Policy* and exchange control regulations *have struggled in response to this challenge* – for now foreign direct investment in inventory based model of e-commerce is not permitted (among other technicalities to stem the disruption) – **watch this space**.
- A new Consumer Protection law (July 20, 2020) has implications for foreign brands and may require a review of digital franchise models.
- Yet, other “disruptive advances” are able to overcome some of the regulatory limitations – For example: advances in technology in supply change management and ability to provide “just-in-time” inventory mitigates intended regulatory barriers sometimes.
- Franchise and distribution model structuring in India is a dynamic / evolutionary exercise and must factor for both change in regulations (which is often) and advances in technology (which is continuous).

**Technology is a game changer – it dissolves national barriers, and may also melt regulatory barriers...**

# Thank you & Bird & Bird

Follow up with:

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