INTERNATIONAL FRANCHISING

A Guide for Franchisors entering into the German Market
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Franchising is an internationally successful business model. A multitude of companies are already running franchise networks in a variety of different national markets and by doing so, have been able to successfully position their brands. Nevertheless, there is still a great deal of potential available when it comes to expanding franchise networks into Germany.

The Federal Republic of Germany is home to the strongest and most stable economy in Europe. While many nations in the world experienced times of economic insecurity and the European Monetary Union suffered a crisis in the last decade in particular, Germany was able to prove the sustainability of its economic system. On top of this, Germany also demonstrated that it is a particularly ideal location for franchise systems in all sectors.

The German Franchise Association has set itself the target of supporting franchise systems from outside of Germany in entering into the German market and accompanying them in all stages of this process. The “International Committee” has been created within the Association to focus on this objective. The German Franchise Association itself boasts a tightly-knit international network.

We therefore invite you to come and discover and conquer the German market for your franchise system and to make the most of the outstanding conditions available in our country.

This guide uses questions and checklists to pool the knowledge of practitioners and experts who have already gained experience in the area of international expansion. It provides an overview of the most important key data concerning Germany as a business location and answers the most important questions, for example: Which corporate form is right for me, how much tax do I have to pay in Germany and what are the specific features of German franchise law?

The globalisation of markets is now in full swing. We are convinced that by expanding into Germany, franchise networks can clearly benefit from this development and become even stronger in the future.

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FOREWORD
GERMANY AS A BUSINESS LOCATION

Germany is one of the strongest countries in the world in terms of economic performance. German products have an impressive global reputation and “Made in Germany” is therefore still an international seal of quality that entrepreneurs and investors looking to enter into the German market adopt as their own.

The Federal Republic of Germany meets the criteria for selection as a business location, particularly in terms of:

- a vital and growing economy
- a high private and public consumption expenditure and a large sales market for goods or services
- a labour market that enables you to acquire all required staff
- a stable political environment with no corruption
- a legal system that makes it easy to start up a company, protects intellectual property rights and facilitates the efficient enforcement of rights
- a fair and transparent company taxation

The Federal Republic of Germany ticks all of these boxes.

KEY ECONOMIC INDICATORS

A particularly clear indicator of Germany’s positive economic situation is the observation of its gross domestic product compared to other countries around the world, as well as the consideration of its economic performance.

The gross domestic product per resident in Germany is approx. € 41,000, which is an impressive 25 % above the average value of the European Union. The fact that the gross domestic product in Germany has increased by over 30 % over the past 10 years is evidence that this is not just a short-term trend. In fact, according to current forecasts, it is a trend that is here to stay.

During this 10-year period, with the exception of 2009, Germany also recorded economic growth of several percent every year.

GERMANY AS A LAND OF START-UPS

Attracting franchisees is an extremely important requirement for a franchise system. Franchisees are independent entrepreneurs and therefore also founders. In order to make it easier for potential franchisees to take the step towards self-employment, a good start-up climate is essential.

Germany offers precisely these required conditions, as is shown by the fact that 282,000 start-up companies were founded in Germany in 2016. These start-ups also chose to make the most of benefits such as an excellent infrastructure, public support and funding programmes and comprehensive protection of intellectual property rights. Potential founders and franchisees in Germany are supported by:

- the ministries of the German Federal States
- Chambers of Industry and Commerce
- Chambers of Trades and Crafts
- the KfW Banking Group and business development banks of the German Federal States
- credit institutions and their associations

These actors not only provide individuals wanting to found a start-up company with expertise and logistics solutions, but also offer them financial support, for example in the form of funding programmes in cooperation with the European Social Fund (ESF). Germany therefore offers excellent general conditions for a large group of potential franchisees.
THE LABOUR MARKET

Another indicator of Germany’s attractiveness as a business location is its labour market.

With an unemployment rate of approx. 3.6%, Germany is well under the European average. It also offers a secure supply of qualified employees thanks to the fact that over 80% of the population either work in an occupation that requires formal training or have completed university studies. This guarantees that you will always be able to access the qualified employees and management staff required for your company. In fact, with a labour force of nearly 44 million individuals, the German labour market is the largest in Europe.

INCOME AND CONSUMPTION

Regardless of whether you offer products or services, it is always important to ensure that you appeal to a target group with high purchasing power and consumer strength. The strengths of Germany as a business location also help to secure a positive income and consumption climate: in 2015, every German household had an average budget of 4196 euros, 74% of which was spent on consumption.

GERMAN LAW

As is the case with most other European legal systems, German law belongs to the highly traditional legal family of continental Europe. One of the typical features of legal systems in this family is their codified, namely systematically developed and regulated, law. In Germany, the codes of law provide a comprehensive summary of the most important legal provisions. In the case of economic law, the most important of these codes are:

- the German Civil Code (BGB), which contains general regulations concerning the formation, performance and implementation of contracts and agreements and the most important types of contracts and agreements, normally in the case of legal transactions between private individuals
- the German Commercial Code (HGB) as the law for traders and merchants with special regulations on legal transactions between traders and merchants and commercial companies
- the German Limited Liability Company Law (“GmbH-Gesetz”) and the German Stock Companies Act (“Aktien-gesetz”), which regulate the two most important corporate entities in Germany, namely the limited liability company (GmbH), which is the most widely distributed type of company, and the stock company
- the German Act Against Unfair Practices (UWG), which prohibits anti-competitive misleading advertising and unfair business practices

German law is predictable and reliable. The legislative authority stipulates its system and structure. Codification therefore leads to legal security and calculability and provides quick and easy access to the law. The concrete arrangement of individual cases falls upon the parties concerned and/or their lawyers and solicitors. Contracts and agreements according to German law are normally much shorter but also, and above all, much more secure and cost-effective than English or American contracts and agreements.
In franchise systems, the brand and the expertise behind it are often the most important assets. The protection of intellectual property rights, or, to use the generic term for such rights in Germany, industrial property rights, is therefore an essential factor for franchisors when choosing a location. Germany forms part of the group of countries worldwide with the most comprehensive and advanced protection of intellectual property rights. Germany is also the top location in the world when it comes to patent issues, as is shown by the fact that the headquarters of both the German Patent and Trademark Office and the European Patent Office are located in the German city of Munich.

On top of this, German law guarantees freedom of trade alongside freedom of contract. This last point in particular means that every individual is able to start up and run their own company and that the legal protection of companies is, to the largest possible extent, independent of their original background. Companies from other countries in Europe are even put on a completely equal footing with companies from Germany.

**POLITICAL SYSTEM**

The democratic system of the Federal Republic of Germany is one of the most stable and corruption-free in the world. According to the Corruption Perception Index 2013 produced by Transparency International, Germany is ranked at number 17 in a list of 177 countries in terms of freedom from corruption. The liberal rights of a country's civil society and its political participation are evaluated by the American NGO “Freedom House” every year. Germany has now received a mark of “1.0” in this evaluation for more than 10 years in a row, which clearly shows that there are no faults in the political system of the Federal Republic of Germany.

**TAXATION**

Many companies consider Germany to be one of the most attractive business locations in the world. Despite the extensive advantages of Germany as a business location, the average overall business tax rate for companies is just 29.8%, a value that is significantly lower than that of many other European or North American nations.

The taxation of corporate entities is mainly a combination of corporation tax and trade tax.

- The Federal Republic of Germany imposes corporation tax at a rate of 15%.
- Subsidiary companies that distribute profit to foreign holding companies have to pay capital gains tax at a rate of 25%. Nevertheless, it is very often the case that these payments can be reimbursed if a so-called double taxation agreement has been concluded with the nation in which the holding company is based. In the case of a holding company from the European Union with a share of more than 10% in the German subsidiary, the capital gains tax is applied to distribution of profit.
- Local authorities impose trade tax at the company location. The trade tax rate can be individually defined by each local authority and is not uniform. The legal minimum rate is 7% and the actual maximum rate is 17.2%. The average rate of the trade tax paid by German companies at their company location is 13.1%.
The fact that Germany offers good general conditions for companies is precisely why the franchising industry in Germany has been constantly developing and growing more and more since the 1980s and has taken an extremely positive and successful approach over the last ten years. The franchising industry in Germany grows with the number of systems, the number of franchisees and the sales generated. This development has now been stable for a number of years and there are no indications that it will come to an end in the future. In fact, it is continuing in full swing as the retail and service environment moves away from individual enterprises and towards large retail chains, networks, trade partnerships and franchise systems. Only these types of enterprises will be able to withstand the demands of the market and competitive environment in Germany. Where this requirement is concerned, liberal general conditions are extremely important.

FRANCHISE LAW

Unlike other countries, Germany does not, per se, have a franchise law. Nevertheless, franchise law is based on qualified general conditions and leaves scope for individual contract design. Unlike in Belgium, France, Italy, Sweden, Spain and Greece, franchising is not regulated by law as a modern distribution system for goods and services. Individual contract design is prioritised, with the jurisdiction stipulating the legal framework and several special laws needing to be considered.

Countries with a qualified franchise law often view this as a disadvantage. The reverse, however, is actually true, as is also confirmed by systems that did not originate in Germany:

- Jurisdiction that has remained constant over decades creates ‘case law’ for most franchise-relevant legal topics
- Special flexibility that corresponds to the multifaceted character of franchising and franchise systems
- No franchise legislation, not even in the pre-contractual sphere
- No other sector-specific or franchise-specific regulations

Legal security and calculability create a qualified legal framework and a preventive franchise contract design that factors in the well-known areas that form a central theme of jurisdiction. The type and scope of pre-contractual duties of disclosure in particular are defined by relevant higher-court jurisdiction and clarified to the greatest possible extent in consideration of entrepreneurial orientation. The main focus is the effective protection of potential franchisees against unforeseeable economic risks. The creation of precontractual information documents, the filing of such documents and, for example, the registration of franchise systems or franchise contracts are not necessary in Germany.
Every franchise system that seriously wants to expand in Europe cannot avoid the market with the strongest economy in Europe. Germany is not only a preferred location for national franchise systems, but also serves as a point of intersection or indicator for many successful internationally oriented franchise systems.

This may be due to the fact that Germany is one of the most important sales locations worldwide for all kinds of goods. In the Global Competitiveness Report for 2015/2016 produced by the World Economic Forum, the German infrastructure is above all praised for the fact that its broadly defined and effective structure enables the highly efficient transportation of goods and passengers. The quality of German streets, airports, ports and the German rail network were also awarded high points totals, as was the outstanding condition of Germany’s communication infrastructure and energy supply network.

It therefore comes as no surprise that Germany is now home to a multitude of globally operating companies in the world of franchising, for example McDonald’s, Burger King and KFC, to name but a few companies from the field of traditional system catering. Other systems that operate on a global level, for example Mail Boxes Inc., have also now been present in Germany for many years.

In as early as 1971, McDonald’s became one of the first international systems to dare to make the move to Germany. There are now already over 1400 McDonald’s restaurants and 237 franchisees operate approx. 80% of all German McDonald’s restaurants.

The franchise network Mail Boxes Etc., which was founded in the USA back in as early as 1980, initially successfully expanded in Italy and other European countries before coming to Germany in 2002. The company has been able to attract 145 franchise partners in Germany to date. It generated total sales of approx 50 million euros.

A large number of national franchise systems only based in Germany, on the other hand, have also used successful expansion in Germany to make their way into countries outside of Germany, most of which are located in Europe.

Examples of such systems include Engel & Völkers, Lufthansa City Center (LCC) and Fressnapf. In the pet industry, Fressnapf is now represented by over 1500 stores in 11 countries while the franchiseor Engel & Völkers supervises offices in 38 different countries all over the world from its headquarters in the German city of Hamburg. LCC started out in Germany in 1991 by opening its first travel agency in the German city of Dresden. This system has now expanded into over 90 countries and has more than 650 partner agencies with a turnover of approx 6 billion euros in 2012.

The award winning boutique fitness brand Bodystreet, as another German example for international growth, has proven its franchise in 300 studios in 7 countries. In 2018, Bodystreet successfully entered the US market and opened its first pilat studio in East Africa.

Mrs. Sporty, on the other hand, was able to achieve a great degree of success with its fitness concept especially for women. The system has now successfully established over 550 fitness clubs in 7 European countries within 10 years.

Another company that started out as a purely national franchise system is Vapiano, which was founded in Hamburg, Germany, in 2002 and now represents a success story when it comes to exporting good concepts and ideas, with over 150 Vapiano restaurants in more than 27 countries and on 5 continents.
WHAT INTERNATIONALISATION STRATEGIES ARE POSSIBLE?

Companies wanting to conquer the German market with their franchise system can chose from a wide variety of strategic approaches. The following chapter provides a brief introduction to the most successful of these approaches:

Direct Foreign Franchising

Direct foreign franchising is based on a franchise contract between the franchisor and an individual franchisee that is adapted to suit the specific features of a franchise in a different country and forms the basis for the opening and running of a franchise unit in Germany by the franchisee.

- The simplest type of internationalisation
- Franchisees in Germany are supervised by the system headquarters in the system’s home country and incorporated into the system to the same extent as those located in the home country.
- Communication is the main hurdle due to language and cultural barriers.
- Language and staff capacities are essential requirements.
- This approach is generally suitable for all markets that do not require many investments in system adaptations or translations.

Indirect Foreign Franchising

Indirect foreign franchising is based on the formation of an independent foreign subsidiary by the franchisor. In Germany, this company independently concludes franchise contracts with local franchisees as a subsidiary of the franchisor and supervises these franchisees as the system headquarters. Effective and provides more options for monitoring the system on location.

- High initial investments in the formation of the subsidiary headquarters and higher running costs for the operation of the local system headquarters in Germany.
- Provides more in-depth procurement of information on location and market proximity.
- Suitable for large markets and markets located far away.

Master Franchising

Master franchising is based on a contract in which the franchisor permits a master franchisee to establish and operate several franchise units in Germany. The master franchisee can either run these franchise units themselves or by concluding so-called sub-franchise contracts with local franchisees. The master franchisee ultimately works as a local franchisor in the target country within the framework of and according to the requirements of the franchisor. A modification of master franchising is so-called “area development” or “multi-unit franchising”, in which the area developer only runs its own franchise units. A significant obstacle is the search for a suitable master franchisee.

- The master franchisee is responsible for start-up, adaptation and roll-out investments in the target country.
- The master franchisee bears the costs for the operation of the German system headquarters.
- There is a danger that the position of power of the master franchisee is too strong. No direct contractual relationships between the franchisor and German franchisees.
- This approach is more suited to complete markets and less suitable for individual regions.
AREA DEVELOPMENT

Area development is based on a franchise contract in which the area developer is commissioned to acquire franchisees in Germany for the franchisor and, after concluding franchise contracts with the franchisor in the home market, to supervise and monitor these franchisees on a long-term basis. The area development contract does not permit the area developer to operate their own franchise units or conclude their own franchise contracts.

- Franchisees have close connections with the German system headquarters.
- The fact that there is no contractual intermediate interface between the franchisor and the target country, as is the case in master franchising, does, however, reduce the risk of a German partner being too strong.
- Contracts are always only concluded between the franchisor in the home market and the German franchisees.
- Lower capital requirements for the acquisition of franchisees because they are mostly only commissioned on the basis of the success of the area developer.
- Area development is, however, mostly suited to small and densely populated markets.

JOINT VENTURES

A joint venture is based on cooperation between the franchisor and a partner in Germany that goes beyond a franchise contract and often involves the formation of a joint subsidiary on a company-law level. Joint ventures can be selected for every form of international franchising.

- A mixed form of indirect foreign franchising and a master franchise contract.
- Suitable for markets that are located far away and are difficult to control from the home market.
- The financial risk is shared.
- Having a local joint-venture partner makes the acquisition of market knowledge, corporate engagement and direct supervision of franchisees easier.
- The distribution of corporate shares additionally becomes more important alongside the franchise contract (e.g. supervision of the joint-venture company, the option to break away from the local joint-venture partner and deviating distribution of profits).
## WHAT STRENGTHS AND WEAKNESSES ARE INVOLVED IN THE DIFFERENT TYPES OF EXPANSION?

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<th><strong>Strengths</strong></th>
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| **Direct foreign franchising** | • No shared charges  
• Information and communication technology make management and supervision easier  
• The most competent support | • Not suitable for countries that are very different to the home market  
• Increased support and supervision efforts required  
• Conflict potential due to cultural differences |
| **Subsidiary**          | • Suitable for larger markets  
• The presence of the subsidiary makes management easier | • Start-up costs  
• Large amount of time and effort required  
• No sharing of start-up and operating costs with the local investor |
| **Master franchise**    | • Capital expenditure by the master  
• Local expertise of the master franchisees | • The wrong master franchisees  
• The position of power of the master franchisees  
• Training requirements  
• Control and supervision |
| **Area developer**      | • Easier to manage than master franchising  
• Stronger supervision of franchisees | • Capital resources of the area developer  
• The area developer as a potential rival  
• Termination of the contractual relationship |
| **Joint ventures**      | • Lower capital requirements  
• Increased acceptance by local partners  
• Risk reduction | • Disagreements in the management of the joint ventures  
• Damage to the company image if the joint venture fails |
The establishment of a foreign franchise system should involve several steps. The main focus is always the pilot phase, during which the system is tested under realistic conditions and adapted to suit the German market where necessary.

The following series of steps is suitable for the establishment of a foreign franchise system in Germany:

**PRELIMINARY TEST**
- Market analysis
- Feasibility study
- Checking the handbook, fee system and PR strategies
- The result of the preliminary test is the market entry strategy

**PREPARING THE PILOT OPERATION**
- We strongly recommend that you set up a pilot operation.
- Translating the handbook and, where necessary, adapting it to meet the German Franchise Association guidelines
- Selecting suppliers and checking the terms and conditions of delivery
- Calculating franchise fees

**RUNNING THE PILOT OPERATION**
- Installing, monitoring and controlling the pilot operation
- Obtaining the required permits and licences
- Focusing on profitability and balance
- Developing a franchise contract based on the experience gathered in the pilot operation

**ESTABLISHING A SYSTEM**
- Finalising the handbook, fee system and contracts
- Checking whether it is possible to acquire a state subsidy
- Developing an advertising strategy
- Searching for and recruiting franchisees

It is important to bear in mind that the final two steps of the inbound process into the German market can strongly vary depending on the internationalisation strategy used. The pilot operation should predominantly be supervised by the future area developer or master franchisee if you choose this strategy, for example.

You should also bear in mind that the capacities to supervise your expansion need to be available at your home system headquarters. On the one hand, you need to have the required expertise and on the other hand, you also need to have the relevant human resources and financial resources.
Whatever form of expansion you choose, the German Franchise Association recommends that you run the pilot phase yourself or organise the running of the pilot phase by, for example, the master franchisee!

WHY IS IT IMPORTANT TO SET UP A PILOT OPERATION?

- Adapting your own system standards in the target country
- Checking acceptance of your own business model, products and services
- Foreign markets are always different to the home market.
- Checking the characteristics/suitability of the local partner

The fact that the benefits of a pilot phase are only accompanied by an extremely superficial disadvantage (namely that quick international expansion is, at first glance, delayed) makes this recommendation clearly valid.

The important factor in an internationalisation process is not speed, but quality. A pilot phase creates trust and more security with regard to the implementation of the further expansion process. This benefit far outweighs the supposed disadvantage of temporary delay.

The pilot phase should be brought to a close in order to start the roll-out once the pilot operation has broken even.
SEARCHING FOR AND SELECTING PARTNERS

The selection of a partner in Germany is the most important decision that a franchisor can make.

If you are already frequently receiving enquiries from Germany, you may be able to eliminate some aspects of the time-consuming search process. You should, however, bear in mind that your consideration of such enquiries should involve the same benchmarks as your active search for partners. We do not recommend that you lower your own requirements for a partner for cost-related reasons or even for the sake of convenience just because this partner is actively offering their services.

WHO CAN HELP ME WITH MY SEARCH FOR A SUITABLE PARTNER FOR MY EXPANSION PLANS IN GERMANY?

- Management consultants and recruitment consultants (as well as international companies/ networks)
- Franchise brokers
- Franchise media
- Franchise portals online
- Franchise and industry trade fairs and exhibitions

Your first priority should be to check whether you already have a contact with experience in Germany and the relevant sector.

WHAT PRECISE CHARACTERISTICS MUST A PARTNER OFFER IN ORDER TO MAKE IT ONTO THE SHORTLIST?

- The “personal chemistry” needs to be right.
- A strong entrepreneurial personality
- Experience with business developments on a large scale
- Ideally franchise experience (not imperative)
- Willing to integrate, to meet requirements and to follow instructions
- Language consistency (alternative: a communication employee deals with language-related matters)
- Financial resources and access to borrowed capital

Your potential partner should be intensively checked and evaluated just like every other applicant. If necessary, a German consultant can also carry out these checks on location.
WHERE CAN I FIND MORE DETAILED INFORMATION AND SUPPORT?

- Deutscher Franchiseverband (German Franchise Association)
- Management consultants focusing on franchising (experts associated with the Association)
- Lawyers and law offices with franchise experience (associated experts of the Association)
- State institutes with foreign trade support programmes, particularly GTAI (see below)
- Industry associations
- Chambers of Industry and Commerce
- Diplomatic missions and consular representations
- Round-Table Events featuring franchisors with international experience of the German Franchise Association

The organisation Germany Trade and Invest – Gesellschaft für Außenwirtschaft und Standortmarketing (GTAI) of the German Federal Ministry for Economic Affairs and Energy (BMWi) in particular can be a strong partner for your internationalisation efforts. Its correspondents based in over 40 locations worldwide and its headquarters in the German city of Bonn offer the following assistance and information:

- Presentation of the economic situation and legal and customers regulations
- An overview of economic developments on the whole and special industry trends
- Information on investment and development plans
- Information on calls for tenders and the business and cooperation requirements of potential German partners

Selecting the right contact can be a difficult task due to the large number of different actors and their range of services, which initially seems unclear and difficult.

⚠️ When it comes to this task, the Franchise Association is your ideal contact and first port of call for all questions concerning the establishment of your franchise system in Germany.

We help you to establish contact with a network of franchise systems that are already successful on an international level and boast long-standing relationships with lawyers and consultants who specifically work as associated supporters. On top of all this, the Association is also excellently networked with all relevant state institutions that support franchise systems with their efforts to expand into the German market.

Have you already visited our website? Alongside all important information on franchising in Germany, you can also find a list of contacts who can help you with your internationalisation efforts at www.franchiseverband.com/wissen/international-franchising
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