



# FRANCHISING IN INDIA

## KEY CONSIDERATIONS FOR FRANCHISORS SEEKING TO GROW THEIR BRANDS

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By Erik Wulff and Abhishek Dubé

India recently staged the largest free democratic election in world history, bringing to power the National Democratic Alliance, led by the Bharatiya Janata Party, and with it a fresh sense of optimism about India's economic future.

The new (and strongly pro-business) prime minister, Narendra Modi, campaigned to revive India's economy, create millions of new jobs, tame persistently high inflation, improve trade ties between India and the United States and, over time, lift restrictions on US exports in a broad range of industries.

India is home to many globally recognized companies – including in the pharmaceuticals, steel, information technology and space technology industries – and has become an important voice on the international stage.<sup>1</sup> And, as a result of India's diverse, skilled and low-cost workforce, its notable economic growth<sup>2</sup> efforts to invest in infrastructure<sup>3</sup> and legal and economic reforms to ease foreign direct investment (FDI) in single brand and multi-brand

retail, there has been an increase in the number of cross-border transactions in which foreign franchisors have sought to establish their brands in India. It should be no surprise to foreign franchisors that franchising in India is expected to continue growing at a rapid pace.

But, despite public optimism stemming from the election results, there remain a number of legal, political, business and cultural barriers that foreign franchisors must consider before investing in India.

In this article, we discuss the business climate in India, India's current market for franchising, and some of the applicable laws that govern the relationships between an international franchisor and an India franchisee. We also take a quick look at other concerns that international franchisors may face when trying to establish their brands in India.

<sup>1</sup> See generally *India Overview*, The World Bank, available [here](#) (last visited March 27, 2014).

<sup>2</sup> *India's path from poverty to empowerment*, McKinsey & Company Global Institute, February, 2014, available [here](#) (last visited July 22, 2014) (noting that India halved its poverty rate from 45 percent of the population in 1994 to 22 percent in 2012).

<sup>3</sup> *India matters: Winning in growth markets*, Deloitte UK, 2013, available [here](#) (last visited July 22, 2014) (noting that the Indian government is planning to double infrastructure investment to almost US\$1 trillion between 2012 and 2017, with power (31 percent), telecoms (25 percent), and roads and bridges (12 percent) receiving the bulk of the investment).

## INDIA'S GROWTH STORY

India is the fourth largest and one of the fastest growing economies in the world. Some notable numbers:

- With 1.2 billion people as of 2014, India is the **second most populous country in the world**. As of July 2014, India's population is estimated to be approximately 1.24 billion (second only to China).<sup>4</sup>
- In 2013-2014, the **GDP real growth rate** was estimated to be 4.7 percent, and it is projected to rise to over 6 percent in 2014-2015, 6.6 percent in 2015-2016 and 7.1 percent in 2016-2017.<sup>5</sup>
- By 2015, the India economy is **expected to be worth US\$2.4 trillion** (INR 129 trillion) and, in addition to the recent government reforms (including the raised FDI ceilings for the retail, airline, telecoms, financial and defense sectors), there is expected to be further growth that could potentially make India the world's fifth-fastest growing economy by 2015.<sup>6</sup>

This impressive rate of growth will inevitably lead to increased opportunities for foreign investors aiming to tap into the India domestic market.

## FRANCHISING IS BECOMING INCREASINGLY POPULAR IN INDIA

The franchise business in India is becoming increasingly popular among domestic and international players across many sectors. Consequently, some of the major industries credit successful franchising in India for their rapid economic growth internationally. According to KPMG India, the key industries with the highest prospects of successfully franchising in India are: (i) retail; (ii) food and beverages; (iii) health, beauty and wellness; (iv) consumer services; and (v) education and training.<sup>7</sup>

As a business model, franchising is becoming especially widespread in India's metropolitan areas. It has gained a firm foothold since the government started loosening financial regulations in the early 1990s to encourage a free-market economy.

Notably, in 2009, the India government lifted the restriction on foreign franchisors' ability to charge royalty rates above certain levels (stated another way, royalty rates considered by

foreign franchisors to be "market") without needing specific governmental approval.<sup>8</sup>

Now, foreign franchisors may charge a lump-sum fee and royalty for the transfer of technology and use of a trademark or brand without any maximum limit through the automatic route.

Today India is home to more than 3,000 brands which adopt the franchising model:

- Bata, one of the leading footwear companies, was **among the first franchisors in India** - other pioneers of franchising in India were NIIT, Apollo Hospitals and Titan Watches.
- According to published reports, **global franchise companies in India** include Arby's International, Armani Junior, Auntie Anne's, Barista Lavazza, Baskin Robbins, Booster Juice, California Pizza Kitchen, ChemDry, Chile's, Cinnabon, The Coffee Bean, Domino's, Dunkin Donuts, Hard Rock Café, Johnny Rockets, KFC, Krispy Kreme Donuts, McDonald's, Pinkberry, Pollo Tropical, Pizza Hut, Quiznos, Sbarro, ServiceMaster Clean, Spring Air, Starbucks, Subway, TGI Friday's, Wimpy's, Yogen Fruz, YogurBerry and Yum Brands.
- According to published reports, **other brands may also enter the India market** at some point in the near future, as among them Applebee's, Armani Junior, BannaStrow's Crepes and Coffee, BG Cleaning Systems, Carl's Jr., Carvel Ice Cream, Denny's, Di Bella Coffee, Lipsy, Luxeyard, Mad Over Donuts, Marc Cain, Moe's Southwest Grill, Muffin Break, Panaria, Roberto Cavalli, Schlotzsky's Deli, Spring Air, Triangle, Wendy's, Winkworth, Willy Winkies, and Yoforia.

KPMG India estimates that by 2017 the franchising industry in India will have quadrupled over its 2012 levels and by that date will contribute to almost 4 percent of India's GDP (growing from a current estimated contribution of 1.4 percent of GDP).<sup>9</sup> In 2014, the Franchising Association of India estimated that the market potential of India's franchise industry would be worth US\$50.4 billion by 2017 (with retail being worth US\$10.6 billion and food and beverages worth US\$1.2 billion).<sup>10</sup>

In turn, this growth is expected to create job opportunities, including both direct and indirect, for an additional 11 million people by 2017.<sup>11</sup> The individual growth and potential of these industries are driving the growth of the overall franchise sector within India.

<sup>4</sup> See *The World Factbook*, Central Intelligence Agency, available [here](#) (last visited July 22, 2014).

<sup>5</sup> *South Asia*, The World Bank, available [here](#) (last visited August 14, 2014).

<sup>6</sup> *EY's Attractiveness Survey: India 2014 Enabling the prospects*, Ernst & Young, 2014, available [here](#) (last visited July 22, 2014).

<sup>7</sup> *Collaborating for Growth: Report on Franchising Industry in India 2013*, KPMG, available [here](#) (last visited July 22, 2014).

<sup>8</sup> *Press Note 8 (2009 Series)*, issued by the Ministry of Commerce & Industry, Department of Industrial Policy & Promotion, New Delhi (December 17, 2009) (available [here](#)) (prior to the issuance of this press note, payments of certain royalties by India residents to parties outside of India in connection with transfers of technology and the usage of trademarks and brand names were "automatically approved," provided that such payments did not exceed: (i) a lump-sum of US\$2 million, and royalties of 5 percent on domestic sales and 8 percent on exports; and (ii) where no technology was transferred (just use of trademarks and brand name), royalties of 1 percent on domestic sales and 2 percent on exports. Higher royalty rates were subject to the prior approval of the Project Approval Board of the Department of Industrial Policy and Promotion).

<sup>9</sup> See KPMG, *supra* note 7.

<sup>10</sup> See "Franchising in India" presented by the U.S.-India Business Council, sponsored by DLA Piper, the International Franchise Association, Inventure, J. Sagar Associates, the Franchising Association of India and RE/IMAX, August 5, 2014.

<sup>11</sup> See KPMG, *supra* note 7.

## INDIA ADDRESSES FRANCHISING VIA A NUMBER OF KEY LAWS

India has no franchise law – there is no requirement to register franchise offerings or to provide franchise disclosure documents, and no specific laws restricting franchise terminations, transfers or other aspects of franchise relationships. Despite this, there are a number of laws that may be implicated by cross-border franchising into India (including laws addressing competition, exchange control regulations, consumer protection, intellectual property, labor, permanent establishment, property and taxation).

Below are some of the key laws that may impact a franchising operation in India:<sup>12</sup>

1. **The Indian Contract Act, 1982.** Depending on the choice of law (or other) provision in the franchise agreement, this act may govern the agreement between the foreign franchisor and Indian franchisee. It provides the requirements for all aspects of the franchise agreement (e.g., offer, acceptance, consideration, validity, breach and termination).
2. **The Trademarks Act, 1999; The Designs Act, 2000; The Patents Act, 1970, The Copyright Act, 1957.** These laws govern trademarks, patents, registered designs and technical assistance required for franchising agreements. As a trademark license typically is the cornerstone of a franchise relationship, it is important to note that – in India, the above statutes provide for protection of trademarks through registration, the ability to bring infringement actions against third parties to seek injunctions, damages and an accounting of profits. Criminal sanctions are also available, at least in theory.
3. **The Competition Act, 2002.** The Competition Act prohibits arrangements related to production, supply, distribution, storage, acquisition or control of goods or provision of services that cause or are likely to cause an “appreciable adverse effect” on competition within India. Under the Competition Act, tie-in arrangements, exclusive supply and distribution agreements and resale price maintenance would be regarded as being anti-competitive if such agreements cause an appreciable adverse effect on competition in India.
4. **The Foreign Exchange Management Act, 1999.** This act, along with its rules and regulations, governs payments in foreign currency. A cross-border franchise arrangement would normally involve such payments (e.g., franchise fees, royalties for use of trademarks and system, training expenses, advertisement contributions, etc.) which can be remitted to the foreign

franchisor without any approvals. As discussed above, the India government has lifted a number of the prior restrictions on foreign franchisors’ ability to charge certain fees without needing governmental approval. Guarantees in favor of a foreign franchisor may also require approval of the Reserve Bank of India.

5. **Income Tax Act, 1961.** This act governs the tax aspects of any franchising arrangement in India and generally provides that a foreign franchisor’s income in the form of royalties or franchise fees would be treated and taxed as business income subject to a tax deduction at the applicable rates. Of course, this would be subject to any tax treaty between India and the relevant country (including withholding tax provisions related to the franchisee’s royalty payments to the foreign franchisor).

6. **The Consumer Protection Act, 1986.** This set of laws provides remedies to consumers in the event of product defects and service deficiencies. Under these laws, because goods and services may be provided by a franchisee, it is possible that consumers could file an action against both the franchisor and the franchisee. In fact, these laws can encourage India consumers to file complaints for any defects and deficiencies in the goods or services supplied by either the franchisee or franchisor – which, may result in consumers having claims against franchisors and franchisees. The party that has more control over the business is used to determine which party would be appropriate party to bring a suit against.

7. **The Arbitration and Conciliation Act, 1996.** This act governs the India law of arbitration (and as a result of case law, the evolving landscape of the enforceability of arbitration awards in which the seat of arbitration is outside of India). Part I of the act addresses domestic arbitration and awards and Part II of the act addresses international arbitration and awards. Following the India supreme court’s decision in *Bharat Aluminium Co vs. Kaiser Aluminium Technical Service Inc.* decision (BALCO), Part I of the act does not apply to foreign seated arbitrations, thereby dissuading parties from approaching India courts for interim relief. While arbitration in India continues to evolve, for the time being it does seem clear (as a result of BALCO) that India courts cannot set aside arbitral awards made, or otherwise intervene in arbitrations seated, outside India (and therefore, the India courts will give effect to party autonomy and choice of an arbitration seat).

<sup>12</sup> See generally *Franchising in India*, International Franchise Association, July 2012, available [here](#) (last visited July 22, 2014).

## KEEP TRACK OF INDIA'S FDI POLICY

In addition to the laws mentioned above, it is important to note that any proposed investment in India would be subject to the FDI Policy, which is released semi-annually by the Department for Industrial Policy and Promotion (which, among other things, determines the permissible levels for foreign investment in India and in which sectors investment is permitted).

In previous years, India's FDI Policy prohibited foreign investment in multi-brand retailing and allowed only up to 51 percent FDI in single-brand retailing. Over the past couple of years, however, the India government has passed FDI Policy reforms designed to encourage foreign investment. Now, the FDI policy allows for up to 100 percent FDI in single-brand retail<sup>13</sup> and up to 51 percent FDI in multi-brand retail.<sup>14</sup> Further, the government has taken steps to remove barriers to FDI in a range of sectors, including (a) 100 percent FDI in aviation, telecoms, asset reconstruction companies and courier services; (b) 74 percent FDI in credit information companies; and (c) 49 percent FDI in power exchanges, stock and commodity exchanges and depositories.<sup>15</sup>

These FDI reforms are notable for franchising because, as a result of liberalizing foreign investment in India (across various sectors), international franchise brands will have greater flexibility in adopting business models that would allow for expansion to India.

## BEFORE ENTERING THE INDIAN MARKET, ADDRESS ANY ISSUES OF CONCERN

Despite the storied growth and positive growth numbers mentioned above, franchisors should take special care to understand all regulatory, legal, political and business ramifications of entering the India market, including:

- **Since 2012, India has experienced a notable slowdown in economic growth.** While there are reasons to be optimistic (e.g., the recent election results and new economic policies), there is no way to predict future economic growth. Prime Minister Modi faces several constraints – namely, that the BJP only controls the lower house of parliament (the Lok Sabha),

but lacks a majority in the upper house (the Rajya Sabha). The absence of a majority in the Rajya Sabha poses a threat to the BJP's legislative agenda. Additionally, India is increasingly governed through its states rather than by the central government in New Delhi.

- **India's legal system is incredibly slow and there are staggering delays associated with India court proceedings** – thus, the path to a non-appealable final resolution may be prohibitively long.<sup>16</sup> Among the 185 economies covered by the World Bank's 2013 Doing Business survey, India ranks as #184 in terms of countries in which it is easiest to enforce a contract.<sup>17</sup> Further, courts at the lower level may not have the experience to handle complex commercial matters for which foreign franchisors may seek resolution, and such proceedings are not confidential. Also, India's legal system is filled with archaic laws no longer applicable to today's marketplace (as India does not employ sunset clauses that require the expiration of certain laws after a fixed period of time).
- **While FDI restrictions have been relieved in various sectors, India still needs to address its great infrastructure shortfalls** (such as shortages of utilities, poor roads and bridges), pervasive state control in business activities (for instance, the number of permits and licenses that may be required to do business can be overwhelming and overly burdensome for a foreign franchisor), and unequal access to quality education (areas beyond metropolitan places must continue to develop to sustain growth and a qualified workforce).
- **Excessive government bureaucracy and corruption** persist at various levels and have proved to be difficult to curb.
- While the India government continues to reform the FDI Policy, **more progress is sought from the business community.**
- India has a diverse consumer base and workforce. But because it is not really "one" market, there are often **cultural, linguistic and socio-economic issues that may make it difficult to establish a uniform business model suitable for the entire country.**

<sup>13</sup> Up to 49 percent is under the automatic route and 49-100 percent is under the India government route "approval route."

<sup>14</sup> *Franchisee route not allowed in multi-brand retailing*, The Hindu, June 7, 2013 (noting that despite the fact that India's government relaxed regulations allowing FDI in multi-brand retail, foreign retailers entering the multi-brand segment will not be allowed to franchise their stores and will have to put 50 percent of their investments in back-end infrastructure specifically for the chain they are setting up. This in turn may lead foreign retailers to own and operate *company* stores in India).

<sup>15</sup> See India's FDI Policy, Department of Industrial Policy & Promotion, available [here](#) (last visited July 22, 2014).

<sup>16</sup> See generally IOL News, *Backlog stalls justice in India* (dated January 21, 2013) (noting that at the end of 2011, more than 32 million cases were pending in India courts, according to government data, and 26 percent of these were more than five years old. India also has an estimated 10.5 judges per 1 million people, and civil cases can take 10 to 30 years before a decision).

<sup>17</sup> See World Bank 2013. *Doing Business 2013: Smarter Regulations for Small and Medium-Size Enterprises*. Washington, DC: World Bank Group. DOI: 10.1596/978-0-8213-9615-5, available [here](#) (last visited July 22, 2014) (also noting that it takes 1,420 days to enforce a contract in India, and commercial disputes before courts in India are among the most lengthy, costly and complex in the world).

## MAKE SURE TO THOROUGHLY EVALUATE THE FRANCHISING OPPORTUNITY IN INDIA

Despite the concerns noted above, franchising in India should experience a bright future under the new, pro-business government.

Over the years, India has become an attractive destination for business investments due to the rapid growth of consumerism, globalization and liberalization. India enjoys a positive economy, large consumer market and loosening government restrictions. The window of opportunity in India is open.

But foreign franchisors should make sure to conduct a thorough investigation and evaluation of business opportunities (taking into account the many legal, political, business and cultural barriers that may exist) before committing long-term to franchising in India. Further, and in addition to working with domestic counsel, consultation with India counsel may be invaluable.

To find appropriate counsel in India, please contact the authors, who will help to guide you.

## ABOUT THE AUTHORS

**Erik Wulff**, a partner based in DLA Piper's Washington, DC office, has a broad-based practice in global brand expansion for consumer products and services companies. He has extensive experience in all aspects of representing clients in expanding their brands internationally and domestically through various collaborative forms, such as franchising, licensing, distribution, acquisition and joint venture arrangements. Erik is a former member of the board of directors of a New York stock exchange-listed company and, as president of its international division, was instrumental in developing its business abroad. He has repeatedly been listed in *The Best Lawyers in America*, which named him the 2015 "Lawyer of the Year" for Franchise Law in Washington, DC.

Erik is a citizen of the Netherlands, was born in Calcutta, India, and has traveled extensively.

**Abhishek Dubé** is an associate in the Washington, DC and Northern Virginia offices of DLA Piper. Abhi focuses his practice on international transactions related to franchising, licensing and distribution, and works closely with both domestic and international clients on a variety of matters involving general corporate advice, corporate governance, contract drafting and negotiation, franchise planning, franchise formation (including master franchising, multi-unit licensing, single-unit licensing, area development and other structures) and mergers and acquisitions.

Abhi is a dual citizen of the US and India and was born in New Delhi.

## ABOUT US

DLA Piper is a global law firm with 4,200 lawyers in more than 30 countries throughout the Americas, Asia Pacific, Europe and the Middle East. We represent clients across the entire spectrum of businesses that have adopted franchising as a means of distribution and cover a broad spectrum of size and experience, from entrepreneurs and startup companies establishing new programs to the largest franchisors, manufacturers and distributors. Our clients manage franchise networks that range from dozens to thousands of outlets as well as trading globally through the online and mobile media channels.

The firm has been widely recognized for its achievements in the franchise industry. We have been hailed as the number one global law firm for franchise law by Who's Who Legal in every year since 2005, and ranked the Top Franchise Practice in the United States by the respected research firm Chambers & Partners, which calls us "the world's most recognizable force in franchising" and comments that DLA Piper "stands in a class of its own." We serve as General Counsel to the International Franchise Association, the major trade association for the franchise industry. We are affiliate members of national franchise associations in key global markets, among them the British Franchise Association and its affiliation to the European Franchise Federation as well as the Germany Association for Distribution law. We also are closely affiliated with organizations in Australia, China and Russia. Find out more at [www.dlapiper.com](http://www.dlapiper.com).