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International Business Law

Legal forms of entering to new foreign markets

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First question: what legal form should we choose for entering foreign markets

Establishing subcompany (or est. Branch abroad)

- more extensive projects
- **Advantages**
 - more consequential leadership and activity controlling, unlike managing contractors
- **Disadvantages**
 - high operating costs
 - Foreign revenue measure impact
 - Possibility to protect employees by domestic labour law regulations
 - Official red tape (bureaucracy) – while establishing, operating

Foreign contractor

- less formal, more flexible
- Most used
 - Distributive contract
 - Dealership
 - Franchising
 - Joint ventures

International distributorship contract

- Method of selling goods abroad, which is one of the most widespread

2 components

1. long-term general contract

- defines rules between contractors
- regulates cooperation and contract of purchase clause
- Clauses are applied to all contracts which will be made in future without being mentioned in those component contracts
 - Improves communication, flexibility, informality

2. Particular contracts of purchase

- Made informally (booking via fax, electronically, by telephone)

Usual text given by international practice of the trade -

content depends on contractors

- **Exclusive distributor s status clause** on specific territory, also **re-export ban clause** and **competetion ban clause**
- **Quantity quota clause**
 - If specified quantity of goods won t be bought then it s obligatory to pay a fine or price of unbought goods (buy it or pay system)
- **Promotion clause.** Distributor is obliged not only to sell importer s good but also actively promote it
 - Spread promotional materials of importer, billboard lease, TV or broadcast (radio) advertisements
 - Can be also settled down the duty of distributor to send certain number of workers to educational training
- **Providing service**
 - Distributor is obliged to provide guarantee service of marketed goods in certain territory

- **Distribution clause.** Distributor usually is not limited as far as particular types of selling goods. For sale organisation it can be used also other domestic contractors.
 - Importer can also reserve the privilege to make a contract with individual sub-distributors
- **Trademarks.** Distributor has to sell goods with trademark of importer
 - Contracts sometimes involve also an obligation to defend trademarks of importer in specific territory and punish for an unauthorized use. This obligation is hardly feasible or enforceable
- **Confidential information clause**
- It is recommended to strictly set which information are confidential for contracting purposes (generally there are patents, know-how, industrial design, trade and monetary policy, etc.)

Model commercial contract ICC

- International chamber of commerce (ICC) from Paris made model of commercial contract:

ICC Model Selective Distributorship Contract

- Focused on recommendation to producers – how to set up a distributorship contract and provide the most effective supervision to sell own goods.

Conflict-of-law rules

- Conflict-of-law for distributorship contract in regulation Rome I, where is in article 4, paragraph 1. letter f) explicitly said that distributorship contract is **regulated by law of the country where the distributor has his residence.**
- Sale contracts between producer and distributor can considered separately.
 - Therefore we need to take into consideration the possibility of using Vienna convention as direct rule – priority – in the first place.

International agency contract (dealership)

- Often used type of contract while expanding into new markets
 - Advantages of sales representatives
 - Knowledge of local legislation in selected sector and of structure and local market capacities as well as knowledge of languages and habits and traditions
 - Unified regulation in the EU:
- **Sales representative** as independent entrepreneur who undertakes to work towards concluding certain types of contracts (trades) or **negotiate and transact business** on behalf of represented customer and on his account
 - 2 activities
 - Leading to transact businesses (brokerage contract)
 - Negotiating and concluding contracts (contract of mandate)
 - **In international business is preferred model where representative acts directly** on behalf of the represented and on his account

Exclusivity and non-exclusivity determination

- Unless explicitly agreed in the contract exclusive representation is **non-exclusive** sales representation.
- **Exclusive representation**
 - Sales representative has to work agreed activity **only for represented party**
 - Represented party must **not use other sales representative** then the one who has exclusivity contract with in certain geographic area and certain shops
 - Represented can **make a deal by itself** but is obliged to pay a commission to sales representative as if the transaction was with his contribution

Comptetion clause

Sales representative may make himself obliged **not to do any activities** which were the object of the contract or which would be competitive nature



International legal regime of sales representative contracts

- Used in practice – **text of sample contract** on international sales representation, developed by ICC in Paris
- **Conflict resolution** – aimed to country of commercial representation settlement
- Directive EEC No. 86/653 which widely protects sales representatives
 - Written form of contract
 - Payment period
 - Right to compensation in event of earlier termination

Distributorship contract X Sales representation contract

Differences:

- **Activity range :**
 - Sales rep contract can be used for wider range of transactions
 - Distributorship contract is aimed only to distribution of goods which means primary contractual agreements on sale are settled through this type of contract
- **Transition of ownership rights**
 - Distributorship relation is based on the fact that goods transit to ownership of distributor and from that it's passing to ownership of end customer.
 - In sales representation contract: representative acts on behalf of represented so in case of contract on sale there is only one transition of ownership rights.
- **Payment**
 - Sales representative gets paid for his work – commission.
 - Distributorship contract: distributor is not paid for each transaction as sales representative but usually purchase price differs from selling price (price difference)

International franchise contract

The basic idea

*Once created powerful and effective business system
(in any field) is competitive enough to break through
in any environment*

Franchisor instead of investing a lot abroad
contact local entrepreneurs who will get paid for
using their producing & trading system

Basic types of franchising

Business format franchising is the most widespread type

- **franchisor** provides
 - Own business and technical procedures **know-how**
 - **license** for own trademarks, patents and other industrial property

- **Franchisee (franchise receiver) is obliged to**
 - Properly use those procedures for payment consisting mainly of fixed one-time entry fee and then periodic payments according to turnover for the relevant time period.
 - Franchisor reserves the right to control the way how receiver uses his own rights and in event of violation of manufacturing or business procedures, franchisor can penalize the receiver in form of contractual penalty or cancellation the contract

- This type of franchising can be also divided into **industrial franchising** and **services franchising**

Basic types of franchising

Distribution franchising

- Entrepreneur sells franchisor's goods under his **trademark** and in marked area by his brand
- It is not about providing specific production processes (know-how)
- It has more in common with basic distributorship contract, eventually sales representation contract

Sorting by range of providing services

Direct franchising

- Franchisor concludes individual contracts with each receiver or franchise separately – demanding
- Very rarely used in international business
- More popular is so called development agreement when receiver of franchise gain permission to open more of its branches in a particular territory that are subject of franchise.

Master-franchising

- franchisor conclude the franchising contract with only one subject on certain territory
- Receiver of franchise is obliged to conclude franchising contracts with end receivers of franchise
- In international business is master-franchising (in a form of business format franchising) among the most used type

Typical clauses of franchising contract

It's important to be focus on:

- Providing **licenses** to intellectual and industrial property of franchisor, esp. its trademarks, patents, utility models, know how, etc.
- **Exclusivity** clause gives the obligation no to have more than one franchise receiver in certain territory
- No **competition clause** where the receiver cannot compete to franchisor by its activity, esp. selling other goods or providing other services....
- **Obligation of receiver of franchise to buy material for production** or equipment in manufacturing and sales areas only from franchisor or its designated partners

Typical clauses of franchising contract

It's important to be focus on:

- Obligation to respect **pricing policy of franchisor** and keep those prices.
- Clause on obligation to send employees **to training courses** organised by franchisor in certain time periods.
- Automatic contract termination clause in event of significant changes in personal or property structure of receiver of franchis
- Clause on right of franchisor to do checks and control terms of franchise
- Determination of **duration** of the contract. Fixed period contracts in several years.

Example

Jack, the trader wants to sell his goods in new market, for example Bangladesh. He doesn't have any activity there and he really doesn't want take care with unnecessary formalities. Jack is also interested in cooperation with local businesses and entrepreneurs and wants to ensure that his product will be taken in pre-agreed amount by his partner from Bangladesh. Regardless of volume of sales to end customers.

Which type of foreign market entering would you recommend to Jack?

Solution

- Jack wants to minimalised all formalities on his side in Bangladesh so it's convenience to entrust his contractual partner there to do it.
- Since it's only sale of goods, it's **not** appropriate **use franchising**.
- Given the requirement of stable amount of goods delivered – **sales representatives** is **not** suitable. Representative is only an agent and he cannot guarantee certain amount of sales.
- A proper solution seems to be **distributorship contract** when goods is bought directly from the producer – Jack – and then it becomes ownership of distributor and he sells it on own behalf. The contracts should contain **a clause on the minimum monthly** or annual volumes of goods to buy as well as “take it or pay” clause

Example

Bob, the trader is interested in operating his chain of cosmetic services in foreign country – in all cities over 5 000 inhabitants. But Bob doesn't want to be involved personally, he prefers local company to take care of his cosmetic service chain there. He would provide full support as well as technological processes, business strategies and regular trainings for employees.

Bob also wants one local company – subject - to be responsible for all others, which would coordinate them but not provide any cosmetic services as others.

Bob however wants to be in contractual relationship only with this one subject.

What would you recommend to him?

Solution

- It's typical international **franchising** case. According to trader's demands to provide technological procedures, employee training etc. it's obviously **business format franchising in service franchising form.**
- It's recommended to use **master franchising** because one subject is responsible for coordination of all receivers of franchise. In master franchising contracts is also possible to incorporate as attachment **unit sample of franchising contract** which master franchisor will use for concluding with franchise receivers.