Assessing Potential Political And Ethnic Conflicts

It is vital to both newly-minted international franchise systems and experienced international businesses to focus on the need to perform a strategic analysis before entering a country or a region.

BY SUSAN GRUENEBERG

Looking back on the Arab Spring of 2011, it is easy to recall how surprising and dramatic the changes in a number of countries seemed. At heart, the protests and demonstrations appeared to be largely about democracy and internal reform. Nevertheless, the potential repercussions for changes in strategic balance in the region were great. Many countries outside the region were confused in their reactions–eager to encourage efforts to bring democracy to the region, but afraid of jeopardizing relationships linked to natural resources.

All of this serves to emphasize how important it is to assess, to the extent possible, the potential for political conflict in an area which a franchisor has targeted for development. Ethnic conflicts are no less complex and potentially destabilizing. It is vital to both newly-minted international franchise systems and experienced international businesses to focus on the need to perform a strategic analysis before entering a country or a region.

Often, franchisors with no experience in international franchising are tempted to react opportunistically. A seemingly reliable potential business partner approaches the franchisor to develop the franchisor's concept in a country about which the franchisor has no knowledge and for which it has no immediate plans. The temptation to accept this unexpected revenue can be great, especially if the franchisor is experiencing an economic downturn domestically.

More mature international systems appreciate the need to be strategic and the dangers that can come as a result of choosing the wrong international developer or not according sufficient operational, legal and business planning to international operations. Nevertheless, even companies that have devoted significant resources to international operations may become complacent with success in one country and approach another region with misplaced confidence that the same strategy can be replicated in every non-U.S. location.

Avenues to International Expansion

There is more than one way to expand internationally. One avenue to consider is corporate expansion into a region with the development of company-owned outlets and regional offices. This type of expansion, at least initially, has the advantage of allowing the franchisor to assess the domestic political situation directly and to establish its own relationship with government authorities before franchising third parties to operate its concept. It also allows a franchisor to deal with issues such as currency conversion and value fluctuations on a more strategic basis since there is less need to expatriate currency on a regular basis. Finally, it avoids the pitfalls in finding a qualified third party to develop a franchisor's concept in another country before the franchisor has an understanding of the region and its particular challenges.

The negative aspects of company-owned development include increased expense, capital investment and personnel. Failure has much greater consequences because the company's investment is bigger.

> One avenue to consider is corporate expansion into a region with the development of company-owned outlets and regional offices.

Franchising avoids these negatives, but has its own set of factors that may challenge a franchisor. For example, commercial agency laws may make it difficult to terminate a franchisee in another country without paying substantial compensation to a local developer. Moreover, these laws can present a danger of loss of ownership of intellectual property if a franchisor does not plan carefully in advance.

Historic Stability

In either case, it behooves a company that is planning to grow internationally to look at the historic stability of the area and the potential for unrest. Divisions within a society based on ethnicity, language, religion and even such subtle differences as those of apparel must be taken into account. Where differences within a society exist, one focus of the analysis should be on whether or not the differing groups of people are hierarchical. If some groups are subordinate with restricted mobility within society as a result of association with the group (known as ranked groups), conflict is more likely than if the ethic groups are parallel in the stature in society (known as unranked groups). The severity of the division among factions in a region is also important. Regions in which the severity is higher tend to be Africa, Asia and the Caribbean.

How the groups are bound together will make a difference as well. For example, groups based on kinship may have the advantage of substituting the infrastructure involved in a family for the more traditional organized structure of the society itself, adding to the potential for stability.

Surviving Political Unrest

Assuming that the franchisor has determined that a country or region presents a situation stable enough to franchise its operations there, what can a franchisor do to improve its chances to survive political unrest?

• Consider defining a territory within which the developer will operate the business by reference to tribal or ethnic boundaries rather than political ones. While this may mean dividing territory among a number of countries or sections of countries, a master developer with ties to the local group will be more likely to recruit and sustain good operators. A master developer will also likely be more skilled in navigating relationships with local government and other authorities.

• If a region has a number of different groups within it, but they have a history of coalition and stability, consider requiring that ownership of the developer include representatives from each of the groups to create an internal coalition. This can also serve to open up the pool of potential operators to members of all of the resident tribes or groups.

• Do not automatically include force majeure or "act of nature" provisions in your contract. These provisions excuse a party from its obligations if a catastrophic event occurs beyond the control of the party. While a government uprising or similar event may ordinarily fall within this provision, a franchisor may indeed want the ability to terminate a contract if the situation becomes too unstable.

• Be wary of exceptions to transfer restrictions. All of a franchisor's efforts to diversify ownership could be ineffective if a developer can restructure by orchestrating transfers of non-controlling interests of its ownership interests.

• Be conscious that actions with respect to a developer may have wider implications. There may be antipathetic relationships among tribes within a country that will affect a franchisor's relationships with other franchisees within that country if the perception is favoritism to one group over another. Similarly, because ethnic ties extend beyond country and regional boundaries, a franchisor must bear in mind that a policy in one country may affect its relationships with developers and governmental authorities elsewhere. For example, China's conflict with the Uyghur minority in Xinjiang Province has affected its relations with Turkish peoples in other countries, including with Turkey itself.

International franchising has been a trend for some time as domestic markets are developed and franchisors seek new areas in which to expand. Increasingly, communications and the marketplace have become global so it is easier and more tempting to jump at opportunities to take a concept to other countries. Potential political and ethnic conflict is only one consideration in the decision to move forward internationally, but it is a vitally important factor, as the new political vista in Northern African and Middle Eastern countries has shown. ■

Susan Grueneberg is a partner with Snell & Wilmer L.L.P. in Los Angeles and can be reached at sgrueneberg@swlaw.com.