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**"ANALYSIS OF THE IMPLEMENTATION PROCESS OF A FRANCHISE IN
CUENCA: CASE NAF NAF"**

**INVESTIGATION PRIOR TO OBTAIN THE DEGREE OF BACHELOR AT
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DEDICATION

I dedicate this work first to my parents Jaime and Ayda, for being the fundamental pillar in my life, supporting me unconditionally, for motivating me to be a good person and giving me the necessary support to fulfill this professional goal, but especially for all their love and kindness

To my friends and teachers of the University of Azuay, who have been of great inspiration throughout my academic career because, with their advice and teachings, I am able to fulfill this purpose.

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SUMMARY

This thesis aims to determine the requirements and the process that must be followed to obtain and establish a franchise in Cuenca, through the specific case of “NAF NAF” and the personal experience of the franchisee. The final objective is to know if this business model is profitable or not for investors. It is necessary to take into account that, at the present moment, the franchise contract in the country is atypical and, thus, this thesis evaluates the changes that would occur with the Project of the Commercial Code when it determines how to regulate this contract. Also, this thesis analyzes whether this proposal would be beneficial or not for the parties involved.

In addition, all the basic concepts around this topic are also analyzed together with the legal regulation at the international and national level. Currently, the existence of franchises in the country, is increasing because many people consider it attractive and beneficial to have the support of a brand that is reputable, along with the constant assistance provided by the franchisor.

INTRODUCTION

This research shows the process that must be followed for the implementation of a franchise, specifically "NAF NAF", which is a French trademark of clothing for women, which has several franchises at the national level, being the object of analysis the establishment of this franchise in Cuenca.

First, it is necessary to determine the main generalities of a franchise such as its background, classification, advantages, disadvantages, the main definitions around this business model and finally the obligations and rights of the parties involved in this process.

Additionally, this study is carried out on the "NAF NAF" franchise, established in the city and its contract based on the personal experience of the franchisee to know the entire process that must be followed to obtain and implement a franchise, taking into account all the requirements that have to be met, as well as all the risks and disadvantages of this business model.

Finally, one of the most important aspects of this research is everything related to the legal field, explaining each of the regulations at the international level specifically the regulatory bodies of France, the country where the franchise originated and also from Colombia, considering that it is one of the largest representatives in Latin America and responsible for granting the franchise to Ecuador. It is also essential to indicate everything corresponding to the national regulations about this subject with special emphasis on the Project of the Commercial Code, whose main proposal is to regulate the franchise contract and make it typical.

To achieve the success of this research, several interviews were conducted with professionals competent in the subject of franchises and the franchisee of "NAF NAF", also some information was obtained from the different regulatory bodies, websites and articles related to this topic.

This analysis is of great interest, because in recent years the franchise has had great development and growth internationally and nationally, because of the number of textile franchises that are established in the country, so it is necessary to know the feasibility for an investor, who is interested in obtaining this network.

CHAPTER I: GENERALITIES OF THE FRANCHISE

Introduction

The franchise is a business model that over the years has had great expansion and development worldwide, becoming an innovative way of forming a business and helping to the progress of several investors, the main reason to analyze its generalities, starting with its historical background is to know the changes from its origin to the present. Also, it is essential to understand the meaning of the franchise and its different elements, from the different points of view of the authors and institutions, also it is necessary to know the different types of franchises, the different ways to internationalize them, the advantages and disadvantages that the franchisor and the franchisee have, because the establishment of any business implies advantages and disadvantages. Additionally, this first chapter details the rights and obligations to be met by the parties according to what was agreed in the contract, the different perspectives on which the franchise develops and finally the various characteristics of this model.

1.1 Background

It is important to highlight that the business model of the franchises is not current, because its origin goes back to the Middle Ages, when it developed differently than today, since at that time the King granted the authorization to his subjects through contracts that were known as "free letters" so they could carry out their hunting and fishing activities, in the area where he ruled.

These authorizations were known as "franc". Also, in medieval France, where the word franchise was born, local governments granted licenses to people of power, to maintain public order and collect taxes. The concessionaire had to pay the government an amount that was determined by the license that was granted, in exchange for military protection in a specific territory and in turn the monarchy took advantage to control the land and collect taxes.

Also, during that time, the church was responsible for granting the landowners the right to perform the function of collecting the tithes in their name, giving them a percentage of what they collected, another percentage to the church and the surplus was sent to the Pope to perform charity works.

The word franchise was introduced in the seventeenth century and its meaning was authorization. This expression was used to indicate the transfer of products from one place to another. In 1959, the term acquires the meaning that we currently know, in which a company gives a person the right to exploit its brand and sell its products or services in exchange for an economic retribution (Anzola, 2016).

In the 18th century, in Germany some breweries decided to grant the right to some private taverns to sell their product, under the business model of franchises, initiating the first franchises, although not as well known or perfected as in the present. Later on, during the 19th and 20th century, the expansion of the franchises in the United States began, where the first franchise contract was carried out by the Singer Machine Company, which was responsible for the development of sewing machines.

The company decided to expand its business in several cities in the United States, to have greater recognition at the local level, because the sale of its products was falling more and more, which was the main reason to make the decision to grant authorization to establishments and private sellers, so that the machines reach more sectors. Currently, this company is known as the pioneer of sewing machines and the development of franchises, achieving great prestige worldwide.

Later, in 1900, other companies of public services, transportation and sale of automobiles such as General Motors and Coca Cola began to follow the steps of Singer, with the purpose of obtaining greater recognition in a broader geographic space and get more gains, granting the right to sell their products to businesses and interested persons, in several places in the United States, but maintaining a relationship of legal and financial independence between the main company and the distributors.

In addition, at the same time in France, the company "La Lanière" of Raubois, which was engaged in the manufacturing of wool, sought the internationalization of their product, so it decided to associate with several companies in different geographical areas for the sale of the product, having a rapid growth and expansion. At the end of the 1900s, there was also the birth of several fast food franchises that have survived in time and are currently the most popular worldwide as Kentucky Fried Chicken (KFC), Dunkin Donuts, Burger King and McDonald's.

It is important to note that McDonald's is known to be the first to make the business model by concessions, under a dependency relationship, through a transfer of production policies and company rules that all restaurants must follow, originating in this way what is currently known as technology transfer or "Know-How" (Morejón, 2009).

The end of the Second World War caused the expansion and development of the franchises, because the people who came to their homes had the need to find jobs and join ~~to the~~ society, but most people did not have extensive financial or commercial knowledge.

It was really difficult to find jobs with a significant salary, so they decide to invest their capital in businesses under the franchise system to have the support of professionals with greater knowledge of the commercial area, this caused the acceleration of this business model, due to the rapid growth of the North American population and their desire to acquire more and more innovative products and services (Anzola, 2016).

In 1960, new sectors decided to transform their businesses into franchises such as textiles, laundries, printing, the hotel sector, among others. Also, due to the growth of the franchises, there were people who took advantage of this situation and created false franchises, managing to defraud thousands of people.

This is the main reason why it was decided to create in the United States, the International Franchise Association (IFA) in 1960, with the main objective of supervising the franchises and protecting their interests, as well as ensuring the American entrepreneurship, so people have the opportunity to develop this type of business with

the support and training of the aforementioned association, without taking the risk of doing it themselves and being scammed.

In Latin America, in year 2015, the Argentine Association of Brands and Franchises, makes a report to identify the 10 countries with the greatest potential to establish franchises, which are: Panama, Brazil, Uruguay, Paraguay, Peru, Bolivia, Chile, Ecuador, Colombia and Costa Rica. For this analysis, two important factors were taken into account:

The environment of the franchise sector

This factor considers the development of local and foreign franchises and the reception of foreign products or services.

The business environment

It is based on the economy, human capital, intellectual property protection, population, restrictions on direct investments, controls on imports and exports, among others. It is considered that the Argentine companies under the franchise model are those that have greater development; Uruguay, Chile and Peru also lead the ranking countries with the greatest potential for the development of franchises.

The Argentine Association of Brands and Franchises (AAMF), establishes that in the case of Ecuador, it is a new market in the franchise system, but despite that situation it has had an annual growth of 25% with respect to the number of establishments by franchise, which means that in the future it could become a market with great potential for the establishment of a franchise locally and internationally. There is also a greater growth of established brands in the country than new brands that are trying to integrate to the market.

The existence of the Ecuadorian Franchise Association (AEFRAN) has been a great help for the growth of franchises, because it is responsible for providing support and controlling the national and foreign franchises. There is no express regulation on the franchise agreement, but despite this the parties, both franchisor and franchisee must take into account that the conditions and provisions must be in accordance with national legislation, such as the Civil Code and other Ecuadorian regulations.

In the case of Ecuador, the first foreign franchise to arrive in the country was Martinizing, from the United States in 1967, establishing in its beginnings a branch in the city of Quito. Later, several fast food franchises decided to establish themselves in the country, such

as Kentucky Fried Chicken that arrived in the country in 1975, Pizza Hut in 1982 and McDonald's in 1997.

In 2015, there were more than 168 foreign franchises in the country, having the highest percentage of the services sector, followed by gastronomy and with the lowest percentage of the commerce sector. Most of the franchises are from the United States with 60 brands, followed by Peru with 33 and finally Colombia with 23 brands. (AAMF, 2016).

1.2 Definitions of franchise

The Ecuadorian Franchise Association, created in 1997, which is an entity that ensures the growth and development of franchises in the country, responsible for providing support and advice to the parties involved in a franchise, focusing on Ecuadorian companies who wish to internationalize under the franchise model and also in the foreign franchises established in Ecuador, states that:

"The franchise is a method of commercial expansion through which the owner of a business concept (Franchisor) allows and supports another person (Franchisee) to replicate their concept and distribute products or services under their trade name and registered trademarks, according to what is established in the contract. Normally, the franchisee pays a right of entry when signing the contract and periodic royalties, which is usually a percentage of sales. The person in charge of the imitation of the business is the franchisee, who does it under the license of the owner of the concept. "

On the other hand, in our country, the Project of the Commercial Code was submitted to the National Assembly, which passed through its first debate on March 15, 2017 and after the approval of the Economic Regime Commission, the previous report was prepared on May 8, 2017 for the development of the second debate.

The legislators agreed that it is necessary that the country updates standards that regulate the commercial activity, being able to include in it not only the merchants, but also the entrepreneurs who engage in this type of activities, so for that reason it is important to refer to the definition mentioned in this project, which I note next:

"The franchise is a contract in which one of the parties called the franchisor or grantor, owner of a trade name, trademark or other form to identify companies, products or services, or a product or service itself grants to another, called franchisee or policyholder, the possibility of commercially exploiting the activities carried out under such name,

trademark or other identification, or goods or services, within the terms specified in the contract, in exchange for economic compensation" (National Assembly).

As determined by the International Franchise Association (IFA), which is the oldest and largest association that is responsible for protecting and promoting franchises around the world:

"Franchising is simply a method for expanding a business and distributing goods and services. In franchising, franchisors (a person or company that grants the license to a third party to conduct a business under their marks) not only specify the products and services that will be offered by the franchisees (a person or company who is granted the license to do business under the trademark and trade name by the franchisor), but also provide them with an operating system, brand and support."

The author Juan Farina, in his book *"Modern commercial contracts"* defines the franchise as:

"A kind of symbiosis: a party, which is known as franchisor, grants a license to an independent merchant, called the franchisee, to sell products or services of its ownership. The franchisee generally pays a fee for this privilege, plus a royalty on large sales. The term franchisee can mean two things: a) the right of the franchisee to sell certain products or services, and b) the place of business where the franchisee exercises that right. "

Lou Pelton, in the book *"Marketing channels and commercial distribution: A relationship management approach"*, gives the following definition:

"The franchises are a vertical marketing system in which a firm (franchisor) offers another person or firm (franchisee) the privilege of a license to form a business in a certain geographical area, along with assistance in the organization, training, merchandising and management "

To conclude, based on the different meanings and ideas obtained from the authors previously mentioned, in my personal opinion the franchise is:

A business model, which is based on the franchisor, who is the owner of the brand and decides to grant another person, called franchisee, the right to exploit the business, through a contract, in which both parties agree to fulfill certain demands and obligations, so the main objective is that the franchise has greater expansion and recognition internationally, in order to achieve its success.

1.3 Definitions of the elements of the franchise

1.3.1 Franchisor Central

It is a company or structure, which belongs to the franchisor. It is in charge of granting the rights to the franchisee for the exploitation of the brand. Its main function is to provide advice, training and all types of information or service needed by the franchisee. It is one of the most important elements in a franchise, because it helps to have a proper maintenance and control to achieve the success of it (Morejón, 2009).

1.3.2 Pilot center

It is an establishment or center, whose main purpose is to control and perform various tests of profitability, operation and acceptance of the franchise or new products or services that are going to be launched. The owner of this center, can be the franchisor or the franchisee, it is generally used to know if a franchise will succeed or not in a specific geographical area (Alonso, 2004).

1.3.3 Franchise agreement

It is the document through which the parties who are involved subscribe in writing and agree, on the one hand, the authorization of the use of the brand by the franchisee, and on the other, the commercial, technological and business support provided by the franchisor. Likewise, within this contract the parties must comply with the provisions, obligations and other generalities that are agreed in it.

This type of contract differs from the others, because it contains three fundamental elements: the brand, the know-how and the continuous support and assistance. In addition, within each contract there are certain clauses and conditions that must be met by both parties, for the franchise to be successful. The main conditions found in most contracts are:

"Identification of the parties, transfer of know-how, obligations of the establishment and personnel, obligations of trademarks assigned, provisions on recommended prices of resale of products or services, provisions relating to exclusivity, territory and relations with others franchisees of the network, obligations of the parties regarding the advertising of the brand and franchise, provisions on the duration of the contract, its termination and the conditions for after its termination, indemnity clauses due to damages, general

clauses about notifications between the parties, applicable legislation and competent courts to resolve conflicts" (López, 2007).

In the case of Ecuador, currently, as long as the new Commercial Code is not published in the official register, which is still not in force, despite having gone through its first debate and making the due report, it is still waiting for its second debate, so Ecuador does not have an express legislation that regulates the franchise contract, so, now it is an atypical contract, which means that there is no express or specific legal regulation that regulates the franchise.

To understand with greater clarity, this meaning, the authors Heriberto Hocsman and Ricardo Uguet, establish:

"Atypical contracts are those that do not find their" headquarters "within the law, those that lack not only a name, but a structure or legal regulation. They are the product of contractual freedom and the necessities of legal life: they do not originate in the imagination of the jurists or from the inventiveness of the legislators, but from the practical necessity that traffic negotiation poses. "

In addition, another feature of the franchise contract in Ecuador is that it is governed by free will, also known as contractual freedom. It consists of each of the parties involved, in this case the franchisor and the franchisee agree by their own will and by mutual agreement, the content of the contract, the obligations and rights, the duration of the contract and its effects.

According to the interview with the Regional Deputy Director of Cuenca of the Ecuadorian Institute of Intellectual Property (IEPI), Dr. Susana Vázquez:

"IEPI does not have competence in the subject of franchises, but this institute is responsible for registering the license to use the trademark, which is included in the franchise agreement. This registration is mandatory and will have legal effects from its registration. The registration of the brand must be done by the franchisor in order to protect and provide security and confidence to the franchisee, also in the contract there are confidentiality clauses to avoid unfair competition and ensure loyalty from the employees to the employer "

In addition, within the Ingenios Code¹ in relation to trademark registration, it is established:

"Art.375 License for the exploitation of the trademark. - A trademark registration or an application in the process of registration may be licensed to one or more third parties for the exploitation of the respective trademark.

It must be registered with the competent national authority in charge of intellectual rights and will take effect from its registration in the presence of the national competent authority in charge of intellectual rights. "

1.3.4 Right of entry

It is a fixed amount that the franchisee must pay the franchisor to be part of the franchise network. This payment may vary depending on some factors such as: the prestige of the network, profitability, operating time, among others. Generally, this payment is not greater than 10% of the total investment by the franchise (López, 2001).

1.3.5 Right of publicity

It is a periodic payment, usually made monthly, that the franchisee must pay to the franchisor, so this person can invest this money in the application of all types of advertising, which favor the entire franchise network.

1.3.6 Territorial exclusivity

It refers to the place or area assigned to the franchisee to carry out the activities of the franchise, in which there can be no other premises of the same network, with the aim of ensuring sales and avoiding competition between businesses belonging to the same network, each franchisee is given the concession of different territorial areas to have greater profitability and profits for both the franchisee and the brand. For the election of the territories or places where the business will be established, the franchisor can do it based on the density of the population or by areas, either by cities, provinces or other factors (Parra, 2016).

¹ IMPLEMENTATION CODE OF THE SOCIAL ECONOMY OF KNOWLEDGE, CREATIVITY AND INNOVATION
Official Register Supplement No. 899, December 9, 2016

1.3.7 Franchisee

Is the person who acquires the right to use, market or exploit a trademark, product or service under a contract, in which the franchisor transfers the rights within a specific geographic area or market, under the recommendations, indications and training provided by the franchisor about the direction of the business.

1.3.8 Franchisor

It is the person who owns the brand, the product or the service and the know-how, who decides to give the authorization or transfer contractually, for another person to exploit or use them, providing technical, financial, administrative and organizational advice to the franchisee in exchange of an economic retribution or royalties for the use of those.

1.3.9 Know-How

Translated into Spanish as “saber-hacer”. It is the set of knowledge, techniques and practices obtained by the experience of the franchisor, which can be positive or negative and are transferred to the franchisee so that they can be used and exploited in the best way, in order for the franchise to succeed.

It is the DNA or the secret formula of the franchise, which makes it different from the others and has to be communicated through operation manuals and protected by the franchisee. In addition, it must be continuously renewed according to technological and commercial innovations, taking into account the characteristics of the place where the franchise is located such as: culture, language, geographical area, among others (Rodríguez, 2013).

1.3.10 Trademark

They are the signs that help distinguish a product or service. It is the base of the franchise, it serves to assure the clients that the products or services have the quality and are original of the franchise network. It must have sufficient distinctiveness to distinguish and identify the products and services that are acquired in the market, so the trademark can be perceived by one of the senses.

1.3.11 Royalties

These are the payments made by the franchisee for the exploitation of the brand and for the services provided by the franchisor, generally these payments are monthly. These

royalties are also for the development of new products, supervision of the premises, advertising and image of the franchise. The royalties are used to cover the maintenance of the franchise. They can be charged by percentage or by fixed fee, as agreed in the contract (Díez;Galán, 1998).

1.4 Types of franchises

Based on the concept of franchising, the ways of classifying franchises vary depending on the point of view of each author and the advancements and variations that have occurred in the relationships between franchisor and franchisee, because every time the issue of franchises acquires greater complexity. Next, the different types of franchises will be detailed, according to the perspective of different authors, who are specialists on the subject.

1.4.1 Classification according to the place occupied by the subjects in the contract

The European Commission in 1978, after conducting several studies on trade and the issue of franchises, states that in relation to the parties involved in the contract, there are five types of relationships, but the problem with this classification was that it differentiated the franchises of services from the others; this is the main reason why years later, the authors Díez de Castro and Fernández in 1992, organize this typology in a better way, classifying the franchises, according to the relations between the parties as noted below:

Vertical franchises

This type of franchise develops between members of different levels in the distribution channel. Within this typology two models stand out:

- **Integrated franchise:** It occurs when the franchisor is the manufacturer and the franchisee the retailer, within this relationship the consumer is not taken into account. It covers the entire distribution channel.
- **Semi-integrated franchise:** In this type there are two relationships: the first is when the franchisor is the manufacturer and the franchisee is the wholesaler, and the other when the franchisor is the wholesaler and the franchisee the retailer. (Bermúdez, 2002)

Horizontal franchises

These are those that are developed, among the members belonging to the same level of the distribution channel. There are two models:

- **Franchise of manufacturers:** In this type of franchise both parties, the franchisor and the franchisee are wholesalers.

- **Retail franchise:** In this franchise both parties are retailers.

1.4.2 Classification according to the nature of the activity to which the contract is subject

This classification is based on the activities or functions performed by the franchise. Ailed Morejón Grillo, in his book "*The franchise contract*", establishes three types of franchises in this group.

Service franchise

This type of franchises, has had a great growth throughout the years and has become one of the most required by the potential franchisees; it consists in "The exploitation of a certain service whose original formula is the property of the franchisor, who transfers it to its franchisees" (Morejón, 2009).

In this franchise, the franchisor grants the franchisee the right to use the "know-how" and the specific method for its provision to consumers. One of the main characteristics of the service franchise is the constant support and control by the franchisor.

Production franchise

In this model, the franchisor is the manufacturer of the products, the owner of the trademark and know-how and the franchisee is the responsible for the distribution and marketing of the products in a specific market. The trademark that is made and distributed is the same, because the franchisor is in charge of performing both functions.

Distribution franchise

In this franchise the franchisor is the intermediary, in charge of selecting the best suppliers and choosing the products that will be marketed in the different establishments, but not elaborating them. Also, the franchisor must communicate these experiences to the franchisee, who is responsible for distributing or selling these products to consumers.

1.4.3 Classification according to the degree of seniority in the market

This classification is based on the development that a franchise has achieved since its origin, for the author Juan Monserrat Gauchi, the most complete classification is made by Hoffman and Preble in 1994, which is divided into two types:

First generation franchise

This is the first commercial franchise, in this type of franchise the most franchised were the products and services. Its main objective was that the franchisors achieve through a system of hiring employees, who would become the franchisees, the distribution of their products.

Second generation franchise

In this classification, the franchises have already gone through a great development and growth, so their main elements are not only products and services, because it includes trademarks and the important "know-how" element. Also, the existing relationship between the franchisor and the franchisee is more formal. Its main objective is to have all the necessary elements to ensure the success of this business model.

1.4.4 Classification according to the space occupied in the establishment

This classification is detailed by the author Guillermo Bermúdez González, in his book *"The Franchise: Elements, Relationships and Strategies"*.

Global franchise

The franchises of this classification have the main characteristic of occupying all the space in which the franchise is located. There is an equality of designs, images, labels and other distinctive signs that are shared between the franchisor and the franchisee.

Franchise shop in shop

It is characterized because this type of franchise is carried out in another commercial establishment, generally department stores, where the owner is dedicated to selling the products or services of the trademark, in the same shop, but with the peculiarity that only an area of the establishment is intended to offer these products, having the same model and the image that the franchise has with the purpose that consumers have the sensation that they are buying inside an establishment of the network of franchises. In addition,

they must fulfill the conditions and specifications imposed by the franchisor and by the brand.

Corner franchise

"It consists in franchising only some of the products or services that are provided in the commercial establishment" (Bermúdez, 2002).

In addition, the main characteristic of this type of franchise is that only a specific activity will be subject to the franchise agreement.

1.4.5 Classification according to the number of establishments per franchisee

According to Guillermo Bermúdez González, in his book *"The franchise: elements, relations and strategies"*, there are three different types of franchises in this group.

Unique franchise

This type of franchise is the simplest of all. It is based on the fact that the franchisee has the right to exploit only one franchise in a specific establishment.

Multifranchise

In this model, the franchisor grants the franchisee the right to exploit several franchises within a specific geographical area. This happens through a franchise agreement.

Plurifranchise

This classification is characterized by the fact that the franchisee can exploit more than one franchise in the same establishment with the possibility that the franchises can include different trademarks. Generally, the franchisee operates a global franchise and the other can be a corner franchise or a shop in the shop, which occupies less space in the store.

In addition, there are other authors who identify other classifications of franchises which are very important and it is necessary to mention them.

In the book *"Practice of the franchise"*, written by the authors Enrique C. Díez de Castro and José Luis Galán González, in the year 1998. They establish:

1.4.6 The classification according to the rights granted: Within this classification, the master franchise is mentioned.

Master franchise

This model is the most used by companies to have an expansion in the international markets. It is mainly based on the fact that the franchisor sells or grants the rights of the franchise to the franchisee, so it can be exploited in their country of origin.

Also, in the master franchise, the franchisee becomes a franchisor, because this person must be entrusted with the control and the development of the establishments that are going to open in the country, the selection of the franchisees, implementation of publicity and other functions that the franchisor usually performs.

Also, in the book "The development of the franchise system", written by the author Mariano Alonso, he states:

1.4.7 Classification according to economic activity: This classification includes the franchise by conversion.

Franchise by conversion

This type of franchise is based on associating an independent business, warehouse, local or any other establishment with a franchise network, but maintaining the same characteristics in regards to the design, image, and commercial name. The objective is to merge the knowledge of marketing to achieve a greater amount of sales and a diversification of advertising expenses.

1.5 Ways to internationalize franchises

Currently, the franchise is a very attractive business model for most investors because this business has an amazing growth and expansion locally and internationally. The franchises are considered the main way to enter the foreign markets and to formalize a close relationship between the franchisee and the franchisor through a contract. According to the authors Antonio Navarro García, Javier Rondán Cataluña and Carlos Rodríguez, there are four forms of internationalization:

- **Foreign direct investment**

This form is done through the establishment of shops or premises. It is based on the fact that the franchisor must assume the management of the new shops, which such person

decided to open by taking up all the risks and the investment. It helps to have greater control of the network and a better return of the investment, but at the same time, this implies an exhaustive financial control and big risks.

Foreign direct investment is very scarce, because the main purpose of the franchises is to obtain rapid international expansion at the lowest possible risk. The main factors that must be taken into account in this form of internationalization are the similarities between cultures, economic stability and politics of the country.

- **Joint venture**

It is based on building a partnership between the network and local investors. In this way, both parties share the risks and benefits since they grant financial and human resources for the establishment of the franchise in a specific place and in exchange these people get important and confidential information about the franchise.

The main characteristic is that the investment is low and its benefits are equivalent to the investment at the time of establishing the company. The main problem is that the interests of the partners can be different from those of the franchisor, which can cause conflicts between the parties. The main characteristic when adopting this model is the difference of cultures.

- **Direct Franchise**

"The franchisor network grants individual franchises in the foreign country becoming in the medium and long term a system of direct franchisees. This option involves regular contact or the creation of a minimum business structure in the country of destination by the franchisor network, in order to control the contractual obligations assumed by the franchisee " (Navarro, 2014).

This model is very similar to the ordinary franchise, because the entry into an international market is more complicated and difficult. Within the direct franchise, it is important to take into account the similarity of cultures, geographical distance and experience that the franchisor has when this person chooses a new market to enter.

- **Master Franchise**

During the last years, this model has had a great growth. It is based on entering in a new market through an intermediary belonging to that place through a franchise master contract, in which it is clear that the franchisee will become a franchisor within that specific market and may grant franchises to other people having to perform the functions

corresponding to the franchisor such as: selection of the franchisee and the place where the franchise will be established, transfer of know-how, training and advice.

Within the master franchise, the risk is lower at the time of entering the new market but it is important to be very careful when selecting the franchisee, because this person must give a good image, profitability and growth to the franchise. The main characteristics to adopt this type of internationalization are: cultural, linguistic and geographical differences.

1.6 Advantages and disadvantages of the franchise

The establishment of any type of business has its risks, but also its benefits, franchises are not the exception. These advantages and disadvantages are mainly for the parts involved in a franchise: the franchisor and the franchisee, who are the most important people in the growth of a franchise, because they are the people in charge of the success or failure through several decisions and functions that must be performed.

The franchise is the business model that in recent years has had a great spreading and expansion worldwide for the facilities it provides to the people who are part of it, but also it is important to note that this business involves a lot of effort, responsibility and certain disadvantages that must be assumed by the parts.

Most of the people who decide to be part of this business model perform an analysis about the points that are in favor and against what the franchise has, taking into account that within it, the parties must have a contractual relationship and also, they have to comply with everything that is established in the contract and make several decisions jointly.

Advantages of the franchisor	Advantages of the franchisee
<ul style="list-style-type: none"> • Speed in the expansion of the business. • Greater efficiency in the development and maintenance of new markets. • Better control and operation of the franchise. • Satisfaction for the success of the franchise. • Collection of initial fee. • Collection of royalties for the use of the trademark. 	<ul style="list-style-type: none"> • Low advertising expenses. • Lower risks when being part of a consolidated business. • Training and support by the franchisor. • Exclusivity at the time of exploiting the know-how. • Personal satisfaction. • Franchisor assistance.
Disadvantages of the franchisor	Disadvantages of the franchisee
<ul style="list-style-type: none"> • Wrong selection of the franchisee. • Less control over the business. • The misuse of the trademark or commercial name. • Strong initial investment for the development of the franchise. • Risk that the franchisee does not pay the royalties. • Risk of low profitability indexes. 	<ul style="list-style-type: none"> • Restrictions to innovate the product, service and design. • The initial cost can be high. • Short term of the franchise contract. • The intervention of the franchisor. • The franchisor may be irresponsible. • Limitations in decision making.

Table 1: Advantages and disadvantages of the franchise

1.6.1 Advantages of the franchisor

- Speed in business expansion

When the franchisee is granted the right to exploit the trademark and market products and services it is easier to enter, grow and adapt in a new market.

- Greater efficiency in the development and maintenance of new markets

One of the main problems for entrepreneurs when they want to open a shop in another country is when they do not know anything about that country, but in the case of franchises this problem does not exist, because the franchise is managed by a person belonging to that country who knows the culture, customs, language, economic and political factors, so the maintenance and control is much easier (Bogotá Emprende, 2009).

- Better control and operation of the franchise

There is greater efficiency and responsibility in the management of the franchise, because the franchisee feels motivated and supported constantly by the franchisor, which inspires him or her to perform the work in the best manner and comply with all obligations and requirements that the franchisor imposes, so it causes the franchise to have greater success and profitability, which is the most convenient for the franchisor (Alonso, 2004).

- Satisfaction for the success of the franchise

The moment when a franchise enters a new country there is the risk that it may not have the expected success, but when a franchise has great recognition and profitability the franchisor feels satisfied, because the product or service has satisfied the needs of that market, obtaining greater recognition and profits which improves its image within the market.

- Collection of initial fee for the use of the brand

To be part of the franchise network, the franchisee must make an initial payment for the right to use the trademark, so with this payment the franchisor benefits, because it helps to recover the investment in a shorter time (Morejón, 2009).

- Collection of royalties usually monthly

The franchisee must make monthly payments to the franchisor for the maintenance and development of the franchise. These payments include: the use of the trademark, the

design of new products or services, supervision and control of the establishment, advice, image development and publicity, which represents an advantage for the franchisor because the expenses are shared with the franchisee.

1.6.2 Advantages of the franchisee

- Low advertising expenses

The implementation of advertising in any business is essential especially for franchises, because it helps spread the fame of the trademark and the products or services that are marketed, but the advertising costs are high. One of the advantages of the franchises is that the expenses are shared between the franchisor and the franchisee, which is a beneficial factor for the franchisee, because this person does not pay the expenses alone (Anzola, 2016).

- Lower risks when becoming part of a consolidated business

At the time of becoming part of a business which has been previously tested and has generated profitability, stability and consumer acceptance, the risks of loss or failure are lower, because the franchisee has the prestige, the image and the good reputation of the trademark (Bermúdez, 2002).

- Training and support by the franchisor

It is not an obligation that the franchisee has a background and advanced knowledge about the franchise, because the franchisor helps through operation manuals, training and advice about how to manage the business, which is an incentive and an advantage for franchisees, because if this person has any problem or inconvenience the franchisor's support is permanently available.

- Exclusivity in exploiting the know-how

This advantage is very important for the franchisee, because there cannot be other franchises of the same trademark nearby the territory where the franchise is established. The main purpose is to avoid competition and to ensure the optimal performance and success of the franchise (Gauchi, 2008).

- Personal satisfaction

As the franchisee has the right to manage his own business and feels like his or her own boss, such person feels motivated to do the work with greater effort, because the

relationship with the franchisor is only contractual and not dependent, so the successes and achievements of the establishment are a consequence of the work and efforts made by the franchisee.

- Assistance by the franchisor

The franchisee gets technical and commercial advice continuously and permanently during the length of the contract. The franchisor must provide all the necessary knowledge related to the development of the franchise, the choice of personnel and the business shaping.

1.6.3 Disadvantages of the franchisor

- Wrong selection of the franchisee

At the moment in which the franchisor decides to grant a franchise, it is important to be aware that he or she has to deliver the trademark, the secrets of the business, the products or services that will be marketed, the experiences that the franchisor has had and also the right that grants the franchisee to use the entire system, so for this reason the franchisor has to choose the franchisee correctly, because it includes a constant and medium or long term relationship that the franchisor must have with this person.

In addition, there are cases in which the franchisees decide to initiate legal actions due to lack of support and delays in the payment of the respective royalties or even some franchisees do not really understand the business model or the maintenance that should be given to the franchise, so they simply decide to abandon or neglect the business, which brings negative consequences and many problems to the franchisor such as the loss of money, loss of time in training the franchisee and other important factors (Morejón, 2009).

- Less control over the business

Within the franchises, one of the most important factors is that this business model can expand or grow under the supervision of another person who is the franchisee through a contract, in which the franchisor grants the right to direct and administer a franchise establishment in a specific country or geographical area, so at that moment the franchisor loses control over the business, because the person who will lead that unit to succeed or fail, will be the franchisee.

The main functions of the franchisor will be: provision of price recommendations, selection of employees and advertising; which is clearly a disadvantage, because the future of the business is in the hands of the franchisee, because that person is who decides to comply or not with the recommendations made by the franchisor.

- The misuse of the trademark² or trade name³

The trademark is the essence of the franchise, it is the element that directs it for its development, growth and helps create an image that will be communicated to the public. The franchisor has worked and made lots of efforts for a long time to get the reputation and prestige that the trademark has, but sometimes due to the irresponsibility of the franchisee that reputation can change due to the bad management of the franchise, bad customer service and dissatisfaction of consumer needs, which has serious consequences because the public perceives the entire brand as bad, prejudicing the entire franchise network (Morejón, 2009).

- Strong initial investment for the development of the franchise

To start with the development and growth of the franchise system the franchisor must invest a large amount of money to make it attractive to investors, because specialized studies of profitability, operation and advertising are needed, which are very expensive, but are necessary to have a correct and successful expansion.

From all these tests the franchisor must start looking for people interested in the business, but who are responsible and committed to the success of the franchise; from that moment the franchisor begins to recover the initial investment.

- Risk that the franchisee does not comply punctually with the payment of royalties

Sometimes the franchisee can be reluctant to comply on time with monthly payments, because the sales or profits of the franchise are too low or there is a lack of assistance from the franchisor, which represents significant losses to the franchisor (Anzola, 2016).

² Article 359.- "A trademark could be understood as any sign that is apt to distinguish products or services in the market." (Ingenios Code)

³ Article 415.- "A trade name may be understood as any sign that serves to identify a person or business establishment in the exercise of its economic activity and distinguish it from others that carry out identical or similar activities" (Ingenios Code)

- Risk of low profitability indexes

Because the profits are shared with the franchisee or, else, there cannot not be expectations regarding the results in the growth of the franchise, which affects to the fast recovery of the initial investment for the development of the franchise system.

1.6.4 Disadvantages of the franchisee

- Restrictions to innovate the product, service and design

The franchisee has few opportunities to innovate or create something, because everything is already established in the operation manuals of the trademark. The franchisee has the opportunity and the right to make improvements, which is beneficial for the franchisor, because he or she can obtain greater profits, prestige and a better image.

The problem is the limitations about what can be considered as improvements, because the franchisee cannot do anything that infringes the intellectual property⁴, which is the objective of the franchise. Also, this person cannot do anything that is considered as an invention that is "capable of satisfying all the formal requirements for the granting of a new patent⁵" (Morejón, 2009) so, this right of improvement is very limited and is a disadvantage for the franchisee, because he or she cannot make any improvement unless authorized.

- The initial cost can be high

The cost of a franchise depends on many factors such as the operating time of the franchise, the reputation of the trademark, the image, the acceptance by consumers, the positioning and degree of adaptation in the international market, so for this reason the price of obtaining a prestigious franchise is very high and often difficult to get, especially for franchisees who are starting in this business model.

⁴ "Intellectual property is related to the creations of the mind: inventions, literary and artistic works, as well as symbols, names and images used in commerce." (World Intellectual Property Organization, 2008)

⁵ Art. 267.- "A patent shall be granted for any invention of a product or a procedure, in all fields of technology, with the condition that it be new, has an inventive level and is capable of industrial application. Traditional knowledge is not considered a protected subject " (Ingenios Code, 2016)

- Short term of the franchise contract

In most cases the contracts that are signed between the franchisor and the franchisee are for a short time, generally these contracts are signed up for a period of 5 years and subsequently must be renegotiated. It represents a disadvantage for the franchisee, because the conditions and requirements established by the franchisor can vary and be more complicated or more expensive for the franchisee.

- The intervention of the franchisor

Within the franchise, even though the franchisee is the person in charge of managing their own establishment, he or she should be willing to comply with the conditions and recommendations made by the franchisor about how to manage the business, which may cause problems, because the franchisee and the franchisor may have different points of view and different interests.

- The franchisor could be irresponsible

The success of the franchise does not depend only on the functions performed by the franchisee, but also the functions of the franchisor who sometimes is not the person who seems to be, because this person could be irresponsible and unethical.

Also, in some cases, the franchisor does not provide the necessary advice to the franchisee or does not give recommendations for the management of the establishment, among other inconveniences, that situation represents a serious disadvantage for the franchisee, because the business can fail and even lose the investment (Gauchi, 2008).

- Restrictions

There are limitations in the decision-making process in regards to the policies and management of the establishment, because each decision has to be consulted with the franchisor.

1.7 Obligations and rights of the franchisor and the franchisee

At the moment in which the parties, in this case franchisor and franchisee decide to sign a franchise contract, they acquire several obligations and rights to which they have to abide. It is important to mention that in each contract this may vary depending on the type of franchise and the market in which the franchisee is located, but the most frequent are:

1.7.1 Obligations and rights of the franchisor

- Transfer of "know-how", the necessary knowledge and operating manuals for the management of the business, also provide assistance and initial training for business success.
- Register or patent correctly the elements that will be granted to the franchisee, such as the commercial name, trademark and other distinctive signs⁶, so that the franchisee can enjoy without any problem the benefits of the franchise.
- Provide protection and advice in the event of any inconvenience with third parties in a quick and continuous manner to the commercial property⁷ that was granted and inform about any change or modification that occurs in the franchise system, mainly in the trading strategy of the network (Sánchez, 2000).
- Grant territorial exclusivity to avoid any kind of problems or disputes between franchisees and ensure the profitability of each of the establishments.
- Quality control, production, uniformity and presentation of the products or services that the franchise network offers to the franchisees to ensure the satisfaction of consumers.
- Advise and support the franchisee in the selection of personnel, establishment, decoration, image, marketing techniques and other functions performed by the franchisee.
- Obligation to supply the products or services, which are required by the franchisee to market them so customers do not lose loyalty to the trademark.

⁶ Art. 459.- "A well-known distinctive sign should be understood as the one which is recognized in the country or in any member country of the Paris Convention, ADPIC, or other country that maintains industrial property treaties with Ecuador." (Ingenios Code, 2016)

Among the distinctive signs, are: "Trademarks, Commercial Slogans, Trade Names, Distinctive Appearances and Denominations of Origin" (IEPI, 2017)

⁷ "Exclusive right granted by the State to use or exploit industrial and commercial inventions or commercial indications to distinguish products or services" (IEPI, 2017)

Article 263.- "The first request for the granting of an invention patent, utility model, industrial design or trademark registration, validly presented before a national, regional or international authority with which Ecuador was bound by a treaty that establishes a right of priority will grant the applicant or the successor of this person a right of priority to apply in Ecuador for a patent or registration on the same subject. The effects of the right of priority will be those provided for in the Paris Convention for the Protection of Industrial Property. " (Ingenios Code, 2016)

- Guarantee of the existence and legitimacy of the prerogatives granted to the franchisee, and recognize that during the term of the contract, this person has the right to exploit and use the franchise.
- Determine and announce to the franchisee the causes and acts that may cause the termination of the franchise contract.

1.7.2 Obligations and rights of the franchisee

- Formalize the contract. In the case of Ecuador, it must be registered in the IEPI. According to what was stated in the interview with the regional deputy director of Cuenca of the Ecuadorian Institute of Intellectual Property (IEPI), Dr. Susana Vázquez:

"For the registration of the contract, first the franchisor must go to the IEPI to make a phonetic search and make sure that there are no similar or identical trademarks that are already registered, then this person has to present a copy of the franchise contract, pay the fee and request registration to the IEPI through a form. "

Also, on the "Ingenios Code", it is stated that:

"Article 376.- Registration of transfer or license contracts.- The national authority with jurisdiction over intellectual property rights will not register the contracts in which the license is transferred or granted for the exploitation of trademarks that do not comply with the provisions of the Common Regime of Management of Foreign Capital, Trademarks, Patents, Licenses and Royalties, or that do not comply with the community or national provisions on restrictive commercial practices of free competition and unfair competition. Otherwise, the provisions of the Applicable Law of Regulation and Control of Market Power will be applied in compliance with the corresponding sanctions about this subject. Sub-licenses will require the express authorization of the rights the owner is entitled to exercise. "

- Exploit the franchise as agreed in the contract complying with the appropriate quality indexes and abiding by the indications provided by the franchisor regarding the stock of products, personnel hiring, retail prices, business management techniques, advertising and others.

- Avoid any type of transformation related to the exploitation of the franchise, without prior consultation and consent of the franchisor, if the franchisee were to proceed in such manner, this act will be considered as bad faith⁸ and unfair competition⁹, because all of the activities and decision-making acts that are related to the exploitation of the franchise are of exclusive will of the franchisor.
- Comply with the payment of royalties and fixed fees as agreed in the contract, such as: the right of entry, which must be paid by the franchisee to enter the franchise network and the payment of royalties in monthly instalments for the exploitation of the franchise. These payments can be made in national or foreign currency as agreed by the parties.
- Obligation to keep the information and content of the franchise system as a secret with the purpose of preventing that the franchisor's techniques and practices can be used by competitors, for this reason within the contract certain clauses are established to avoid this type of situations.
- Promote the development and growth of the franchise, because the success of this business model is based on the expansion to a greater number of markets.
- Exclusive provisioning of the franchisor or suppliers authorized by this person, of machinery, products and necessary equipment, because these suppliers are necessary for the development, prestige and image of the establishment and the franchise network.
- Prohibition to compete, which is not finished with the termination of the contract. The franchisee cannot offer or sell products or services of other trademarks in the establishment without the authorization of the franchisor. Also, the franchisee cannot communicate the secrets of the franchise to competitors or continue to exploit the distinctive signs when the contract has ended.
- Comply and follow all the instructions and the training program provided by the franchisor.

⁸ Art.950.- "The possessor in bad faith is responsible for the deterioration that the thing has received due to his or her fault". (Civil Code, 2005)

Art. 957.- "The good or bad faith of the holder refers, relatively to the products, to the time of perception, and relatively to the expenses and improvements." (Civil Code, 2005)

⁹ Art.25.- "Any fact, act or practice that is contrary to honest customs or practices in the development of economic activities, including those conducted in or through the advertising activity, is considered disloyal. The term "economic activities" involves an ample understanding that includes trade, professional, service and other activities. "

(Law for the Implementation of Regulation and Control of the Power of Market, 2011)

1.8 Perspectives of the franchise

The franchise can be analyzed from different points of view, considering that each of the perspectives are of vital importance for the development of such type of business. The success of a franchise is based mainly on the relationship between the franchisor and the franchisee.

The main factors or components are: communication, support and advice from the franchisor when the franchisee needs it or requests it, the degree of satisfaction of both parties, the fulfillment of the obligations by the franchisee, taking into account the laws of each place where the franchise is located. During the last years, this business model has had great expansion and recognition at an international level, so Francisco Pérez, recognizes the importance of defining each of these five perspectives.

- Economic perspective

The franchise is based on the fact that the franchisor has already established the business, so this person decides to grant the rights to exploit it to independent investors, who are meant to be part of the franchise network and to run with their own business risk, but under certain control of the franchisor, to maintain the uniformity of marketing of the products or services and maintaining the prestige, which is recognized by consumers.

The franchisee is responsible for controlling the income and employees of their establishment, which benefits both parties. The main economic advantages are:

- Elimination of intermediaries.
- Motivation of the franchisee to develop the business.
- Satisfy the needs of consumers.
- Greater employment opportunities.

- Legal perspective

The nature of the franchise is contractual, so the parties are part of this business model through a written contract, which establishes rules and penalties in case of default by any of the parties, so it must have a correct regularization, because there may be unethical or illegal behaviors such as improper exploitation, breach of agreed

responsibilities, among others, which damage not only the parties involved but also the franchise system.

Investing in a franchise is a great opportunity for the franchisor and the franchisee, but prior to making such an investment or signing the contract, the parties must clearly understand what the network of franchises involves and have the support of a qualified lawyer and specialist in the subject of franchise, who can advise in the best way.

Within the legal scope there are certain legal elements that cannot be absent from the franchise contract, which are established by the author Aníbal Arreulas Villafuerte in his work "*The Commercial Franchise Contract in the Ecuadorian Legislation.*" The first element is consent, "In contractual and commercial law, this element must be unobjectionable, so that it cannot be used as an argument in the future in regards to the existence of defects that cancel the legal effectiveness of the contract for lack of essential requirement " (Arruelas, 2014).

Another element is the legal capacity that a person has to acquire rights and obligations; the third element is the basis and the lawful purpose, the lawful purpose refers to "complying with the laws, morality and public order; or, at least, not perform acts prohibited by such rules " (Cabanellas, 1981) and the lawful purpose within the Civil Code of Ecuador in Art. 1477, third paragraph states" If the object is a fact, it must be physical and morally possible. It is physically impossible to oppose nature, and morally impossible, the act that is prohibited by law, or contrary to good morals or public order. "

The will is another of the indispensable elements, because the parties to enter into a contract do in such way freely and by mutual agreement. The last element is the fulfillment of certain legal formalities, such as the presentation of the franchise contract in writing and the subscription of this by a Notary Public.

- Commercial perspective

The expansion and growth of a franchise is based on attracting more and more people interested in the business with the advantage that the success and profitability of it is already consolidated, due to years of operation and knowledge and experiences that the franchisor has. The main purpose of the franchise is to achieve a consolidated business relationship between the franchisor and the franchisee, to have greater benefits and have a greater flow of purchases and sales between the parties to obtain higher profits.

The franchisor is the person who was in charge of developing his idea and perfecting it, getting to materialize it in the establishment of the business to market it to interested people. The franchisee is the person who had the necessary financial and human capital in order to obtain the franchise and cooperate for its growth.

The main commercial factors for the success of a franchise are:

- Needs of consumers or customers.
- Identification of the clients and the segment to which the franchise is directed.
- Determination of the potential and actual demand of the business.
- Strategic decision making.
- Implement positioning and advertising systems.

- Business perspective

The franchises are considered as a business, which encourages people to develop their entrepreneurial spirit, but it must be taken into account that within the existing relationship between the parties, the franchisee is not entirely independent. For this reason, it needs the approval of the franchisor to make certain decisions about the business.

In order to avoid problems between the parties, the policies to be followed, operational and control jurisdictions, interests and aspirations are established through mutual agreement, and even to motivate the franchisee to contribute creative and innovative ideas that help the franchise to grow.

The main reasons that motivate investors to be part of a franchise are:

- Be part of a group and a trademark that is recognized by consumers.
- The need for the investor to realize achievements through post-sale satisfaction and to run with fewer risks than in other businesses.
- The perception and evaluation of the franchise.

- Socioeconomic perspective

The franchises usually have a very rapid expansion and growth, reaching large cities and smaller places, managing to share technology, development and other factors that

not only favor the franchise but also the other businesses around where they are established. In particular, within small cities, franchises offer several economic and social benefits such as:

- Innovation in commercial structures.
- Creation of more stable companies.
- Increase of the employment rate.
- Access to new technologies.
- Encourage development and innovation.

1.9 Characteristics of the franchise

The main aspect that must be analyzed in order to ensure the success of a franchise according to Ailed Morejón Grillo is the behavior of the market, feasibility studies, tastes and preferences of consumers, prices, production costs, competitors and the demand for the product or service that will be offered in a certain market. The main characteristics of a franchise are:

- Ensure the marketing of products or services, based on the prestige that the franchise has acquired over the operational years.
- The sale of the products or services is not limited to a specific place, because one of the most important factors is the expansion of the franchise.
- Grant the franchisee the exclusivity of a specific place, in which the franchise will be established.
- Communicate information to the franchisee about the commercialization of the products or services, the management of the business and the "know-how".
- It is a business that has already carried out several feasibility tests.
- Consolidation of the relationship between the franchisor and the franchisee, with the purpose of improving the franchise system, exchanging innovative and creative ideas about the franchise and the products and services to be offered.

- Determines the initial and monthly payments that the franchisee must make to the franchisor.
- Motivates the franchisee to participate in the development and growth of the franchise.
- Offers the possibility of renewal, cancellation or renegotiation of the franchise agreement, depending on the parties' compliance.

Conclusion

To conclude with the information provided in the first chapter, the purpose is to perform an analysis about the generalities of the franchise, in order to be clearer and to detail the different topics that it involves, such as: the origin, various meanings from the perspective of several knowledgeable authors about the subject, to consider that as in any business, the franchise also has advantages, disadvantages, obligations and rights that franchisors and franchisees must meet at the time they decide to be part of this model of business. It is very important to understand the characteristics and the different perspectives it covers, such as: economic, legal, business, socioeconomic and commercial.

It is necessary to consider special emphasis on the legal aspect, due to the importance it has at the time of obtaining and establishing a franchise. In this chapter many characteristics of the franchise have been detailed to know more about how this system is developed and expanded, which represents a great attraction for investors and other people who are interested in establishing a business.

CHAPTER 2: NATIONAL AND INTERNATIONAL LEGAL FRAMEWORK

Introduction

The legal study is relevant, because through the franchise agreement the parties initiate a contractual relationship in which they must comply with everything established in the contract. This chapter takes into account the legal basis at the international level, so it is important to analyze the following legal bodies: the Model Law for the disclosure of information regarding franchising, issued by the World Intellectual Property Organization; Colombian laws: Commercial Code, Civil Code; supranational norms, such as the decisions of the Andean Community: Decision 486 and 291; French regulations, such as: the European Code of Ethics for franchising, the Paris Convention for the Protection of Intellectual Property and the Civil Code; and, at the national level: the Civil Code, the Commercial Code, the Ingenios Code, the Production, Trade and Investment Code, the Labor Law Code and the Project of the Commercial Code.

The purpose is to know the differences and similarities between the regulations of the different countries, which have been analyzed in relation to the French franchise "NAF NAF", in which its largest representative and responsible for granting franchises within Latin America is the company "Grupo Uribe ", with residence in Colombia, who grants the franchise to Ecuador, especially Cuenca. It is important to note that, in the evaluated countries, the regulations for companies, which are detailed in the study of this chapter, highlight that the franchise contract in all of these countries is atypical and based on the will of the parties, different from other countries such as: Canada, United States, Mexico and Spain, where this contract is regular.

2.1 International legal base

Taking into account that the issue of franchising is developed at the international level, it is very important to know the legal frame and also the applicable guidelines related to the contract in Colombia and France, due to the development that "NAF NAF " has had in these two countries.

Model franchise disclosure law

This optional law is mentioned due to its importance in the franchise, because it is considered a guide for all the member countries of UNIDROIT. It contains recommendations and guidelines on the correct handling of the franchise by the parties involved.

This model law was created by the International Institute for the Unification of Private Law (UNIDROIT), which is an intergovernmental organization created in 1926, the headquarters are in Rome. Its main objective is to find the procedures and necessary methods to modernize, coordinate and harmonize private law, especially commercial law in order to create legal instruments, rules and principles.

It is composed of 63-member states, corresponding to the five continents, including Ecuador, Colombia and France. The funding of this organization is given through the annual contributions made by its Member States (UNIDROIT, 2016).

For the creation of this guide and its explanatory report, UNIDROIT considered that currently the franchises have a great growth within the national economies and that this model law would be of great help to provide legislators and legislative procedures to resolve problems related to the franchise, avoid fraud, having the possibility that the parties have the same information within the contract and knowing if the laws related to this topic are applied correctly.

It is important to consider that it is not mandatory, so it is a simple recommendation for all countries, those who have specific legislation on the subject of franchises and for those who keep the atypical contract.

"The Model Law aims to encourage the development of the franchise as a negotiating instrument. As a document that favors commerce, it recognizes that franchising offers the potential for greater economic development, particularly among countries that want to have access to know-how " (UNIDROIT, 2016).

Within the Model Law in its first article, it is recognized:

“(1) This law applies to franchises to be granted or renewed for the operation of one or more franchised businesses within the [State adopting this law].

(2) Except as otherwise expressly provided in this law it is not concerned with the validity of the franchise agreement or any of its provisions.”

In the second article, there are several detailed definitions related to the subject of franchising, such as:

“Development agreement: means an agreement in which a franchisor in exchange for direct or indirect financial compensation grants to another party the right to acquire more than one franchise of the same franchise system.”

“Disclosure document: means a document containing the information required under this law.”

In article 3 of the model law it is established that the franchisor must provide the franchisee a document that includes all the necessary information along with the proposal of the contract in a period of 14 days, before:

- The franchisee's signature on everything related to the franchise agreement, unless the agreements are about the confidentiality of the information already granted or soon to be granted by the franchisor.
- Payment by the franchisee to the franchisor about obtaining a franchise with the condition that it is not reimbursable.

Article 6 of the model law refers to the information that must be disclosed by the franchisor within the information document, detailing the following:

- “The legal name, legal form and legal address of the franchisor and the address of the principal place of business of the franchisor;
- The trademark, trade name, business name or similar name, in which the franchisor performs or intends to perform a business in the State in which the prospective franchisee will operate the franchise business;
- The address of the franchisor’s principal place of business in the State where the prospective franchisee is located;
- A description of the franchise to be operated by the prospective franchisee;

- A description of the business experience of the franchisor and its affiliates granting franchises under substantially the same trade name;
- The names, business addresses, positions held, and business experience of any person who has senior management responsibilities for the franchisor's business operations in relation to the franchise;
- Any criminal convictions or any finding of liability in a civil action or arbitration involving franchises or other businesses relating to fraud, misrepresentation, or similar acts;
- The total number of franchisees and company-owned outlets of the franchisor and of affiliates of the franchisor granting franchises under substantially the same trade name;
- The names, business addresses and business phone numbers of the franchisees, and of the franchisees of any affiliates of the franchisor which are granting franchises under substantially the same trade name whose outlets are located nearest the proposed outlet of the prospective franchisee, but in any event of not more than [X] franchisees, in the State of the franchisee and/or adjoining States, or, if there are no adjoining States, the State of the franchisor;
- The following information regarding the franchisor's intellectual property to be licensed to the franchisee, in particular trademarks, patents, copyright and software: the registration and/or the application for registration, if any, the name of the owner of the intellectual property rights and/or the name of the applicant, if any; the date on which the registration of the intellectual property rights that are conferred expires; and litigation or other legal proceedings, if any, which could have a material effect on the franchisee's legal right, exclusive or non-exclusive, to use the intellectual property under the franchise agreement
- In the State in which the franchised business is to be operated; information on the categories of goods and/or services that the franchisee is required to purchase or lease;

- Financial matters, including: an estimate of the prospective franchisee's total initial investment; the funding offered or arranged by the franchisor, if any; the financial statements of the franchisor and when available audited or otherwise independently verified financial statements, including balance sheets and statements of profit and loss, for the previous three years. Franchisors, the creation of which goes back less than three years, are under an obligation to disclose the same documents that were issued since they began their activity;
- A description of: the state of the general market of the products or services that are the subject of the contract; the state of the local market of the products or services that are the subject of the contract; the prospects for development of the market;
- The following information shall also be included in the disclosure document. However, where the information is contained in the franchise agreement, the franchisor may in the disclosure document merely make reference to the relevant section of the franchise agreement. Where the following items of information are not included in the proposed franchise agreement, that fact shall be stated in the disclosure document: the term and conditions of renewal of the franchise, if any; a description of the initial and on-going training programmes; the extent of exclusive rights to be granted ; the conditions under which the franchise agreement may be terminated by the franchisor and the effects of such termination; the conditions under which the franchise agreement may be terminated by the franchisee and the effects of such termination; the limitations imposed on the franchisee, if any, in relation to domicile and/or to customers; the initial franchise fee, whether any portion of the fee is refundable, and the terms and conditions under which a refund will be granted; other fees and payments; restrictions or conditions imposed on the franchisee in relation to the goods and/or services that the franchisee may sell.

2.1.1 Colombian Laws of franchises

In Colombia there is no legislation that regulates franchises. It is essential to analyze Commercial Code and the Civil Code, because in these regulations, there are descriptions of the obligations and other details related to the contracts in general. In addition, there will be an analysis of the Technical Standard No. 5813 and the Code of

Ethics for the franchises in Colombia that are not clearly laws but are guides that provide recommendations about the correct way in which the parties involved should develop a franchise. "NAF NAF" Colombia is located at Carrera 52 # 7 30 Medellín, Colombia (NAF NAF Colombia, 2016).

2.1.1.1 Colombian Commercial Code

This Code is analyzed for its importance regarding contracts in general, highlighting that, although it does not regulate the franchise contract, it contains regulations related to merchants, agents, intermediaries, representatives of national and international firms and commercial establishments, that are involved with the activities of a franchise.

Article 4 of this Code provides:

"The agreements in the contracts will have validity over the supplementary legal frame and commercial uses."

Within article 28 in the first paragraph, it is detailed that all the persons who carry out commercial activities such as: agents, brokers, intermediaries, commission agents and representatives of national and international firms, must register the month following to start the activities in the commercial registry.

In addition, article 516 establishes the elements that are part of a commercial establishment, being the most related to the franchise, the following:

- The trademark of the products or services offered and the commercial name.
- Right of the employer for industrial or artistic inventions used for the activities of the establishment.
- Merchandise in the establishment or in the process of production.
- The obligations and mercantile rights that are related to the establishment activities.

In the "Third Book of commercial goods: Title II of industrial property", it is mentioned that within Decision 486 of the CAN, the following issues related to industrial property are highlighted:

- "The right of property that every national has to apply in the Member Country of a patent of invention or the registration of industrial design or trademark. It indicates the documentation that must be submitted with the application, the deadlines and other forms for its viability and concession.

- The granting of compulsory licenses in the event that the owner has not exploited the patent in the terms that the law establishes.
- It is explained the meaning and the process to register (...) slogans, trade names, labels or signs and distinctive signs. Likewise, there is a specific chapter that described the relevant actions at the moment of infringing a right or in the case of practicing unfair competition. "

It is necessary to emphasize that Ecuador and Colombia are part of the Andean Community, so the decisions are applied to both countries, so for that reason it is important to analyze them.

In the article 824 of the Commercial Code establishes that merchants must express their will to be bound in writing, verbally, or any other way.

This code defines the contract as:

"An agreement of two or more parties to constitute, regulate or extinguish between them a legal patrimonial relation and unless otherwise agreed, the contract has to be celebrated in the place of residence of the proponent and at the moment in which this person receives the acceptance of the proposal. "

In article 871 of the Commercial Code, it states:

"Contracts must be executed and concluded in good faith and the parties must comply not only what has been expressly agreed, but also with everything that corresponds to the nature of the contracts, according to law, custom or the natural concept of equality."

In Article 909 of this Code, it is determined that all expenses that arise in the execution of the contract must be divided equally between the contracting parties, unless they agree otherwise.

2.1.1.2 Civil Code of Colombia

This Code is of great importance, because it indicates the particularities of the contract in general, the obligations and requirements that the parties involved have to comply at the time of adhering to it, highlighting that this law does not regulate the franchise contract, but the provisions can be applied and used for this type of contract.

In article 1494, it is detailed that: "The obligations arise from the actual contest of the wills of two or more persons, as in contracts or conventions; (...)"

Within article 1495, the contract is defined as:

"An act by which one party is obligated to another to give, do or not do something. Each part can be formed from one or many people. "

Article 1501, determines that every contract comprises the things that are of its essence, and without these, the contract does not cause any effect or changes into another contract; those that belong with its normality, those that belong to the contract without the need of a special clause; and finally, the purely accidental, which do not belong either essentially or naturally, but are added by a special clause.

The main requirements for a person to be forced to another by a declaration of wills, according to Article 1502, are:

- Be legally capable.
- Express consent in the act or declaration.
- Have an effect on a lawful object.
- Have a lawful cause.

In article 1517, it is established that the declaration of will must have an object or more things that a person wishes to give, do or not do. The simple use of the thing or its possession can be object of the declaration.

In article 1518 it is determined that the things, which are object of the declaration of will, may be those that already exist or that are expected to exist, which must be defined in relation to their gender, but their quantity may be uncertain.

Article 1524, states that there cannot exist obligation without lawful and real cause, which should not necessarily be expressed, pure liberality or beneficence is sufficient.

"Cause is understood as the reason that induces the act or contract; and for unlawful cause, the one prohibited by law, or contrary to good morals or public order. "

Article 1602 provides that any contract that has been legally executed constitutes a law for the contracting parties and cannot be invalidated except for their consent or for legal reasons.

In Article 1603, it is established that all contracts are executed in good faith and obligate not only the parties that appear in the same but all the things that originate from the obligation or the ones that correspond by law to the contract.

Article 1611, refers to, "The promise to enter into a contract does not produce any obligation, except in the following circumstances:"

- Appear in writing.
- The contract to which the promise refers is not declared by the laws as ineffective because it does not contain all the requirements established in article 1511, in which it is determined: "The error in fact vitiates the consent when the substance or essential quality of the object of the act or contract is different from what is believed " (Colombian Civil Code, 1887).
- The promise includes the term in which the contract will be celebrated.
- The contract is clearly determined, so at the time of perfecting it, only the tradition of the thing or the legal formalities is lacking.

Article 1625, establishes that any obligation can be extinguished by an agreement in which the parties agree to give it for null. In addition, they can be extinguished by:

- The cash payment.
- Renewal of the agreement, which is: "the replacement of a new obligation with a previous one, which is therefore extinguished." Art.1687 (Colombian Civil Code, 1887)
- Confusion.
- Compensation.
- Loss of the basis
- Declaration of nullity.
- Prescription.

2.1.1.3 Colombian Technical Standard (NTC 5813)

This norm was created by the Colombian Institute of Technical Standards and Certification (ICONTEC), this non-profit entity is responsible for supporting producers and consumers. It collaborates with the government and private sector to get better benefits competitive in the internal and external market. This standard provides the general requirements and good practices for the pre-contractual, contractual and post-contractual stages of the franchise. It was ratified on December 15, 2010. This norm is voluntary and can be used by franchisors and franchisees.

This standard contains the main requirements and good practices that must be comply by both parties involved in the contract: franchising companies must have several elements that help to build loyalty, provide confidence and security and improve relationships with franchisees, through transparent negotiation, while these persons must take into account some criteria, recommendations and requirements to evaluate a franchise and know if it is appropriate or not to invest in this business.

Within this norm are explained the meanings of the main elements that form part of a franchise, the obligations of the franchisor, description of the know-how, organizational structure, financial viability, technical assistance by the franchisor, the principal manuals of the franchise and the contractual relationship between the franchisor and the franchisee.

2.1.1.4 Code of ethics for franchises in Colombia:

The main reason to examine this Code of Ethics is the importance that it has in Colombia and in other countries that have taken it into account the recommendations and practices to protect the interests of the parties and help to achieve the correct operation of the franchise, with the aim of achieving recognition and success in the market in which it develops, highlighting that this Code is simply a guide or recommendation, whose application is not mandatory.

This Code was created by the Colombian Chamber of Franchises COLFRANQUICIA, is formed by natural and legal persons, being part of this group, the franchisors whose business is based on the granting franchises in Colombia, people interested to exploit the business model of franchising and finally it is formed by consultants and advisors, specialists in the subject of franchises in the country. This Code became effective on December 4, 2012.

The objective of this non-profit entity is to organize all franchisors and other people involved to encourage cooperation in some sectors like the business and promote the study of the franchise from different points of view, also makes publicity and takes care of the interests of the people who are involved to promote good practices and behaviors to the users of the franchise in Colombia.

The Code in reference is not intended to replace any legislation or originate legal relationships between the parties involved in the contract but is the result of a thorough investigation of different codes of ethics and deontological about franchises, which have had great relevance and importance at international level.

Within this Code is the definition of franchise, then the guiding principles, as well as the obligations of the franchisor and the franchisee and what the parties should do in case of disputes, highlighting the following:

- To exhaust the necessary channels to resolve disputes in the best way, considering the good faith and will of the parties.
- When the franchisor believes that one of the franchisees committed any damage or infraction to the contract, whose seriousness does not incur in the immediate termination of the contract, the franchisee will be notified in writing, giving him or her a term to resolve the problem.

In addition, another important issue of the Code is the advertising and information delivered to the franchisee, so it is important to mention the following:

The advertising, propaganda and other materials delivered to the franchisee for the capture of advertising must be objective, not misleading and free of confusion

Prior to signing the contract, the franchisor will have to send a copy of this Code and a document called Uniform Franchise Offer Circular, which will contain all the economic, technical and commercial information of the franchise, detailing the following:

- Name, business name, nationality and domicile of the franchisor.
- Description of the franchise.
- Payments that must be made to the franchisor.
- Territorial coverage granted to the franchisee.
- Assistance and training provided by the franchisor.
- Right of the franchisee to grant or not subfranchises to other people.
- Obligations of the franchisee regarding to the confidentiality of the information provided.
- Conditions for the renewal of the contract.

In relation to the selection of the franchisees, it is established that the franchisor after conducting an investigation about the most important elements such as: basic skills, economic resources, training and personal qualities, will choose the franchisees that meet these requirements, with the objective that the franchise achieve the success and development expected by the franchisor.

Another issue covered by this Code is the franchise contract, highlighting the following:

1. The contract must comply with the provisions of this Code of Ethics and the Colombian legislation.

2. The obligation to protect the rights of intellectual and industrial property by the franchisee.

3. Establish the obligations and responsibilities of the franchisor and franchisee.

4. Detail the basic and essential information that the franchise contract should have such as:

- Rights and obligations of the parties.
- Product or service delivered to the franchisee.
- Amounts and payment terms.
- Duration of the contract and detail if the franchisees can amortize their initial investments. In the case of "NAF NAF", it is for an indefinite period.
- Possibility of renewal.
- If the franchisee has the possibility of granting the franchise to third parties, it is necessary to detail the conditions and rights under which the franchisee must do.
- The right to use and maintain the distinctive signs, trademarks, trade names, logos, signs and other intellectual property rights.
- The possibility of modifications or implementation of new methods to the franchise by the franchisor.
- Provisions on the termination of the franchise contract.

As a final disposition, it is determined:

"The provisions contained in this Code of Ethics should apply to the relationship between the franchisor and its franchisees, and equally between the master sub-franchiser and its sub-franchisees."

2.1.2 Decisions of the CAN

The Decisions of this Community are of great importance because Colombia, Ecuador, Bolivia and Peru are part of this community, so these binding rules are applied for these countries and for the other member countries, being the main issues of these decisions

the brands, patents, licenses, royalties and unfair competition, which are related to the franchises.

2.1.2.1 Decision 486

This Decision refers mainly to the protection and regulation of trademarks, patents, industrial designs, licenses, appellations of origin, unfair competition and in general, everything related to industrial property, based on the provisions of the World Trade Organization and the Paris Convention for the Protection of Industrial Property. This decision entered into force on December 1, 2000.

Within articles 1 and 2, national treatment and most-favored-nation treatment are explained:

Article 1 states that for protection of industrial property, each of the Member Countries must grant to the nationals of the other members of the Andean Community, the World Trade Organization and the Paris Convention for the Protection of Industrial Property, a treatment as well as its nationals. Also, the same treatment may be given to nationals of a third country, according to the provisions of the domestic legislation of that country.

In relation to the most favored nation, article 2 establishes that all the advantages, immunities or privileges must be granted equitably to all nationals of the Member Countries of the Community, the World Trade Organization and the Paris Convention for the Protection of Industrial Property.

These articles are essential, because Ecuador and Colombia are part of the CAN and consequently, this Decision applies to their nationals, who enjoy of these privileges and advantages for the protection of industrial property, which is one of the topics that are related to this investigation.

In Article 9, it is provided that the first application for a patent or trademark registration, that is exposed to any Member Country, or to a national or international authority, that is related to that country through an agreement, in which it is determined a right of priority similar to those established in this Decision, grants the applicant the right of priority to request its registration.

It is essential to emphasize that, within every franchise, there are some distinctive signs that are of vital importance for the development and existence of this business model, such as: the brand, the commercial slogan, the commercial name and the industrial secret, so it is necessary to detail the articles of the decision, which mention them:

Article 134 defines the trademark as:

"Any sign that serves to distinguish products or services in the market. The signs susceptible of graphic representation may be registered as trademarks. The nature of the product or service to which a trademark be applied will not be an obstacle for registration. "

The article 135 explains everything that cannot be considered as a trademark, indicating the following:

- Those that lack distinctiveness.
- Consist only in usual forms of the product or its packaging.
- It is a sign or indication that serves within the commerce to explain the quantity, quality, value, origin or other characteristics or information related to the products or services.
- Consists of an indication or sign that refers to the technical or generic name of the product or service.
- Produce confusion to the media and the public.
- Contain, reproduce or imitate a protected appellation of origin for the same or different products, causing confusion.
- Without the corresponding authorization, imitated or reproduced flags, emblems, marks, symbols and other signs related to the control and guarantee of the States or any other heraldic imitation.
- When they are contrary to the law, morals, good morals or public order.

In addition, trademarks cannot be registered for commercial use when they affect the rights of third parties.

In article 138 it is recognized that the application for the registration of a trademark must be submitted to the competent national office and it must include a single class of products or services, complying with all the requirements, which are:

- The petition.
- Reproduction of the trademark.
- The powers that are necessary.
- Proof of payment of the taxes imposed.

- If it is necessary, the certificate of registration in the country of origin, issued by the pertinent authority with the proof of payment of the established tax, in accordance with the provisions of the domestic legislation of that country.

Article 152 states that the registration of a trademark will have a duration of 10 years, counted from its granting and may be renewed for an equal period.

Article 154 refers to the fact that the right to the exclusive use of a trademark will be obtained by registering it in the respective competent national office.

Article 162, provides:

"The owner of a registered trademark or in the process of registration may license one or more third parties for the exploitation of the respective trademark.

Any license to use the trademark must be registered with the competent national office. Failure to register will cause the license to have no effect. For the registration, the license must be in writing. Any interested person may request the registration of a license. "

Article 175 establishes that commercial slogans may be registered as trademarks by the Member Countries, in accordance with the provisions of each of the national legislations.

Article 178 clarifies that the trademark must be transferred with the registered trademark to which it is associated and its validity will be the same to this distinctive sign.

Article 179 provides that the exclusive right of the commercial name is obtained from the first commercial use and ends when finalize the used of it or the commercial activities of the company or establishment.

In article 260, the industrial secret is defined:

"Any undisclosed information that a natural or legal person possesses legitimately, that can be used in any productive, industrial or commercial activity, and that is susceptible to be transmitted to a third party, so this information should be: "

- Secret, (...) in the sense that as a whole or in the precise configuration and meeting of its components (...), "it is not easily known or accessible, by people who" (...) are in the circles that normally know the respective information. "
- Possess commercial value for the fact of being secret
- Take measures by the possessor to keep the information secret.

In addition, the information that has to be disclosed by legal provision is not considered as an industrial secret.

Within Article 262, the unfair competition of business secrecy is explained:

"Who lawfully has control of a business secret, will be protected against the disclosure, acquisition or use in a manner contrary to fair trade practices by third parties. The following acts related to a business secret will constitute unfair competition: "

- Exploit it without authorization from its legitimate holder, which has been accessed subject to a reserve obligation, given by a contractual or employment relationship.
- Disclose the secret without the authorization of the possessor, with the purpose of obtaining own benefits or harming the possessor person.
- Obtain, use or disseminate it by illicit or adverse means to honest commercial uses.
- Exploit the business secret acquired from another person, knowing that the secret was obtained illegally or without the authorization of its owner.

2.1.2.2 Decision 291

It refers to the Common Regime for the Treatment of Foreign Capital, Trademarks, Patents, Licenses and Royalties.

Chapter IV, Article 14, determines the effects of the registration of external technology transfer contracts, trademarks and patents.

All Member Countries must take into account that the following clauses are not included in their contracts:

- "Clauses in which the supply of technology or the use of a trademark, carries with it the obligation for the country or the receiving company to acquire from a certain source, capital goods, intermediate products, raw materials or other technologies, or the clause to permanently use personnel appointed by the technology provider company; "
- Express that the company that sells technology or is in charge of granting the use of a trademark reserves the right to establish the sale or resale prices of the products that are manufactured based on that technology;
- Have restrictions on the volume and structure of production;
- Prevent the use of competing technologies;
- Oblige the buyer of technology to transfer to the supplier, the inventions or improvements that are acquired for the use of that technology;

- Require payment of royalties to holders of trademarks and patents, for those that have not been used or are expired;
- Other clauses with similar effects.

2.1.2 French legislation on franchises

France is one of the first European markets to venture within the franchise sector, it has had an impressive growth and success in relation to this business model, because most of the franchises established in Europe are of French origin, there is a minority of franchises of foreign origin. In addition, it is important to emphasize that the franchise contract in France is atypical and based on the will of the parties, because the franchisors prefer a contractual relationship based on freedom and commercial dynamism.

Also, it is interesting that France is one of the most influential countries in the world of fashion, due to the popularity and expansion of trademarks and designers from this country, which have achieved great recognition around the world, such as the case of "NAF NAF" franchise (Front Consulting International, 2016).

2.1.2.2 European Code of Ethics¹⁰ of the franchise

The analysis of this Code is essential, because it is considered one of the most important and used not only in Europe, but in other countries, which have taken this model for the creation of other similar codes, such as the Code of ethics for franchises in Colombia, because this code contains a lot of recommendations, advices and practices that help to maintain good behavior between franchisors and franchisees and promote the development of the franchise, knowing that it is optional and does not constitute a law for the parties.

This Code was created by the European Franchise Federation (E.F.F), which is an international non-profit association. It was established on September 22, 1972. It is formed mainly by associations or franchising organizations in Europe, such as: The Franchise Association of Finland, Italian Franchise Association, British Franchise Association (BFA), but also admits the entry of affiliated members, which can be organizations that do not belong to Europe or natural and legal persons related to the

¹⁰ It refers to a type of discipline that is based on the study of values, norms or criteria, on a specific field, but based on morals or ethics.

issue of franchises, but with the condition that these members cannot be directors of the federation and do not have the right to vote.

The objective of the federation is "the objective and scientific study of the franchise in all its aspects, the coordination of the actions of its members, the promotion of the franchise in general and the interests of its members in particular" (European Code of Ethics of the franchise, 1991).

The federation has two committees, the legal, which is formed by jurists specialized in the subject of franchises and the arbitration committee, which serves for the solution of conflicts or inconveniences existing between the parties.

"This Code of Ethics is the result of the experience and work of the F.E.F. and its members (Germany, Austria, Belgium, Denmark, France, Great Britain, Italy, the Netherlands and Portugal) in agreement with the Commission of the European Community " (European Code of Ethics of the franchise, 1991).

It contains the good customs and practices to establish a fair conduct of the franchise in Europe, protecting this industry, without the purpose of replacing the laws or regulations in force at national and international level. This code entered into force on January 1, 1991.

Within the first numeral of this Code the franchise is defined, highlighting some essential elements such as:

The legal and financial independence of the franchisor and franchisee, mentioning that the franchisee is the person responsible for the human and financial resources and acts performed in relation to the exploitation of the franchise. In addition, this person must contribute to the success of the network that have acquired.

The concept of this business model is based on three elements:

1. The right to use or exploit: trademark, trade name, company name, logos and other distinctive signs.
2. The exploitation of "know-how".
3. Products, services and / or technology that has been granted by the franchisor.

"The right granted authorizes and obliges the Franchisee, in exchange for a direct or indirect financial contribution, to use the distinctive and / or trademark of products and / or services, the " know-how "and other intellectual property rights, supported by the

continuous provision of commercial and technical assistance, within the framework and for the duration of the written franchise agreement, established between the parties. "

In relation to "know-how", it is defined as the set of unpatented practices, obtained by the experience of the franchisor and proven by this person. It is transmitted to the franchisee when acquiring the franchise, under the condition that it cannot be disclosed or used with the objective of damaging the network during the pre-contractual, contractual and post-contractual stages.

In the second numeral the general principles are established, the most important are the following:

- The franchisor is the owner of the franchise network, which is formed by this person and its franchisees, this network will help improve the production and distribution of products or services, promoting technical and economic development.
- The franchisor must: exploit the commercial concept for a reasonable time in a pilot unit before starting with the franchise network; be the holder of the rights over the distinctive signs that will be granted to the franchisee, which must have a duration equal to the contract and provide the franchisees the initial training and commercial and technical assistance during the term of the contract.
- On the other hand, the franchisee must: dedicate itself to the development of the franchise network and to the maintenance of its reputation; provide the franchisor with the necessary data on the financial statements and accounting information to guarantee effective management and direction of the establishment; and guarantee that "know-how" will not be divulged during or after the term of the contract.
- Both parties must: Proceed in an equitable manner in their contractual relationship so, if there is any breach by the franchisee, the franchisor must notify this person in writing and give a specific term to resolve it and solve all problems and complaints of goodwill, opting for negotiation and direct communication.

The following section mentions hiring, advertising and dissemination. This information is very similar to the Code of Ethics for franchises in Colombia. The most relevant information regarding to this topic is:

Advertising should not be confusing or possess misleading information. The franchisor must deliver a copy of this Code with all the information about the clauses of the contract in writing, before signing it. The confidentiality clauses must be specified in relation to the "know-how" and the duration of the contract.

In addition, other topics in which both Codes, the Ethics for franchises in Colombia and the European Deontological franchise, have great similarity is in the selection of franchisees and the franchise contract, being the points more Important to highlight:

- The contract must comply with the provisions of National, Community and Ethics Code.
- The relationship between the parties involved has to admit all the essential changes that help to improve the network and the service provided to the client.
- Permanent dialogue will be allowed, with the aim of providing solutions between the parties.
- Contracts, under which the relationship between the franchisor and franchisee is developed, must be written or translated into the official language of the country where the franchise is located.
- In relation to the renewal of the contract, the franchisor must advise with prior notice the intention of not wanting to renew the expired, old contract or sign a new one.
- At the end of the contract is necessary to detail the recovery clause of any material or immaterial element that belongs to the franchisor.

Finally, this Code establishes that it will not apply for the relations between the franchisor and the franchised master, however, it does apply for the relationship between the franchisee master and his franchisees.

It is important to establish that the European Code of Ethics of the franchise and the Code of Ethics for franchises in Colombia, have practically the same information, with the difference that the European must be accepted by several member countries. Also, it is important to note that it represents the basis for the development of the other codes related to the subject of franchises, such as the Code of Ethics for franchises in Colombia, so the European Code is one of the first to develop and enter into force.

2.1.2.3 Paris Convention for the Protection of Industrial Property

This agreement is one of the most important in this study, due to the fact that Ecuador, Colombia and France are part of its member countries, so its rules are binding for these countries, and the main issues analyzed by this agreement are the trademarks, commercial names and unfair competition, in order to ensure its correct use and protection, taking into account that these elements are basic for the analysis of the franchise.

It was adopted on March 20, 1883. Among its member countries are Ecuador, which is part of it since 1999, Colombia had its accession in 1996 and France in 1883. The objective of this agreement is the protection of patents, industrial models, trademarks, commercial names, utility models, appellations of origin and combating unfair competition.

Within Article 2 of the Agreement, it is established:

"The nationals of each of the countries of the Union enjoy in all the other countries of the Union, in relation to the protection of industrial property, the advantages that the respective laws grant currently or in the future to their nationals, (...) Consequently, they will have the same protection and the same legal recourse against any attack on their rights, as long as they comply with the conditions and formalities imposed on nationals."

This Convention can also be applied to nationals who are not part of the Union but are domiciled or have commercial or industrial establishments in any of the countries of the Union.

In Article 4, it is detailed that the person who has made the deposit of the application for a patent of invention, utility or industrial model or trademark, in any of the countries of the Union, can make the deposit of a right of priority¹¹ in the other countries.

The regular national deposit refers to "any deposit that is sufficient to determine the date on which the application was deposited in that country, whatever the subsequent fate of this request."

Article 5, in its literal c, details that the use of a commercial or industrial trademark by the owner, when its distinctive character is not altered, under which it was registered in any of the countries of the Union, will not cause the invalidation of the registry or the reduction of the protection granted to it. In addition, the simultaneous use of the trademark in similar or identical products by establishments considered co-owners, according to the provisions of the laws of the country that is claiming protection, will not prohibit the registration or diminution of the protection granted in any of the countries of the Union, when it is not contrary to the public interest, or confuses people.

¹¹ This right arises from the Paris Union Convention, is based on the term provided for a person who submits an application for an Intellectual Property right in any country member of this agreement, so this person can also do in others member countries, with the aim that both are recognized as valid and comply with the effects. The time to enjoy this right in the case of trademarks is 6 months. (Spanish office of patents and brands , 2015)

The conditions of registration or deposit of the trademark will be determined in each country according to what is established in its national legislation.

Article 8 provides that trade names will be protected by all the countries of the Union, without the obligation of registration, whether trade names are part of the trademark or not.

In relation to unfair competition in article 10, it is detailed that the following acts must be prohibited:

- Acts that create confusion in relation to the products, establishment or commercial or industrial activity of a competitor.
- False statements regarding commercial activities, which may injury or discredit the establishment, its activities or the products of a competitor.
- The indications in the exercise of trade, which may cause the public error of nature, characteristics, manufacture, mode of use or quantity of products.

2.1.2.4 Civil Code of France

This code is known as "Napoleonic Code" is one of the most famous internationally, was enacted on March 21, 1804. It has had several reforms and additions of new topics. The most recent modification was on March 2, 2017. It is important to emphasize that its articles do not specifically regulate the franchise agreement, this code contains issues that are related to this topic, such as bilateral contracts, mutual agreements, the elements and requirements that every contract must have.

Within article 1100 of this Code, it is established that the obligations derive from the acts, legal facts or through the authorization of the law. Also, obligations can be given by the voluntary execution of an act or by the promise of execution of a duty of conscience towards others.

In article 1101 the contract is defined as:

An agreement of wills between 2 or more people destined to create, transmit, modify or extinguish the obligations.

In addition, every person is free to contract or not, to choose the other part, establish the content and form of the contract according to the limits provided by law.

Article 1104 of the Code provides that every contract must be negotiated, formed and executed in good faith.

Article 1106 highlights the meaning of the bilateral contract, which is related to the franchise, because it is defined as: A contract in which the parties bind each other.

In addition, another of the contracts that has similarity is the contract of mutual agreement, defined in article 1110 as the one whose terms are freely negotiated between the parties.

In article 1113, it is detailed that the contract is formed by the fulfillment and acceptance of an offer or commitment, through which both parties demonstrate the will to participate.

Under Article 1119, it is provided that the terms and conditions imposed by one of the parties will be valid, when these are communicated and accepted by the other part. In case one of the parties does not agree with a clause, it will be without effect.

Article 1128, determines the elements necessary for the validity of a contract, which are:

1. Consent of the parties.
2. Have the ability to contract.
3. Establish legal and true content.

About the content of the contract, article 1162, states that the provisions and purpose of the contract cannot go against public order, regardless of whether it has been known or not by the parties.

Under Article 1211, it is determined that when the contract is for an indefinite period, either part may terminate it at any time, when it is respected with the deadline established for its notification or, it is announced to the other party within a reasonable period of time. This type of contract being the one used by "NAF NAF".

But if the contract is for a specific term, each of the parties must comply until its termination.

According to the provisions of article 1214, the definite term contract may be renewed as established by law or by mutual agreement of the parties. In case of renewal, the new contract is created with the same information to the previous one, but its duration is indefinite.

With respect to the breach of the contract, article 1231, specifies that the damages caused should be settled, only when the debtor has been formally notified to comply within a certain period, when the breach is not definitive.

In addition, the debtor must pay for damages caused by the breach of an obligation or by the delay in the execution of an act, when it is not justified that the breach was made by force majeure.

2.2 Ecuadorian laws: Current applicable regulations and reference to the project presented in the National Assembly

It is of vital importance to highlight all the legal norms that have certain relation with the subject of the franchises, because in Ecuador, this business model has had great growth and expansion. Currently, the franchise agreement is atypical, so there is no specific law to regulate this issue, for this reason it is based on the will and freedom of the parties at the time of contracting.

2.2.1 Civil Code

It is one of the most important standards in Ecuador, because it is of common interest for all citizens. In addition, with respect to the subject of the franchise agreement, that is not regulate in a particular way by the law, but despite of this, the Civil Code contains the obligations that must be fulfilled by the parties, the regulation of the contract in general and the cases of nullity.

This normative body has had several modifications, the last one was made on June 19, 2015.

Within article 1454, the contract is defined as:

"An act by which one party is obligated to another to give, do or not do something. Each part can be integrated by one or several people. "

In article 1455, the meaning of bilateral contract is explained, which has great similarity with the meaning of the Civil Code of France, expressed previously.

"The contract is bilateral when the contracting parties are reciprocally bound."

Article 1460 establishes that the contract is identified by 3 elements, the things that are essentially, being those that if missing leave the contract without effect; those that are by nature, defining as those that although not essential, are part of the contract without obligation of a clause and finally the accidental things, which do not correspond essentially or naturally to the contract, but are included through a special clause.

According to article 1461 of this normative body, for a person to bind with another by a declaration of will, it is essential:

- Be legally capable (A person can obligate without the authorization of someone.) (Civil Code of Ecuador, 2015).
- Consent in the declaration, and that it does not suffer from vice.
- That falls on a lawful object.
- Possess a lawful purpose.

Article 1476, states that the declaration of will must have as its object one or more things that are intended to be delivered, done or not done. It can be considered as the object of the declaration, the use or possession of the thing.

According to article 1483, it is determined that there can be no obligation without a real and lawful purpose, although it is not essential to express it. Pure freedom or benefit is enough.

In article 1486, it is detailed that the obligations can be:

- Civil: Grant the right to claim compliance.
- Natural: These obligations do not provide the right to demand compliance, but once these are in place, is allowed the withholding of what has been granted or paid.

In relation to the effect of the obligations, article 1561, states:

"Every legally executed contract is a law for the contracting parties and cannot be invalidated except by their mutual consent or for legal reasons."

In Article 1562, it is established that every contract must be made in good faith and obligates to comply with what is expressed in it and also all things that derive from the nature of the obligation or that correspond to it by law or custom.

In accordance with article 1583, the obligations may be extinguished fully or in part, by:

- "The convention of the interested parties, who are able to dispose freely of their own;
- The solution or effective payment;
- Novation; (Art.1644. It is the substitution of a new obligation to another obligation, which is, therefore, extinguished.) (Civil Code of Ecuador, 2015)
- The transaction;
- The referral;
- The compensation; (Art.1671. When two persons are debtors to each other, a compensation is operated between them that extinguishes both debts.) (Civil Code of Ecuador, 2015)
- The confusion;
- The loss of the item that is owed;
- The declaration of nullity or termination;
- The event of finished condition; (Art.1495) When a right is extinguished due to its fulfillment.) (Civil Code of Ecuador, 2015)
- The prescription."

About the nullity of the contract, article 1697, determines that a contract is void when any of the requirements established by law are missing, in relation to its kind and quality or state of the parties, because these requirements are necessary to make the agreement valid. Also, the nullity can be absolute or relative.

In article 1698, it is stated that nullity is absolute when it is taken for an unlawful purpose or cause, omission or some requirement or when it is celebrated by absolutely incapacitated persons.

About this subject, it is necessary to highlight the meaning of nullity, which refers to all acts or contracts that do not comply with the necessary requirements established by law to be valid or when it is prohibited by law. On the other hand, termination is defined as the ineffectiveness of a contract properly concluded by the performance of an action or event that causes harm to any of the parties, which causes the disability (Legal encyclopedia , 2014).

Clearly both terms are different, because the nullity occurs when one of the essential requirements is missing in the contract to be considered valid, so from the beginning it is invalid if what is established in the agreement is not carried out in full, and the termination occurs when the contract is already considered as valid, but with the existence of an act, that causes some type of damage to one of the parties involved, it is without effect.

2.2.2 Commercial Code

It has great relevance because this code regulates the commercial situation and the relationships that are generated, providing regulations and requirements that companies and persons involved in commercial activities have to observe. The main issue is the contract in general, focusing on the fact that it does not regulate the franchise contract, but provides guidelines that can be used in this area.

In the first article, it is established:

"The Commercial Code regulates the obligations of merchants in their commercial operations, trade acts and contracts, even if these are executed by non-merchants."

In article 6, it is determined that, according to the Civil Code, any person who has the capacity to contract, also has to exercise the trade.

Article 147 of the legal body that is analyzed determines:

"When the domicile of the contracting parties is in different places, it will be understood that the contract has been concluded, for all legal purposes, in the residence of the part who accepted the original proposal or the modified proposal."

In article 164, it is indicated that mercantile contracts will be approved by any means provided by civil law and also with:

- Extracts from brokers' books.
- Books of commercial brokers.
- Invoices accepted, or that are recognized by law.

In Article 165, it is detailed that when the law requires as a requirement that the contract must be submitted in writing, no other evidence can be allowed, so if this requirement is not observed, the contract will be understood as not celebrated.

2.2.3 Implementation Code of the Social Economy of Knowledge, Creativity and Innovation

Also known as Ingenios Code, which replaced the Intellectual Property Law. Its objective is to regulate the National System of Science, Technology, Innovation and Ancestral Knowledge. It applies to all people who perform activities related to the social economy of knowledge, creativity and innovation. It was published on December 9, 2016, through Official Gazette Number 899.

In article 88 of the legal body in reference, it is determined that intellectual property rights are an important tool that serves to "(...) the development of creative activity and social innovation (...)" and in turn these help the transmission of technology and innovation.

Article 89, details that intellectual property is divided into: copyright and related rights, industrial property and plant modifications.

Article 99 provides that transfers, application in process, license or authorization to use intellectual property rights must be registered with the competent national authority on intellectual property rights and will take effect thereafter.

In relation to the trademark, article 359, states:

"The following signs or means may constitute trademarks:

1. The words or combination of words;
2. The images, figures, symbols, graphics, logos, monograms, portraits, labels, emblems and shields;
3. The sounds, smells and tastes;
4. Letters and numbers;
5. A color delimited by a shape or a combination of colors;
6. The shape of the products, their packaging or wrappings;
7. The reliefs and textures perceptible by the sense of touch;
8. Animations, gestures and sequences of movements;
9. The holograms; and
10. Any combination of the signs or means mentioned in the previous sections. "

In article 370 of this Code, it is determined that the registration of the trademark does not grant its owner the right to prohibit third parties from using it to advertise, sell or show the existence of products or services that are legitimately marked, when it is made in good faith and used to inform the public and not cause confusion or error about the business origin of these products.

In article 380, it is recognized that a trademark is used when the products or services that possess the same, are "(...) placed on the market or available in the market under that trademark (...)", according to the adequate form and quantity, considering the nature and forms in which it is marketed.

In relation to the commercial slogan, in article 395 of the referred normative body, it is defined as:

"The word, phrase or legend, which is used to complement a trademark."

About the commercial names in article 415, it is detailed:

"A person or business establishment may have more than one business name. The commercial name may constitute a company name or other designation registered in a registry of persons or commercial companies. The commercial names are independent of the denominations or social reasons of the legal persons, so both can exist. "

Within article 422, it is detailed that the transfer of the commercial name must be carried out with the name of the company, where the activity identified under that commercial name is developed.

In the article 506, it is detailed about the undisclosed information, which in the case of the franchise could be the "know-how", establishing the following:

"Undisclosed information has the prerogative of effective protection against disclosure to third parties and unfair practices."

In relation to all the articles detailed above about the Ingenios Code, it is necessary to consider that these are of great relevance for the development of this research, because it covers issues that are essential for a franchise, such as intellectual property rights and the information related to industrial property, being the closest to this topic: the trademark and the commercial name, which are part of this business model and are transmitted to the franchisee for its protection and exploitation. This regulation is fundamental to understand the different meanings of these terms and also to know how these distinctive signs are transferred for their use in a correct way.

2.2.4 Labor Law Code

The study of this Code is of great importance, because in a franchise there is personnel who works for the franchisee, so these persons have to comply with the regulations and dispositions established in this legal body.

In the first article the scope of application of this code is detailed, mentioning the following:

"The precepts of this Code regulate the relations between employers and workers and apply to the different modalities and conditions of work."

In the case of "NAF NAF", established in Cuenca, the contract that the franchisee has with the employees is expressively set, being defined in accordance with article 12, as the one in which "(...) the employer and the worker agree to the conditions by speaking or writing. "

It is also important to note that this contract must be registered in the Ministry of Labor. In this case, it is the obligation of the franchisee of "NAF NAF" to provide insurance to all its personnel to the IESS with an employment relationship. In addition, the contract that the employees of this franchise have is indefinite.

2.2.5 Project of the Commercial Code

This project is one of the most important and relevant in relation to the issue of franchises, because one of the main proposals is the regulation of the franchise contract, with the aim of making it typical. It was presented by the Vice President of the Economic and Tax Regime Commission, Master Galo Borja, on November 11, 2015, when the president of the National Assembly was Licensed Gabriela Rivadeneira. Currently this project has gone through its first debate, so it is essential to study it, because at some point it can be approved by the current National Assembly and have full effect.

For the analysis of this issue, it is necessary to interview a professional in the field, Attorney Nicolás Muñoz, who is the Legal Advisor of the Chamber of Commerce of Cuenca and an associate of Sur Legal Estudio Jurídico. Currently, he uses his profession in the areas of intellectual property, corporate law and criminal law, so it is very important to include below what he expressed.

From the legal point of view, it is better that the franchise contract be kept atypical because the main advantages are: the autonomy of the parties, flexibility when

negotiating and signing the agreement. An important fact is when a small company intends to start and turn the business into a franchise, usually it does not have the necessary financial resources, because it is really expensive to make a franchise contract and have all the essential elements such as the "know-how", the registration of the trademark, legal and economic advice, so with the atypical contract, there is the possibility of negotiating with the franchisees to lower costs and grant a franchise that does not have so many demands.

On the other hand, for internationally recognized and famous franchises, it is assured that these persons have a team of trained professionals who were in charge of drafting a contract, which prevents any kind of problems that may occur in the future between the franchisor and the franchisee.

On the contrary, from the practical point of view, the best thing is that the contract is typical, due to the fact that the contracts are obsolete, which causes many controversies between the parties, so it is necessary a regulatory body that regulates this situation and prevents problems.

Also, the Project of the Commercial Code tries to avoid disappointment to franchisees, because in many cases the contracts contain information that confuses people, but through this code all the information must be detailed in a clear and concise manner, expressing everything that is included and also what is not in the franchise, so in this way everything must be exposed in the contract.

"From my personal point of view, the franchise contract should be kept atypical because the parties have some flexibility and freedom to negotiate. In addition, the franchises are a great business model and have a complete system, so both parties must participate and make decisions jointly, which mainly encourages the entrepreneurial spirit of franchisees and franchisors, because these persons are responsible for leading the franchise towards development and success. "

Based on what was stated by Lawyer Nicolás Muñoz, it is a good statement because the parties should have the possibility to change certain aspects that do not fit their interests and have more communication when hiring and ensuring for the benefit of both interested parties.

Continuing with the analysis of the project in reference, it is necessary to refer to article 581, which explains the meaning of franchising, noting that:

It is the contract within which one of the parties, known as franchisor or grantor, who is the owner of the trade name, trademark or any other form that helps to distinguish the

company, product or service, granted to another person known as a franchisee or taker, the right to commercially exploit all the activities under this name, trademark, other distinction, the goods or services, as established in the contract, in exchange for an economic retribution.

In article 582 it is determined that the franchise can be of products or services. In the products case, what can be allowed is the manufacture of a specific product for marketing or simply selling it. While in the services, the franchisee has to provide a specific service under the name and commercial techniques of the franchisor.

Article 584 of the project, provides that the franchise contract must be delivered in writing, with the possibility of adding annexes that explain the scope of the operation of the franchise.

In relation to the royalties paid to the franchisor, article 585 details that it is one of the most important elements and that can be agreed according to what is most convenient to the interests of the parties.

This issue is essential, so it is important to consider that there must be good communication between the franchisor and the franchisee, so they can establish the royalties, which adjust to their interests, taking into account that this payment must be as balanced as possible, so the parties are not affected.

Article 586 establishes that the franchise contract must contain all the necessary requirements for its validity and existence, or in its effect the following:

- Description of the rights and terms in which they are granted.
- Compliance guarantees delivered by the franchisee.
- The compensation for the franchisor.
- Determination of the location in which the franchisee will proceed.
- Establishment of the duration of the contract.
- Other terms and conditions that the parties have to observe.

In regards to the time of duration or extinction mode due to the expiration of the contract, article 587 recognizes that if the parties have not reached an agreement on this matter, the provisions of the distribution contract, which are found in article 571 of the project, details that this type of contract can be agreed for a fixed or indefinite time.

If a specific duration is not set, it will be understood that it is indefinite, so the other part has the option of notifying the other about its termination with a 90-day notice period, counted from the day after the notification and until the last day of the term.

On the other hand, it is important to highlight which are the elements that are an essential part of the franchise:

According to Article 588, one of the elements that are detailed in the franchise agreement is confidentiality¹², which refers to all verbal or written information that is delivered to the franchisee for protection in the pre-contractual stage or in the development of the contract.

In addition, in relation to confidentiality, article 584 states the following:

"Except as otherwise provided and when the authorities of the country require in compliance with their purposes or in judicial or arbitral proceedings, the terms of the franchise agreement are understood to be confidential for the parties and for the authorities."

Also, within article 589 of the project, it is provided that the contract authorizes the use of the trade name, distinctive signs and other rights that are related to the object of the contract and that are necessary for compliance. Also, the relationships that occur between the parties, which are essential for the franchisee to develop the franchise.

In addition, article 590 details that, according to the nature of the franchise agreement, the following assumptions may be included:

1. The use of the common denomination and other intellectual or industrial property rights.
2. Presentation of the establishments or means of transport, which are the subject of the contract or other proof that demonstrates that the activities are performed in accordance with the franchisor's guidelines.
3. The communication about the "know-how", by the franchisor to the franchisee, fulfilling the characteristics of singular, own and substantial.

¹² It is the principle that guarantees that the information can be disclosed to third parties, when the consent of the parties has been obtained or when the law determines it.

4. Non-competition¹³ with the franchisor and other limitations established, respecting the provisions of the Law for the Implementation and Regulation and Control of Market Power¹⁴ and other regulations.

5. Technical assistance, commercial assistance or both, during the term of the contract by the franchisor to the franchisee.

About the obligations and rights of the parties, they are found in the following articles:

In article 592, the rights of the franchisor are indicated:

- The franchisee must make use of the business model, complying with the same procedures, which were specified in the contract.
- Receive payment for the use of the franchise, complying with the payment method and terms that were agreed in the contract.
- Control the proper development of the franchise, having the possibility of asking the franchisee to make certain modifications.
- To be compensated for damages in the trade name or distinctive sign, caused by the misuse of the franchise.

Article 593, recognizes that in the same way the franchisor also has the obligation to accurately report the main aspects that help the franchisee to develop the network according to the provisions of the contract.

Also, the franchisee has to comply with some obligations, which are established in article 594, and it is essential to highlight the following, which are most related to "NAF NAF":

- Follow the procedures in an exact way and as determined by the franchisor for the development of the network.
- Keep as a secret all confidential information provided by the franchisor.

¹³ It refers to the existence of rivalry or confrontation between two or more companies that offer similar products or services in the same market. In the case of the franchise, the franchisee will not be able to manufacture or sell goods or services that compete with those of the franchise network.

¹⁴ Entered into force on October 13, 2011. Official Registry Supplement Number. 555.
Art. 2. Scope.- "All economic operators, individuals or legal entities, public or private, national and foreign, with or without profit, who currently or potentially perform economic activities are subject to the provisions of this Law. The people who carry out economic activities in all of the national territory or in part of it, the unions and those that perform these activities outside the country, in the case that their acts, activities or agreements produce or can produce harmful effects in the national market. " (Law for the Implementation of Regulation and Control of the Power of Market, 2011)
Its controlling entity is the Superintendence of Market Power Control.

- Maintain the establishment according to the specifications determined by the franchisor, in relation to the decoration and the trademark.
- Keep the same franchise model, so it is identified as an establishment with the same characteristics and nature, belonging to the same franchisor. Franchisee cannot make changes to the model without the express and written authorization of the franchisor.
- In case of any damage caused by the bad use of the franchise, the franchisor must be compensated.
- Take into account the recommendations and indications made by the franchisor, about the use of the franchise.

According to article 595, the franchisee has all the rights, which have been established in the contract, being able to grant the freedom to use the trademark, corporate image, business model of the franchise network and the techniques and knowledge during the time established in the contract. In addition, this person has the right to receive the "know-how", assistance from the franchisor, the operating manuals and other documents or necessary instructions, continuously or for a specific time, according to the provisions of the contract.

In relation to one of the fundamental elements of the franchise, which is the "know-how", article 600, describes this contract as:

"(...) A commercial agreement, by which a person, called licensor, owner of the know-how, authorizes and transfers the use, enjoyment and exploitation of a non-patented or patentable knowledge characterized by being confidential, substantial and individualized, to another person named licensee or beneficiary, so this person is obliged to satisfy the payment of a royalty, which is calculated on the basis of the volume of manufacturing or sales of products or services made with the use of the licensed know-how. "

Article 601, details that the permission to use the "know-how" is a set of commercial and industrial knowledge that have not yet been disclosed, to which the licensor has given a patrimonial value for the use of the business.

It is very important to add what is described in article 602, which states that the "know-how" helps in the development of products or to develop the procedure that a service involves.

In Article 603, it is recognized that the licensee must safeguard the information that is part of the "know-how", with the aim that it is not disclosed or used by unauthorized third parties, provided that:

1. Be secret, so that the body and components are not known or easily accessible by people who are in an area where that type of information is handled.
2. Be under the protection of the licensor, taking appropriate measures to keep it secret.
3. Possess commercial value by virtue of being secret.

In addition, it is necessary to emphasize that not all information can be protected, as it is mentioned in article 604, the information that will not be protected includes the following:

- Be of public domain.
- Be evident to a professional in the field.
- Be *"(...) disclosed by legal provision or court order."*

Similarly, in this case the licensor has obligations, which are described in article 607:

- Provide all the necessary knowledge about the "know-how", which will be granted to the licensee and all the conditions for exploitation materially and intellectually.
- Granting the elements and technical documentation necessary for the exploitation of the "know-how", establishing in the contract the form of delivery, duration, purpose and the manner of restitution at the end of the agreement.
- Provide training and technical assistance to the beneficiary's staff.
- Provide all the means to the beneficiary to use the "know-how".

On the other hand, in Article 608, it is determined that the licensee's obligations are:

- Exploit the "know-how", complying with all quality standards.
- Do not expose confidential information, not grant or assign licenses without the authorization of the licensor.
- Cancel royalties on time.
- When the contract has been terminated, this person should not use the information that relates to the exploitation of the "know-how" and must return the documentation provided.

In my personal opinion, the Project of the Commercial Code in the subject of franchising and its proposal to make the contract typical, it limits the parties involved to comply with the established provisions, which is not beneficial for the franchisor or for the franchisee, because there must be some freedom at the time of hiring to have a good contractual relationship.

In addition, when the franchise contract is atypical, the parties have the opportunity to reach a better dialogue and communication, to achieve their interests in an equitable manner, so I finally concluded that the franchise contract should be kept atypical and based on the will of the parties.

2.2.6 Implementation Code of Production, Trade and Investments

This Code regulates all the people and associative forms that are dedicated to perform a productive activity, in any part of Ecuador, so the franchise, being an investment and a trade activity, must consider this legal body to achieve its correct development and operation.

"The purpose of this Code is to regulate the production process in the stages of production, distribution, exchange, trade, consumption and productive investments oriented towards the realization of Good Living. This regulation also seeks to generate and consolidate the regulations that promote and encourage higher-value-added production, which establishes the conditions to increase productivity and promote the transformation of the productive matrix, facilitating the application of productive development instruments that can generate quality employment, a balanced equitable, eco-efficient and sustainable development with the care of nature "Article 3 (COPCI, 2010).

Also, it is necessary to emphasize that "NAF NAF" does not have any kind of privilege at the time of importation, so this franchise must pay all taxes on foreign trade, so for this reason it is essential to define and highlight the difference between exemption and exception, to indicate that the franchise is not either one, instead it is an importations regime, specifically importation for consumption, due to the type of merchandise that is imported, which is clothes.

In the first place, regarding the exemption, the Tax Code, within article 31, defines it as *"(...) the exclusion or legal elimination of the tax obligation, established for reasons of public, economic or social order. "*

To have greater clarity on this subject, the COPCI, in article 125, indicates the goods that are exempt from the payment of taxes to foreign trade:

- Traveler's personal items.
- Work equipment and household items.
- Relief shipments in case of natural or similar catastrophes.

- Samples that have no commercial value, according to the limits established by SENAE.
- *"(...) The goods, products and supplies destined to artistic and cultural activities, which have a favorable technical report from the Ministry of Culture.*
- The equipment and elements to be used exclusively in the development of research projects or social innovation, (...) that are duly accredited before the Secretariat of Higher Education, Science, Technology and Innovation. " (COPCI, 2010) among others.

While the exception is the exclusion of the general rule, so when there is such a rule, which has certain formalities, not all formalities will be met.

In order to demonstrate that the franchise is an importation regime for consumption, it is necessary to define what is a custom regime, which is included in the Regulation on the Title of the Customs Facilitation for Trade, Book V of the COPCI, in its article 2, literal fff), recognizing it as "the customs treatment applicable to the goods, requested by the declarant, in accordance with the current customs legislation." It's divided in:

- Export regimes: According to the COPCI, these are classified as:

- o Definitive export

- o Temporary export for reimportation in the same state.

Temporary export for active improvement

- Import regimes: According to the COPCI, the most important to highlight, in the subject of the franchise are:

- o Importation for consumption: Article 147, defines it as "the custom regime by which goods imported from abroad or from a Special Economic Development Zone can circulate freely in the customs territory, in order to remain in the territory definitively, after the payment of import duties and taxes, surcharges and sanctions, when applicable, and compliance with customs formalities and obligations " (COPCI, 2010).

- o Reimportation in the same state.

- o Customs warehouse.

- o Replacement of merchandise with duty-free.

- Exceptional regimes: The most relevant to mention, in relation to this investigation, as provided in this Code, are:

- o Postal Traffic.

- o Accelerated Courier or Courier.

- o Border Traffic.

- Other customs regimes: The COPCI divides them into several, but in relation to this issue, it is important to highlight the following:

- o Free warehouse.

- o International fairs.

- o Trans-shipment.

One of the important issues to mention is the rate of control service in customs, ruling since November 2017, except for the Postal Traffic, Accelerated Messaging, Customs Transit and Trans-shipment regimes, which begins to rule since February of the current year, this has provoked several reactions that are against the payment of this fee.

The Chamber of Commerce of Guayaquil and the National Federation of Chambers of Commerce of Ecuador filed a lawsuit against SENA E, on February 2 of this year, in front of the Specialized Chamber of Taxation of the National Court of Justice, alleging that the collection of the mentioned rate is against the principles of equality, being considered as discriminatory, since it is alleged that it is a tax disguised as a fee and that the director of SENA E has no competence for the creation of taxes.

The plaintiff states that this fee "(...) violates the rules for its issuance and its content is illegal; (...) violates the international legal order and incorporates anti-technical calculation elements" (Líderes Magazine, 2018).

On February 8, the Specialized Chamber of Taxation of the National Court of Justice, qualified the claim, determining that SENA E has 30 days to respond to it. On February 9, 2018, through a press release, this institute confirmed that the application was entered, stating that "(...) SENA E has always been respectful of the legal, national and supranational provisions that govern its management, all its acts are regulated, so they comply with the rules of law that establish the scope of their competence and the procedure to be followed " (SENA E, 2018).

It is necessary to consider that in Article 108 of the COPCI, it is recognized that SENA E "(...) through resolution will create or abolish customs service fees, set their rates and regulate their collection." Currently, the Chamber of Commerce of Guayaquil and the Federation of Chambers of Commerce of Ecuador hope that the Specialized Chamber of the Tributary of the National Court of Justice, may issue its ruling for May of this year.

Another of the situations that has arisen around the application of this rate is the disapproval on the part of the CAN, Community of which Ecuador is a member. This case started when Peru expressed that the collection of this fee is illegal and goes against the provisions of the Cartagena Agreement, the General Agreement on Tariffs and Trade and the Multiparty Agreement with the European Union.

This request was accepted by the CAN on January 17, 2018, giving a period of 20 days for the rest of the member countries to express their disagreement against this rate, Colombia being the first to agree, informing that the work of SENAE is to carry out this control, so there should be no additional charge, stating that "(...) the measure imposed by the country does not have a relationship of proportionality between the service currently provided and its approximate costs" (Expreso, 2018). At present, the community is still waiting for the decision of Bolivia, another member of CAN.

Given the lawsuit, the director of SENAE, Econ. Mauro Andino Alarcón, defends the collection of this fee, arguing that the purpose of such fee is to strengthen customs control and, thus, to avoid smuggling.

In addition, he states that "(...) this rate will be justified when part of the values collected are used to strengthen the operational, technological and personnel structure of the control institution (Expreso, 2018)." In addition, he points out that currently with the income received by the customs control service fee, the organization provides its services for the clearance of goods, on Saturdays, Sundays and holidays, which did not previously exist, so the institution improves its functionality.

In spite of the fact that it is not yet known what will happen in the future with the payment of this fee, I consider that this fact causes discomfort and inconveniences, nationally and internationally, so it is really negative, especially for customs, for this reason the competent authorities in this issue should reflect on the number of people who are negatively impacted and choose to eliminate this charge that affects not only the importers of the country, but the final consumer, who is the one who pays this rate in the end.

Conclusion

Based on everything explained and analyzed earlier in this chapter, in consideration of both national and international regulations related to franchising, in my personal opinion, the franchise agreement should be kept atypical, based, therefore, on the will of the parties, which are the franchisor and the franchisee. It is important that some freedom exists and that there is flexibility to agree with the requirements and obligations that must be observed during the term of the contract, because the interests of both parties can be different from what is established in a specific law or regulation that regulates this business model.

In addition, the franchise agreement, being atypical, helps the parties have a better contractual relationship, because they can talk about the aspects that they consider better, being able to negotiate and reach an agreement in which both are fully compliant, so they are not limited to simply complying with the provisions of the law.

In relation to the analysis carried out on the customs control service rate and the inconveniences caused, I believe that SENA should eliminate this payment, because the real duty of this institution is to control the merchandise in all its phases and to avoid contraband, so there should not be an additional cost for what is part of their activities.

It is also important to note that, in the legislations of the countries that were analyzed, there is no specific regulation that regulates the franchise contract, although in these countries there is a great development and growth of this business model, but they preferred to maintain the freedom of the parties at the time of negotiation.

It is also important to refer to some countries such as Mexico and Spain, places where this contract is typical, which has caused several discomforts and inconveniences mainly in the franchisees, due to the rigidity of the regulatory bodies and the existence of certain clauses that harm their interests. Based on these cases, I believe Ecuador should choose not to regularize the franchise contract, but create a Code of Ethics or Deontology as this can provide recommendations to people involved in the issue of franchises, not to force them to comply with certain requirements as proposed in the Project of the Commercial Code.

CHAPTER 3: TEXTILE FRANCHISE "NAF NAF"

Introduction

Within the development of this chapter, the "NAF NAF" franchise is described, detailing the background and history of the franchise, and then explaining the requirements and steps to follow to obtain the trademark and the establishment, complying with everything demanded by the franchisor.

In addition, based on the interview conducted with the franchisee in Cuenca, Mrs. Ruth Flores, it is necessary to know other details and information such as: their main competitors, advice and training received from the franchisor to monitor progress and ensure the success of the establishment, general view of the way in which sales are carried out, taking into account that the franchisee has to comply with some requirements and goals.

Also, it is important to know more about the franchise contract, because it is the basis for establishing the relationship between the franchisee and the franchisor, so it is essential to analyze the most important and necessary clauses, based on the will of the parties and finally, in relation to all the information granted by the franchisee, determine the advantages and disadvantages of this textile franchise.

3.1 Profile of the “NAF NAF” franchise

In 1973 the brothers Gérard and Patrick Pariente, decided to create a clothing trademark in Paris, France, in the Passage du Caire, where the most popular fashion stores were located, under the name of "Influence". After 5 years, in 1978 the trademark name was changed to "NAF NAF", whose meaning is based on the famous story of the 3 little pigs, whose names in French are: Nuf Nuf, Nif Nif and Naf Naf, the last one has the characteristics of: enterprising, responsible and hard-working, so for this reason the Pariente brothers decided to opt for this name to give the company a more attractive and magical image.

In the same year, the first clothing collection was launched under the name "NAF NAF" and after one year it became a company with the same name. In 1984, the brand achieved greater popularity and positioning due to the launch of an advertising campaign called "Le Grand Méchant Look", through which the brand is recognized as colorful, feminine, innovative and young, achieving a significant increase in the sale of the products.

In year of 1986 "NAF NAF" opened its first premises in Paris and months later due to the acceptance of the public, they decided to internationalize, arriving first in the Japanese market. In that year there is also an event of great importance for the trademark, since the Princess Estefanía from Monaco, came out in a photo wearing a shirt of "NAF NAF" in an interview by a very famous newspaper, which caused that all the women would want to acquire that garment, causing the sales of the trademark to have a great growth. A year later, the company decided to launch firefighter style jackets, which caused great interest and marked a trend in young women, becoming an indispensable, classic and basic garment for all women.

In 1991, the company decided to innovate and give a new twist to the business, launching its first perfume "Une Touche of NAF NAF", with the collaboration of the company L'Oreal, this product had an impressive acceptance and became the leading perfume nationally and also internationally. Since 1992 "NAF NAF" has decided to expand its market and reach more countries such as Belgium, England, Italy and Spain.

In addition to the great acceptance that the trademark had in France, there is the opening of the 100th location in the country. In 1993, its expansion and growth continued, reaching more and more countries such as the Netherlands and Germany, and due to the popularity and progress of "NAF NAF", it is listed on the Stock Exchange of France.

Since 1997, the trademark had great renown and its garments were identified as the best quality and most innovative and attractive designs for the public, so the owners of the trademark decided to enter into more European markets.

In 1998, they decided to enter in Latin America and granted the first franchise to Colombia, opening the first establishment in Cali. "NAF NAF" celebrates 30 years of the creation of trademark in 2003, so the magazine "ELLE" of Spanish origin and focusing on beauty, fashion, health and entertainment, aimed especially at women, published a report about the growth and development that the trademark has had since its creation until that year, so this situation was very important to give it greater publicity and recognition.

In 2006, the creatives of the trademark managed to give an innovative image to "NAF NAF", with a new style, colors and designs, which is very beneficial because consumers welcomed these changes, so it caused sales to increase in all locations internationally, reaching "more than 13 million items sold around the world" (NAF NAF, 2016).

In 2007 the owners of the trademark, the Pariente brothers made the decision to join the Vivarte Group, with the aim of having greater growth and development internationally, due to the success that this group has had in the world of fashion and the expansion that the brands that are part of it have achieved. After two years, they decided to make a new image, through an advertising campaign, in which it is imposed as a more delicate, feminine and colorful trademark.

In 2010, due to the great reception that the trademark had in Colombia, the managers decided to enter more Latin American countries, granting franchises to Venezuela, Ecuador, Peru, Costa Rica and Colombia. From the year 2011 until 2014, more than 14 campaigns were launched, focused on the seasons: spring, winter, summer and autumn, giving a surprise and increasing loyalty to the consumers, causing greater impact in the world of fashion and having each year a higher sales index than the previous one (NAF NAF Colombia, 2016).

In the case of Ecuador, "NAF NAF" was first established in Quito, after in Guayaquil and finally in 2009 arrived in Cuenca. For the year 2013 the trademark had more than 8 stores nationally, having a varied style and offering formal and informal clothing, ideal for any occasion or event, reaching a great reception in the country. In addition, the average age of women who purchase the articles of this franchise, is between 21 and 40 years.

3.2 Interview with the franchisee of "NAF NAF" in Cuenca

To know more about the way in which the franchise was implemented in Cuenca, it is necessary to refer to the experience of the franchisee of "NAF NAF" in the city, Mrs. Ruth Flores, especially to know the process she had to adhere to in order to obtain and establish the franchise, complying with all the requirements and obligations set by the franchisor through the contract, based on the will of the parties.

The questions asked in the interview were:

Q1: How did you know about the franchise?	Through trips I made to Quito. I really liked the quality of the clothes.
Q2: How did you get the "NAF NAF" franchise?	Contacting the commercial manager of the "Grupo Uribe", Waldir Jaramillo and expressing interest in acquiring the franchise.
Q3: Requirements	These were simple to comply with, because they wanted the brand to enter the market.
Q4: Is it more beneficial for the contract to be atypical or typical?	Atypical because in that way you can ensure the benefit for both parties involved.
Q5: Is it more beneficial to establish a business independently or through franchising?	It is better through franchising, because you have the support of the franchisor and the reputation of the trademark.
Q6: How is the importation process performed, do you obtain any benefit for having a franchise?	There is no benefit, the expenses and importation tax payments are the same.
Q7: How does the payment of the Customs Control Service Fee affect, whose entry into force for importation to consumption was on November 13, 2017?	It affects the franchisee itself, but not the franchise.
Q8: What is the duration of the contract, can it be renewed?	It has indefinite duration.
Q9: What requirements do you have to comply with?	It is mainly necessary to comply with established sales and maintain the establishment correctly.

Table 2: Interview to the franchisee of "NAF NAF".

Q10: What are the main competitors?	In Cuenca there are no textile franchises that have characteristics similar to "NAF NAF".
Q11: How was the establishment's advertising carried out?	It was not necessary, because the brand was already known nationally.

Done by: Claudia Cazorla

3.3 Description of the process of obtaining and establishing "NAF NAF" franchise

In the interview with Mrs. Ruth Flores, franchisee of "NAF NAF" in the city of Cuenca, she mentioned:

"I knew the brand in the city of Quito, about 15 years ago, I liked the clothes very much because they were of very good quality, modern and of very good price, the main characteristic that I observed in the clothes were their delicate models and the shape of the pants. At that time "NAF NAF" had its own stores in Quito and Guayaquil, so I decided to contact Gloria López, who was the administrator of "Inducortec SA", which was the company that owns the trademark for Ecuador, because they did not grant franchises, so they only had their own premises in the country.

After some years, through a contact that my sister had, I was able to meet with the commercial manager of "Grupo Uribe", which is the representative company of the franchise in Latin America, and these persons informed me that they were already granting franchises."

The main steps to obtain the franchise were:

- **Contact the franchisor or its representatives:** In this case the commercial manager of "Grupo Uribe", the company that owned the trademark in Latin America and expressed interest in obtaining the franchise.
- **Send personal information and other requirements:** Deliver the curriculum of the person concerned to the "Grupo Uribe", which is responsible for the representation, production and marketing of "NAF NAF" and other brands on the global field.
- **Response by the franchisor or its representatives:** In this franchise, the response came from the commercial manager of the "Grupo Uribe", Mr. Waldir Jaramillo, who is currently the group's general manager, through a meeting with the franchisee to inform about the details of the franchise.

- **Signature of the contract:** Based on the will of the parties and allowing the modification of some clauses, it was signed. Through this contract the parties have to comply with everything agreed and begin a contractual relationship.
- **Search of the premises:** It is important that the establishment, in which the franchise will operate, complies with the specifications of "NAF NAF". The only requirement that had to be met in relation to the space and location of the premises, was that it should have at least 70 square meters.
- **Payment of the entrance fee of the franchise:** Through this payment the franchisor grants to the franchisee the exploitation and use of the trademark.
- **Payment of the advertising fee:** In the case of "NAF NAF", this payment is made continuously, because it includes the acquisition of showcases, accessories and decoration of the establishment continuously.

Regarding the process of establishment of the franchise in the city, Mrs. Ruth Flores, said:

"The first franchise of " NAF NAF "in Cuenca, was established in the Shopping Center "El Vergel " in the underground plant, in 2009, the requirements imposed by the trademark at the time of establishing the franchise were easy to comply with and accessible, because the city was small and there was a low population index.

In addition, the franchise had great interest to enter in the market. It was possible to establish it in a small installation, but for the opening of the second franchise in the Mall del Rio, located on the top floor next to Vanidades, the demands changed and these were more rigid, because the space of the premises had to be at least 100 meters. "

3.4 Advice and training by the franchisor

It is important to emphasize that the advice and training by the franchisor to the staff and the franchisee is free, but for people who arrive in the city, the franchisee had to pay the hotel and food. Also, in the contract it is established that the staff of the franchisor or in this case their representatives or administrators, must come to the establishment twice a year to ensure that the franchisee is complying with all the requirements established by "NAF NAF", in order to achieve its success and progress. The "Grupo Uribe" is responsible for paying the cost of these trips to its employees.

The people who come to the city to give the necessary advice and control are from the visual merchandising department, who are in charge of marketing and advertising. They are in charge of controlling that the garments and other articles are being exhibited in an appropriate way to capture the attention of consumers and the general public. The staff and other representatives, who come to the installation in Cuenca belong to the "Uribe Group", because this company is the representative of the trademark in Latin America.

In relation to training, it must be considered that:

- The first training is received by the franchisee, when the contract is already signed and the operating necessary manuals for the operation of the franchise are granted.
- Attendance at the time of establishing the franchise and continuously every 6 months, for the employees of the franchisee, which is provided by the staff of the visual merchandising department.
- Periodic visits (twice a year) to the franchisee, to verify that the franchisee complies with the requirements imposed by the trademark.
- Continuous support through telephone calls or emails to clarify any doubt or problem the franchise could have.

The advice and training provided are of vital importance for the development of the franchise, because it helps it to prosper, so this type of support is given to the franchisees and its employees to give them the tips and techniques regarding sales and the correct way to serve the client and the ways in which people must be persuaded to buy more clothes. The staff in the establishment is also trained with information on the trends of a collection, the reason of the colors that are chosen for a specific season, among other data of interest (Flores, 2017).

3.5 Franchise agreement

In the franchise agreement several clauses are included, which are agreed based on the principle of will of the parties. In this case, based on "NAF NAF", the most important clauses are:

i. Description of the object of the contract: This clause must include all the distinctive signs and other intellectual property rights that are part of the franchise and the franchisor will grant for the use and exploitation by the franchisee.

ii. Powers and functions granted by the franchisor to the franchisee: It is necessary to describe the activities and functions that the franchisee can perform in a specific territory, granting the franchisor full authorization for the implementation of these.

iii. Territorial exclusivity: The right that the franchisee has to establish the premises that this person wishes within a specific territory, providing greater confidence and security that in a geographical area there will be no direct competition from the same franchise.

In relation to this clause, there was an amendment by mutual agreement of the parties because initially the contract established that, "NAF NAF" was free to establish a store in Cuenca without prior authorization. The franchisee with legal advice had a dialogue with the representatives of the "Grupo Uribe" and they decided to change this clause, finally granting territorial exclusivity to Cuenca, establishing in the contract that an establishment of the trademark could be opened in the city, when this person has the authorization of the franchisee and the rejection of the proposal to open a new establishment in that area (Flores, 2017).

iv. Obligations of the franchisor and franchisee: It specifies in a concrete manner and by mutual agreement between the parties the activities, duties and requirements that must be met by the franchisor and the franchisee, to ensure the progress of the trademark.

v. Compliance with the respective payments: The amounts that must be paid for the entrance fee, advertising and other expenses that the franchisee must pay to use the trademark.

vi. Advice and training: The activities that the franchisor must perform to control and help the franchisee and the staff about the proper way to manage the business.

vii. Know-how: It is the most important clause in this type of contracts, because through it, the franchisor grants the franchisee the use, enjoyment or exploitation of the secret or technical knowledge that the franchise has.

viii. Confidentiality: Through this clause the franchisor ensures the loyalty of the franchisee, in relation to not disclosing any type of secret information about the franchise.

ix. Amount of sales and profits for the franchisee: In this clause a goal is established in relation to the sales that the franchisee must comply with to ensure that the franchise is financially stable.

It also indicates an estimate percentage of the profits that the franchisee must comply with. In the contract for "NAF NAF" a 50% profit was determined, but in reality, this was not fulfilled, because the changes and the payment of new importation taxes that were established within the country caused that the profits obtained were decreasing more and more and at present the profitability that is obtained from the franchise is really low.

"There are even garments in which I have between 30% to 25% profit, so I decided to communicate with Waldir Jaramillo, who told me that the trademark cannot take any action in this situation, because these types of taxes are established at the national level and do not belong within the franchise, so for that reason the stocks I have today are much lower in relation with the time I opened the first franchise in the city " (Flores, 2017).

x. Conflict resolution: Consists of the possibility that in the event of any controversy or conflict between the parties, they must resolve it in the best way, reaching a mutual agreement or through arbitration or jurisdictional mechanisms. When conflicts exist, these will be resolved in the place where the franchise is domiciled, in this case in Ecuador.

In "NAF NAF" Cuenca there have never been serious problems between the franchisee and the franchisor, there have only been minor problems mainly due to delays in the shipment of the garments, which have been resolved by speaking with the representatives of the "Grupo Uribe".

In the case of having a problem, it would be best to resolve through alternative means of conflict resolution, because it is the best option to maintain a good relationship with the other party, but if the parties cannot reach a solution through these means, it is necessary to proceed through the judicial way (Flores, 2017).

xi. Final comments and possibility to include new clauses: In this clause, the parties have the possibility of including new clauses to the contract, according to the benefit or interest of the parties, taking into account that none of these have an effect on the existing legislation in the country of the franchisee and in the country of the franchisor.

It is important to highlight that the contract for the "NAF NAF" franchise is for an indefinite period, because there is no clause that establishes the specific time of this contract, so the only requirement that establishes the franchisor to continue exploiting and using the trademark is the fulfillment of the obligations, guidelines, payments, sales goals and correct maintenance of the establishment. Also, there is no clause to renew it.

At the time that Ms. Ruth Flores acquired the franchise, the contract was atypical and based on the will of the parties, having the possibility of modifying several clauses in order to ensure the benefit of the franchise and the interests of the involved parties.

3.5. 1 Entry fee

"The payment of the entrance fee is not high, but the most expensive is the assembling of the establishment. In addition, everything that the franchise imposes must be purchased, because this requirement is established in the contract " (Flores, 2017).

The payment of the entry fee, in the case of the "NAF NAF" franchise, is of a value of \$ 10,000, which includes the following:

- Value for recognition and brand name.
- Right to use or exploit the franchise.

3.5.2 Advertising fee

The value for the advertising fee, is canceled only once at the time of obtaining the franchise, in relation to "NAF NAF" located in the Mall del Río, is around \$ 150,000, which includes:

- Payment for catalogues, flyers and other means to advertise the store.
- Necessary supplies to establish the shop, since everything must be imported: mannequins, showcases, lamps, furniture, borders, bags where the clothes are delivered to the clients and other items that are necessary for the establishment (Flores, 2017).

3.5.3 Royalties

The main elements that are taken into account to calculate the payment of royalties are: the expenses of the franchisor in providing training, continuous support and research and tests for the development of new products or services for the franchise. Royalties can be charged in two ways to the franchisee, based on sales of the establishment or fixed fees independently of sales. These can be charged weekly or monthly, depending on the agreement between the parties (Maubert, 2010).

In "NAF NAF" franchise, the franchisee does not pay royalties, it is only necessary to pay the entry and advertising fee (Flores, 2017).

3.6 Economic situation of the franchise

3.6. 1 Sales of "NAF NAF" Cuenca

There are formulas that apply in regards to budgets for sales, which are secret and unique for each franchise and which serve to control the sales in the establishment and determine if the obligations established in the contract are being fulfilled. In the case of "NAF NAF", there are established sales goals that must be complied with by the franchisee, based on the square meters of the establishment are determined monthly, depending on the season, these fees are not fixed, but change depending on the festivities in each month of the year and other factors that may affect.

See Figure 1.

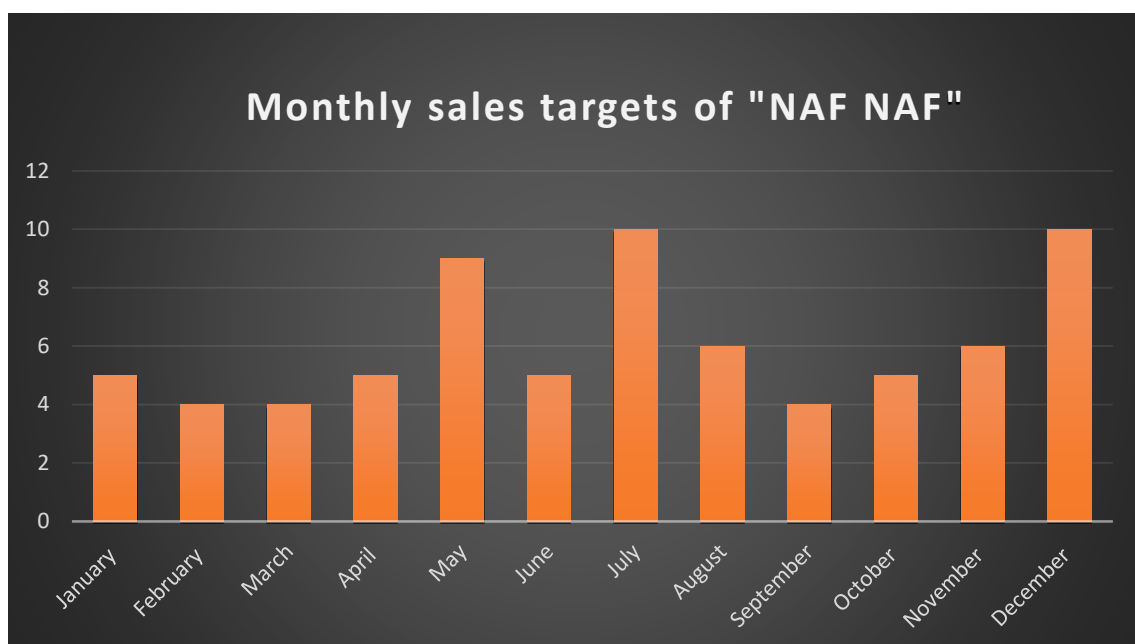


Figure 1: Monthly sales targets of "NAF NAF"

Made by: Claudia Cazorla.

In relation to Figure 1, the highest sales targets are in the months of: May, July and December, because in those months there are festivities such as Christmas, Mothers'

Day and holidays, so this is the reason why the sales increase, due to the arrival of tourists to the city and the acquisition of gifts to celebrate these holidays. In addition, the franchisee must comply with all the quotas to demonstrate to the franchisor that the establishment is stable and that its profitability is maintained. In addition, sometimes the established rates are exceeded.

"A very important event for the establishment of " NAF NAF " in Cuenca, happened in the year 2012, when the location of the Shopping Center " El Vergel " by the number of meters of the store was recognized as the best sales obtained at the level of Colombia and Ecuador, according to the unit of products per transaction, which refers to the ability of the establishment's vendors to convince a person to buy more items than that person had expected to acquire, it is the number of pieces sold per invoice .

In 2012, this index almost doubled, because the normal value was 1.60 and it reached 2.70, so this meant that the trademark had great reception, for this reason I received an award for having record sales, because the goals imposed were surpassed and even duplicated.

This situation occurred because the franchise had little time in the city and the style of the garments was unique, so most people who came to this mall and who passed through the establishment felt attracted by the merchandise, which caused that the customers were loyal to the trademark and most of them commented to their family and friends about "NAF NAF", causing a significant increase in the sales and costumers.

That situation was the main reason that motivated me to open a new store in Mall del Río, but months after the inauguration of that establishment, there was an increase in VAT, duties and other taxes, which caused the sales to fall significantly. In general, the current situation in the country has affected me a lot, because I cannot buy the same amount of clothes as I did before and also profits are getting smaller " (Flores, 2017).

3.6.2 Purchases of "NAF NAF" Cuenca

When it is time to purchase a new collection for the establishment, the franchisee must travel to Colombia to choose the clothes that will be purchased in a parade that is done frequently for the release of the garments belonging to a certain season.

Previously the trips were made every 3 months, because "NAF NAF", was based on a more classic fashion, but now the collections are shorter, because the trademark has become part of the "early fashion", which means that when a garment comes out and it

is popular and attractive to people, clothing establishments must obtain it immediately, which makes the duration of a collection shorter (Flores, 2017).

It is necessary that the franchisee travels to Colombia to ensure: the quality of the fabrics, the way in which the garments look on the models and make sure to obtain the garments that mostly attract the attention of the public, taking into account the market where the franchise is, because the fashion in each country can vary depending on the preferences of consumers. It is necessary to know what are the fabrics that displease and the clothes that people would not buy. The franchisor gives a guide with regards to the budgets and the number of items to buy, but it depends on the franchisee to follow these recommendations in relation to purchases.

In addition, for the importation of all garments and the essential items for the decoration of the establishment, it is necessary to hire a Customs Agent¹⁵, who is responsible for carrying out all the procedures and important procedures for the dispatch¹⁶ of the commodity. In the case of "NAF NAF" this person is in Quito, because he works for the company "Inducortec", so the representatives of the trademark recommended the services of this person to the franchisee. The fees charged by the Customs Agent are \$360 per import performed.

In the case of the purchase of the initial decoration for the opening of the shop, it was made through several imports. The purchase of garments for the establishment depends on the production and availability in the Colombian industry, this company communicates to the franchisee when the merchandise is ready. Then the franchisee tells the Customs Agent, who performs all the respective procedures and finally the clothes arrives in the city in an approximate period of 3 weeks to 1 month.

"The time the merchandise was delayed the most at arrival, has been for a month and a half, when there was a problem in Customs, because in the label¹⁷ of the garments, in

¹⁵ Art.256.- "It is the natural or legal person whose license, empowers him or her to manage in a habitual manner and for others, the clearance of the goods. The customs agent will have the character of notary and auxiliary of the public functions and SENA will certainly have the information that they record in the customs declarations that they formulate, ensuring that it keeps conformity with the information and documents that legally serve as base for the Customs Declaration. "
(REGULATIONS TO THE TITLE OF THE CUSTOMS FACILITATION FOR THE COMMERCE FROM THE BOOK V COPCI, 2011)

¹⁶ Art.139.- "Dispatch is the administrative procedure to which the merchandise must submit when entering or leaving the country, this process begins with the presentation of the DAI and ends with the release." (COPCI, 2010)

¹⁷ Labeling: Refers to the action of placing a label on an item or thing.

the section of form of washing, one of the graphs was wrong, so the entire container had to be returned to the border and the labels were changed in Ipiales, Colombia. In addition, when it is necessary to carry out physical gauging¹⁸, it takes much longer than normal " (Flores, 2017).

In order to know more in detail about all the steps to follow for the importation of garments of the franchise, an interview was conducted with the Customs Agent, Engineer German Cantos, who stated:

"To import any product into the country, the person concerned must comply with the following steps:

- Importer registration by the National Customs Service of Ecuador (SENAE)
- Registration in the Ministry of Industries and Productivity. (MIPRO)
- When garments are already in the country, these have to be labeled due to the INEN (National Standardization Institute) with certain types of specifications on the label that can be fulfilled once the merchandise arrives in the country or origin.
- The labeling of garments is inspected in conjunction with a SENAE official, verifier¹⁹ and Customs Agent or their assistants.

Label: "Is any label, tag, inscription, mark, image or other descriptive or graphic material that has been written, printed or marked in relief or attached to the product, in order to provide certain characteristics of the product " (Ecuadorian Technical Standard NTN INEN 1875, 2017)

¹⁸ Art.140. "Gauging. - It is the act of tax determination by the Custom Administration and is carried out through electronic, physical or documentary verification of the origin, nature, quantity, value, weight, measurement and tariff classification of the goods. " (COPCI, 2010)

It is classified into: "documentary, physical (intrusive and non-intrusive), electronic and automatic. The selection of the gauging modality will be made according to the analysis of risk profiles implemented by the National Customs Service of Ecuador. " (REGULATIONS TO THE TITLE OF THE CUSTOMS FACILITATION FOR THE COMMERCE FROM THE BOOK V COPCI, 2011)

Art.82. "Physical gauging channel: It is the physical recognition of the goods, to verify their nature, origin, condition, quantity, weight, measure, value in customs and / or tariff classification, in relation to the data contained in the Customs Declaration and the accompanying and support documents, contrasted with the information recorded in the computer system of the National Customs Service of Ecuador, in order to determine the correct liquidation of taxes on foreign trade and / or compliance with the customs provisions required by the customs regime and declared goods. This type of gauging may be carried out through intrusive inspection or physical verification of the merchandise, or through non-intrusive inspection technology systems. " (REGULATIONS TO THE TITLE OF THE CUSTOMS FACILITATION FOR THE COMMERCE FROM THE BOOK V COPCI, 2011)

¹⁹ "These are private entities authorized by SENAE, which are responsible for verifying the quantity and quality of the goods at the time it enters to the country, subsequently issuing a report to the INEN, to communicate that it complies with all the requirements. Example: Bureau Veritas, Cotecna.

- The verification company issues the certificate of conformity if all is well, otherwise the company does not issue it until the errors are corrected and inspected again.
- The ECUAPASS²⁰ system assigns a gauging channel, which most of the time is physical due to value alerts that garments usually have.
- Authorization of exit of the goods when there is no notification of justification by SENAE."

In addition, as explained by the engineer German Cantos, it is necessary that in this case the franchisee meets certain requirements to import, the main ones are:

- Obtain the RUC in the SRI, to subsequently register as an importer in the SENAE.
- Acquire the electronic signature in the certification entities.
- Perform the registration of the importer in the ECUAPASS system.

Also, through this interview the Customs Agent mentioned that the main problems that occur in the importation of clothing are:

- Badly consolidated invoices²¹.
- Packing lists²² erroneously issued in the country of origin.
- Excess or missing²³ merchandises that are not declared due to involuntary errors of the shipper in the country of origin.

²⁰ It is the system that allows operators and public institutions engaged in foreign trade activities, to make their customs operations easier and to ensure customs control in the country, reducing the time of import and export procedures, through electronic signature and the use of a device to operate more securely. It is applied since January 15, 2012 (SENAE, 2018) Previously there was the Interactive Foreign Trade System (SICE)

²¹ This situation occurs when inside the invoice, where all the articles that are imported are summarized, there is erroneous information about surcharges, quantities or origin of the merchandise. Generally, this fact occurs because the originator consolidates the invoices wrongly.

²² It is the document that contains all the detailed information about the merchandise such as weight, quantity and other characteristics such as numbers and trademarks of the merchandise. It is used by the exporter, carrier, insurance company, customs official and importer to identify the goods and facilitate the dispatch and recognition of the articles.

²³ Art.2 "Missing merchandise. - Merchandise that will not be found as a result of an inspection or physical inspection, but that is included in the respective Cargo Manifest " (REGULATIONS TO THE TITLE OF THE CUSTOMS FACILITATION FOR THE COMMERCE FROM THE BOOK V COPCI, 2011)

Art.96 "Surplus merchandise. - When at the time of the physical capacity there is evidence of surplus merchandise " (REGULATIONS TO THE TITLE OF THE CUSTOMS FACILITATION FOR THE COMMERCE FROM THE BOOK V COPCI, 2011)

- Lack of labels on some garments.
- The labels are not in compliance with the regulations.
- Wrongly classified²⁴ garments.

3.7 Advantages and disadvantages of "NAF NAF" franchise

In the first place, it is important to point out that according to the statement made by Mrs. Ruth Flores:

"Undertaking a business on one's own is really difficult, because the administrative part is extremely expensive and the importation costs are so high that a small business cannot satisfy the costs easily. In my opinion the benefit of having a unique -brand is that in an establishment the franchisee cannot have several clothing brands that are not related and can confuse consumers.

Also, it is a benefit that the franchise is responsible for delivering the collections according to the season and based on what is fashionable at that time, it is also important to have the support of being part of a renowned trademark, which constantly provides help and advice. "

Based on the interview conducted, it can be highlighted that the main advantages and disadvantages for the franchisee, when purchasing a franchise such as "NAF NAF", are:

3.7.1 Advantages for the franchisee of "NAF NAF"

- Feel the support of working with an internationally recognized trademark.
- Have constant support, in this case from the "Grupo Uribe" and its staff.
- Have the advice and training provided by the expert staff of the visual merchandising department.
- Do not worry about the type of clothing that should be in the store, because the company representative of "NAF NAF" is responsible for sending to each franchisee the clothes corresponding to each season with the designs and colors that are in fashion.

²⁴ Tariff classification: Refers to the system within which the merchandise is located in a tariff nomenclature, granting them a specific tariff heading, according to their characteristics.

- It is not necessary to perform extra advertising by the franchisee to promote the establishment, because the trademark is popular and known by most people, also within the official franchise page there is detailed information about the existence of the franchise in the city.

3.7.2 Disadvantages for the franchisee of "NAF NAF"

- There is no benefit to import through this business model, the only benefit is when importing in high volumes, the fixed costs are lower, but the fact of being a franchise does not exempt this business from paying any tax (Flores, 2017).
- At present, importation taxes are too high, so the profit is too low for the franchisee. According to Article 108 of the COPCI, the taxes on foreign trade are: "Tariffs; the taxes established in implementation and ordinary laws, whose generating events are related to the entry or exit of goods, and, the rates for customs services." The main taxes canceled by the franchisee are: tariff charged on the goods (AD-VALOREM), Development Fund for Children (FODINFA), specific tariff per unit or quantity of imported merchandise, VAT and the new rate of customs control service.
- It is necessary to pay the salaries of the personnel working in the establishment, legal advice, and the hiring of an accountant. The value per month of the salaries paid to all the staff of the two establishments are around \$ 2,200.
- Sometimes certain clauses established in the contract are not fully observed. In the case of the franchise in Cuenca, there are times when the personnel in charge of training does not come throughout the year.
- There are months when sales fall, so the goals of the quotas imposed by the franchise cannot be achieved. In these cases, there is no penalty, the franchisor simply communicates with the franchisee to inform that the fee has not been fulfilled and asks if there is any problem with the establishment and provides motivation and advice about some sales techniques with the aim that for the following month the sales increase and the quota is fulfilled in its entirety.
- Another factor that affects the franchise, is the new tax on the customs control service fee that must be paid for the imported items.

"The Customs Control Service Fee began to have effect on November 13, 2017, except for the customs regimes of" Postal Traffic ", " Accelerated Messaging ", Customs Transit

and Trans-shipment, whose entry is scheduled for January 15, 2018 "(Resolution No. SENAE SENAE 2017-0004-RE (M)).

This rate is for customs control throughout the Ecuadorian territory. The main objective of this rate is "to strengthen customs control, through coordinated actions and articulated with other State institutions improvements and innovation in risk management, technological and physical infrastructure, equipment and specialization human talent, will allow robustly combat customs offenses such as smuggling²⁵ and customs fraud²⁶ and obtain security and customs facilitation to formal importers who observe and comply with supranational regulations, other laws and current regulations" (*Resolución N. 2017-0001-RE(M)*) (SENAE, 2018).

The formula to calculate this rate is:

$$\text{Customs Control Service Fee} = \frac{\text{Merchandise weight (grams)}}{\text{Control unit (grams)}} \times \text{Rate (0,10 ctvs)}$$

In relation to this rate, Mrs. Ruth Flores, indicated that:

"It's something that directly affects me as a franchisee but not the franchise or the" NAF NAF " trademark, just like the other taxes that I have to pay are my responsibility, since the franchise has nothing to do with this issue. The last import arrived the first days of

²⁵ Art.301. "The person who wants to evade customs control and surveillance on goods whose amount is equal to or greater than ten unified basic salaries perform one or more of the following acts, will be punished with imprisonment of three to five years , a fine of up to three times the customs value of the merchandise subject to the offense, when: Clandestinely enters or extracts goods from the customs territory; Mobilize foreign merchandise within the secondary zone without the document proving the legal possession of the same; Load or unload unmanned goods from a means of transport, provided it is carried out without the control of the competent authorities; Landing, unloading or launch on land, sea or other means of transport, foreign goods before submitting to customs control, except in cases of forced arrival; Hide foreign merchandise by any mechanism without having been submitted to the control of the customs authorities; Violate or remove seals or other securities; Extract merchandise that is in primary zone or temporary storage, without having obtained the release of the same." (Integral Criminal Code, 2014)

²⁶ Art.299. "The person who harms the customs administration in the collection of taxes, on merchandise whose amount is higher than a hundred and fifty unified basic salaries, will be punished with imprisonment of three to five years and a fine of up to ten times the value of the taxes that were intended to be evaded, if any of the following acts is carried out: Import or export merchandise with false or adulterated documents to change the value, quality, quantity, weight, species, age, origin or other characteristics; Simulate a foreign trade operation with the purpose of obtaining a total or partial economic incentive; Do not declare the correct amount of merchandise; Obtain unduly the release or reduction of taxes to foreign trade; Induce by any means the error to the customs administration in the conditional return of taxes." (Integral Criminal Code, 2014)

the month of November of the current year (2017) so I still do not pay the fee, but in the next import that arrives on December 12, I must cancel this new fee²⁷. "

In addition, according to the interview with Ing. German Cantos, regarding this issue, he considers that:

"It negatively affects not only the garments, but all the items that have to pay this new rate. Personally, for me, for many of my colleagues and for people involved in imports, the rate is nothing more than a new camouflaged tax. This new rate punishes legal importers and generates an extra payment for a service that SENAE is supposed to provide without any type of payment. In addition, it affects the competitiveness of our country, as well as encourages smuggling. "

It is also necessary to know another point of view, so I interviewed an official of the Customs Office of the District of Cuenca, Mr. Carlos Brussil, to know his opinion on this rate, who explained:

"The objective of the fee for the customs control service is the collection of taxes for customs control in its phases: prior, concurrent and subsequent. From a personal and academic point of view, I analyzed that several amounts were previously charged for safeguards, which have already ended and the country cannot re-establish this payment, so this rate is a good initiative that partially replaces safeguards and it was not feasible to increase taxes and tariffs on foreign trade taxes, due to international agreements.

In addition, it should be taken into account that the rates allow SENAE to create and eliminate these, for example in the case of reimportation in the same State. It is clear that for importers, the payment of this rate is harmful, because it is an expense that causes the increase in fixed costs. Currently the payment of this fee per container is \$ 1000 to \$ 1200, but it is planned to establish a limit of \$700, with the objective that importers are not affected by this tax. "

²⁷ Art.1 Tributes are classified as: taxes, fees and special or improvement contributions. (Tax Code, 2005)
"Tributes are benefits in money, goods or services, determined by the Law, which the State receives as income based on the economic and contributory capacity of the people, which are aimed at financing public services and other purposes of general interest. "

"Taxes are the tributes required by the State, without a consideration and the taxpayer is obliged to pay for being in the case foreseen by the legal provision that configures the existence of the tax" (SRI, 2012)

"The rate is the tax generated by the provision of an effective or potential service, given directly by the State. The person pays for the use of a public service and independently of the economic capacity. If there is no administrative activity, there can be no fee "(SRI, 2012)

"Special contributions or improvements are payments to be made for the benefit obtained by a public work or other individualized state social benefit, whose destination is financing it." (SRI, 2012)

In my personal opinion, the measures imposed in the country, such as the customs control service tax and other taxes are very harmful for all people whose businesses are based on the sale of imported goods. In the case of franchises, these taxes represent a great disadvantage, because the franchisee must cover this payment with their own means, which means an additional expense that causes that purchases for the supply of the establishment become smaller and the price of the merchandise increases.

This situation causes loss of clientele and decrease in sales, so it would be a good initiative to set a limit on the payment of this rate, because in the importation of several items it represents a high expense, which is difficult to afford. In addition, this is one of the factors that discourages investors and people interested in establishing a business in Ecuador with imported products.

3.8 Competition of the "NAF NAF" franchise

The franchise like other businesses is not exempt from having direct and indirect competition, which in many cases can significantly harm the franchise, because similar products are offered, causing sales to go down.

In the case of "NAF NAF", established in the city of Cuenca, due to the amount of clothing stores that exist in the city, but mainly in the shopping centers, where the establishment is located, it has a variety of indirect competition, but in relation to direct competition, this is really scarce because in the city there are not many textile franchises. In the city the franchise has 2 establishments. The first one is in the El Vergel Shopping Center and the second one in the upper floor of the Mall del Río.

3.8.1 Indirect competition

Refers to premises or establishments of clothes, which are not franchises, according to the location of "NAF NAF", are:

3.8.1.1 Shopping Center "El Vergel"

- **V PINK:** It is a women's clothing store that offers informal, formal garments, jewellery, footwear, wallets and purses. Most of the articles are imported.

- **PASA:** It is one of the main Ecuadorian textile companies, it is mainly responsible for the manufacture of clothing for children, women and men. It has several shops in Ecuador.

3.8.1.2 Mall del Río

- **KOAJ:** It is a Colombian trademark, which offers women and men's clothing, mainly aimed at young people. It has great international acceptance. It is important to mention that in Cuenca, KOAJ is not a franchise, so it has a license to use the brand to market the products.
- **Moda RM:** It is a network of clothing stores for men, women and children, which is established in most cities of Ecuador. It sells national clothing, which is produced in Quito, and imported clothes from Colombia.
- **Coco Studio de Moda:** It is a place that offers casual and formal clothes, shoes and wallets. The main trademarks of the store are: Jennifer Lopez, Studio F, Ellipse, Off course, Jessica Simpson, Bebe, which are imported from Colombia and the United States.
- **Vanidades:** It is a store; whose owners are from Cuenca. It sells casual and formal clothing, footwear, jewellery, purses and handbags. The trademark has more than 15 years in the market. All garments are imported mainly from the United States.
- **Vatex:** It is a Cuenca company, which has achieved a great expansion and growth in Ecuador. The store is dedicated to the production and sale of clothes and also to the sale of imported clothes for women, men and children.
- **Etafashion:** It is an Ecuadorian company that is dedicated to the production and sale of casual and formal garments, intended for young people, adults and children. The company also sells imported clothing mainly from the United States and Brazil.

3.8.2 Direct competition

- **Chevignon:** It is a French franchise focused on men and women who love denim²⁸. Its most sold items are jeans and leather jackets. The franchise mainly offers casual clothes.

²⁸ It is a very resistant and durable cotton fiber fabric. It is generally used in the manufacture of pants, shirts and jackets.

According to the statement by Mrs. Ruth Flores, in the city of Cuenca there are no direct competitors for "NAF NAF", because there are no clothing franchises that offer products with a style similar to the trademark. In addition, its main competitors would be: Mango, Zara, Bershka and Stradivarius, which have the same line and style that manages the franchise, but these do not exist in Cuenca.

Regarding "Chevignon", this franchise despite belonging to the same group, offers clothing that does not focus on the same style. The main feature of "NAF NAF" is to offer fashion to all women, but on the contrary, Chevignon offers more jeans and jackets with cowboy styles, more classic and conservative. The only garment that we have as similar are jeans, but the difference is in the prices, because that trademark is much more expensive.

Coco Studio de Moda does not have a single brand, like "NAF NAF", because that store offers several trademarks in the same establishment. In addition, the style of clothing offered is tighter and more casual. In Cuenca there are no trademarks that offer clothing similar to this franchise, whose main focus is selling fashion " (Flores, 2017).

3.9 Advertising of "NAF NAF" in Cuenca

As explained by the franchisee, Mrs. Ruth Flores, the advertising in the city was relatively small because the trademark was already known internationally and nationally, since "NAF NAF" was already established in Quito in the "Quicentro Shopping" and in Guayaquil in "San Marino Shopping", so entering to the Cuenca market was easy, because all people looked forward to the arrival of the trademark in the city.

The manner in which the citizens were informed was through publications made on the official page of the franchise and in magazines of great popularity in the country.

At the inauguration of the two establishments in the "El Vergel" Shopping Center and in the Mall del Río, invitations were sent to the press, mainly to newspapers and magazines.

In addition, representatives of the franchise, such as the visual merchandising staff and the manager of the "Grupo Uribe" arrived, for this reason a person was hired to dress as a princess and advertise in the same shopping center with the objective that people knew the exact place where "NAF NAF" was located, snacks were also offered for the people present at the inauguration.

3.10 Requirements imposed by the franchisor

The main requirements that the franchisor establishes and that the franchisee has to observe, in the case of "NAF NAF", according to the interview with Mrs. Ruth Flores, are:

- The employees of the franchisee must have a good presence, ability to convince, serve customers and know how to use the visual merchandising.
- Send photos constantly about the condition of the establishment to verify that everything required by the franchisor is fulfilled in relation to the showcases, discounts and promotions that are made.
- Inform the franchisor about the existing stock, because it is forbidden to sell clothing belonging to previous years. The franchisee makes a firm purchase, not a consignment, so everything purchased is the responsibility of this person. In relation to the garments of previous years, which the franchisee has not been able to sell, these are relatively few, because there are a maximum of 10 pieces, these are given to the staff of the establishment or to people who need it.
- Recommendations about the selection of personnel, but it is the franchisee's decision to hire them.
- Training the employees of the establishment about the manner in which the garments should be folded and exhibited.
- Purchase of the showcases and all the decoration according to the different seasons. The acquisition of four showcases in the year: Christmas, January discounts, Mothers' Day and holiday season.

3.11 Staff

"NAF NAF", has a total of four employees, among which are three saleswomen who depending on the season, rotate between the "Vergel" Shopping Center and Mall del Río and an accountant. All the personnel are paid the salary, insurance, additional yearly salaries, profits and also the sellers are paid a commission for the number of sales they make individually.

Conclusion

This chapter is of great importance for investors or people interested in acquiring a franchise, mainly textile as in the case of "NAF NAF" and it is necessary to know the point of view of the franchisee in this case, Mrs. Ruth Flowers, because as it happens with everything, obtaining and establishing a business has its benefits, but also its disadvantages.

Throughout this chapter, there is a description of all the steps that the franchisee must follow to acquire a franchise. It is necessary to comply with certain requirements determined by the franchisor in relation to the amount of sales, the decoration of the establishment, the fulfillment of the respective payments by the franchisee, the way in which the franchise contract is developed, the main competition of the trademark, considering the place in which it is established, the support and training provided to the franchisee and its employees, in order to ensure that everything is being carried out correctly for the benefit of the trademark.

In my personal opinion, considering the advantages such as having the franchisor's support and the trademark's international reputation and considering that in Cuenca, there are almost no textile franchises that would be the main competitors. Also, its main disadvantages such as the need to have a high capital for the establishment of the store and the economic situation in Ecuador that shows that this business model does not represent a good investment of money because the payment of taxes is too high, which directly affects the franchisee, so the profits established at the beginning of the contract decrease, due to the obligation to pay more and more taxes.

The payment of taxes discourages investors who want to establish a franchise in the country. Evaluating all these aspects, I consider that currently obtaining and establishing a franchise is complicated, because it is hard to comply with the main economic requirements that are imposed by the brand, the payment of various taxes, fees and other extra expenses that must be paid continuously, such as payment of fees to the Customs Agent, payment of salaries to employees, among others, which make the maintenance of this business model more difficult.

CHAPTER 4: CONCLUSIONS AND RECOMMENDATIONS

Conclusions

After having completed the proposed analysis and fulfilling the purpose, it can be determined that this last chapter will help to improve the understanding of this work, taking into account that the franchise is a business model that has had in recent years a great growth and development not only at the international level but also at the national level, because it is considered an innovative way to establish a business and to help the development of investors and people interested in becoming part of this system.

Like any business, the franchise implies risks, responsibilities and obligations that must be fulfilled by the parties involved, so the franchisee and the franchisor are responsible for bringing success to the franchise through permanent communication, support, continuous assistance, trust and loyalty that all the information provided to the franchisee will be kept secret and will be protected by this person.

Currently, in Ecuador there are several foreign franchises established in the main cities such as Quito, Guayaquil and Cuenca. In the case of Cuenca this system is relatively new, because the existence of textile franchises such as "NAF NAF" is very scarce, which is favorable for it, because there is no direct competition.

In relation to the study of this textile franchise that is focused on colorful and youthful women's garments, it is possible to conclude that obtaining a franchise has its benefits such as having the assistance and continuous support from the franchisor, having the support that the trademark is known internationally and the quality of the garments is guaranteed, not having the need to carry out advertising without support because the franchisor is in charge of doing it.

This situation does not happen when a person tries to establish a business in an independent way, because this person does not have the support of someone, it is uncertain to know if the products offered will be successful or not, because in most cases these are not recognized brands. Also, if there is a problem the owner must solve it on his or her own without the experience and help of someone who already knows more about that business.

On the other hand, although "NAF NAF" is practically the only franchise with this style of clothing in the city of Cuenca, at the present moment the situation is not favourable because there are a lot of taxes and tariffs that the franchisee has to pay to import all the merchandise and necessary decoration for the establishment, which is a great disadvantage because these payments must be covered through the franchisee's account, representing one more expense. This situation causes that most people interested in investing in a franchise and establishing it in the country feel unmotivated for the amount of taxes that must be paid and the fact that these are increasing, as the new rate of customs control service.

Also, it is necessary to consider that when a person obtains a franchise, this person has to comply with certain requirements imposed by the trademark. In the case of "NAF NAF", the most challenging requirement to the franchisee is compliance with a number of specific monthly sales, because the sales of the establishment can go down by conditions that the franchisee cannot control and it is really difficult to comply with that quota. Also, it can be unfavorable the fact that in the premises there cannot be garments of previous years, which is a great loss for the franchisee, because such person cannot return or sell these.

One of the most important areas in this research is the legal one, in which its main element is the franchise contract. This contract in Ecuador and in the other countries analysed is currently maintained as atypical based on the will of the parties and flexibility when contracting, despite the fact that the country intends to regulate as proposed in the Project of the Commercial Code, which has already been approved in its first debate.

In other countries such as Mexico, Canada, the United States and Spain the franchise contract is typical. The existence of problems mainly caused by the rigidity of the regulatory bodies that regulate this business model causes great discomfort mainly in the franchisees, because there is no possibility of modifying clauses that do not fit with their interests.

On the other hand, these inconveniences are rare in the franchisors, because being the owners of a network that is internationally known, they have advisors and experts, who guide them to write contracts according to their interests and benefits, so in this situation the most disadvantaged are the franchisees.

In my personal opinion, the franchise contract should be kept atypical, because the parties have a better chance to negotiate and obtain a contract that benefits both and suits their main needs. In addition, the parties can have a better contractual relationship, so dialogue and communication are more encouraged. It is necessary to consider that

obtaining a worldwide recognized franchise brings the security and certainty that the contract is correctly prepared, preventing any eventuality or problem in the future, so the contracts of famous brands, do not need an express regulation, because these contracts have the essential advice and support to achieve the progress of the franchise and the successful contractual relationship between the franchisor and franchisee.

In relation to the contract, the authorities of Ecuador should evaluate the disadvantages that would be caused by regulating it, because now the parties have the possibility to have freedom to adjust it to their benefit. If the contract is typical, it will turn out to be an unattractive business, because the parties will only have to comply with the provisions of the law, which can be a great disadvantage, because there may be clauses in which some of the parties do not agree and they do not have the possibility of modifying them, so the people will simply choose not to obtain that franchise.

A good option is that the authorities should create a Code of Ethics, which simply provides recommendations on the correct way to negotiate and obtain a franchise, but that does not force the parties to comply strictly with the provisions in a specific regulation.

In conclusion, after analyzing all the advantages and disadvantages, I can say that the franchise is a very attractive business model for investors and interested people in having a business due to the success of the trademark after market studies, the experience of the franchisor, the constant support that the franchisee has, so for this reason this system has achieved great progress worldwide.

In the country, establishing a foreign franchise can be complicated not by the fact that this network implies, but for the amount of taxes and payments that must be paid when importing all the merchandise and other necessary items for its operation. It is important to consider that the main reason why investors do not opt for this system is not for the requirements of the trademark, because these can be negotiated by the parties and can be modified, but the increase in taxes is a situation that worries people interested in obtaining a franchise, because it represents an extra expense, which is really high and difficult to pay by entrepreneurs who have just started with this business.

In addition, the franchise is not an exemption or is not included in the exception regimes, but it is an importation regime; specifically, it allows to import goods for consumption, but the franchise must pay all taxes on foreign trade, so it does not have privileges. Regarding the legal issue, which is the main aspect of this research and is an essential perspective in the franchise, after analyzing several legal bodies, I have concluded that the best option is to maintain the franchise contract atypical, so each of the parties

involved can adjust it to their interests and not simply comply with what is established in a legal body.

Recommendations

- Firstly, at the moment of obtaining a franchise both parties must evaluate the obligations, responsibility and requirements that must be observed, in order to avoid problems of non-compliance in the future.
- When the contract is atypical, the franchisee must negotiate with the franchisor the clauses that can affect his or her personal interests.
- The franchisee must guarantee that the franchisor provides all the information and necessary support to ensure the success of the franchise and that the brand, trade name, know-how, manuals, distinctive signs and documents are correctly registered for the operation of this business model.
- Take into account that in the country, the payment of taxes and other duties is really high, the competent authorities should consider reducing these payments a little. In the case of the payment of the new customs control service fee, it has gone through several inconveniences due to the lawsuits that have been filed against SENA. It is important to consider that the best option would be its elimination, due to the damages it has caused not only at the national level, being the most affected importers and consumers of imported products, who finally end up paying these taxes. It is also necessary to consider all the inconveniences that have been given internationally.
- Consider which is the direct competition that the franchise will have in the place where it will be established to ensure the reception of this business model by the clients.
- If there is any problem with the franchise, consult and ask for assistance from the franchisor, because this person knows more about the business.
- Maintain loyalty and confidentiality in all of the information provided by the franchisor, in order to have a good contractual relationship with the other part.
- In Ecuador it is necessary to consider the implementation of a Code of Ethics, which will guide the parties to contract and obtain a franchise in an appropriate manner, due to the growth that this system has had in the country and not force the parties to strictly comply with the provisions of a specific regulation.

- In relation to the Project of the Commercial Code and its proposal to regulate the franchise contract, it is unfavorable for the parties, because it limits them to comply with the provisions of the law and does not have the possibility to negotiate and make changes to help meet their interests. This situation may be contrary to what is established in this Project which can affect the franchisor and the franchisee. Taking into account that Mexico, the United States, Spain and Canada consider this contract as typical, but in these cases the main persons who are affected are the franchisees, because they cannot have freedom when hiring, so they must comply with the provisions of the different laws that regulate this business model, which in most of the cases do not satisfy their interests.

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Appendices

For the completion of this research, it is considered necessary to attach the following annexes:

Appendix 1: Interview with Mrs. Ruth Flores, franchisee of "NAF NAF" in Cuenca:

• How did you know about "NAF NAF"?

I learned about the brand 15 years ago in Quito and I liked it very much, but at that time franchises were not granted. Later, through a contact that I have in that city, so I communicated with the manager of "Grupo Uribe", who told me that franchises were already being granted.

• How was the negotiation process with the franchisor?

I spoke with Wadir Jaramillo, who was the manager of "Grupo Uribe" and he asked for my curriculum, so I sent it to him. Then we had a meeting to clear up all the doubts and finally signed the contract, based on the will of the parties.

• How did you establish the franchise in Cuenca?

I did not really have to look for the place, I simply went to the shopping center "El Vergel" and I found the place that met the only requirement requested by the franchise, which was a space of 70 square meters and I decided to lease it.

• What were the steps you followed to obtain the "NAF NAF" franchise?

In summary, the main steps were: contact the franchisor or its representatives, send personal information to the representatives of the franchise, wait for the response of the franchisor, sign the contract, after clarifying the doubts with Waldir Jaramillo, find the location that met the requirements established by the franchise, pay the entry fee at the time of obtaining the franchise and finally pay the advertising fee continuously.

• Do you think it is more beneficial for the contract to be atypical or typical?

It is better to be atypical, because in this way the franchisee and the franchisor have the possibility of adjusting the contract according to their own interests and through the will of the parties.

- **Do you know about the changes proposed in the Project of the Commercial Code, especially regarding franchises?**

I really do not know about this topic.

- **Do you consider that it is more beneficial for people who want to establish their own business, to do it independently or through the franchise system?**

In my opinion as a franchisee, I think the best is through the franchise system because it has the support of a brand recognized worldwide and the help of the franchisor in case of any inconvenience. Establishing a business independently is really difficult, because the administrative part is too expensive.

- **In relation to clothing, how is the importation process carried out, do you have any benefit to be a clothing franchise or the expenses are the same?**

There is no benefit, the costs and payments to all taxes on foreign trade must be paid like a normal importation.

- **How does the payment of the customs control service fee affect the franchise?**

It directly affects me as a franchisee, because all the import tax payments and fees must be paid by me and the franchisor has nothing to do with this situation, because these taxes are imposed by the country.

- **What is the duration of the "NAF NAF" contract?**

It is of indefinite duration.

- **What requirements must be complied to obtain the franchise?**

The requirements are: have a stable economic situation, accept and comply with all the provisions of the contract, buy all the necessary items for the decoration of the establishment and achieve the sales goals established by the franchisor.

- **What are your biggest competitors?**

I consider that I do not have direct competitors of the franchise within the city, because my competitors would be Bershka, Zara, Stradivarius, but those trademarks are not established in the city.

- **How do you carry out the establishment's advertising?**

At the time of obtaining the franchise, I did not need to make publicity, because the brand was recognized.

The only advertising was that on the official page of "NAF NAF", it was written that the brand would arrive in Cuenca and I invited to the press for the opening of the establishment.

Appendix 2: Interview with Lawyer Nicolás Muñoz of Sur Legal.

• According to your experience in the subject of franchises, is it more beneficial for the contract to be typical or atypical?

From the legal point of view, it is better that the contract is atypical because the parties have the necessary flexibility and freedom to contract. From the practical point of view, it is better typically, because the contracts become obsolete and this causes many controversies between the parties, so it is necessary to have a law to prevent all kinds of problems.

• What is the current status of the Project of the Commercial Code, is it filed or is it still ongoing?

At present after having passed the first debate, it is in process.

• What are the advantages of the contract being atypical?

The main advantages are:

- The will of the parties involved.
- Flexibility
- For the franchises that are recognized, you can be sure that the contract is done correctly and for the small companies that have the system, but not the money, they have the possibility of adjusting the contract to their needs.

• What are the advantages of the contract being typical?

The advantages are:

- Helps to have all aspects clarified in regards to what the franchise involves and what it does not involve.
- Prevents problems in case of disagreements between the parties.

Appendix 3: Interview with Dr. Susana Vázquez, Regional Director of the Ecuadorian Institute of Intellectual Property (IEPI).

- **Regarding the issue of franchises, what are the duties performed by the IEPI?**

The IEPI does not have competence regarding the subject of franchises, but it does have competence in the trademark use register, which is mandatory and takes effect from its registration.

- **How is registered the use of the trademark?**

It must be done by the franchisor to protect and give greater security to the franchisee. It is necessary to know that the brand does not have any type of inconvenience and that it will not be used by an unauthorized person.

- **What do you consider to be the most important clauses in a franchise agreement?**

In my opinion, the confidentiality clauses, the exploitation of the brand and the clause referring to the "know-how" or industrial secret to protect the franchisee and ensure the loyalty are of great importance.

- **Do you know about the changes proposed by the Project of the Commercial Code to regulate the franchise contract and make it typical?**

I do not really know about this issue, because the commercial issues are not the responsibility of the IEPI.

Appendix 4: Interview with engineer Carlos Brussil, official of the Customs Office of the District of Cuenca

- **What do you think about the customs control service fee?**

This rate is a good initiative that partially replaces safeguards since it was not feasible to increase taxes and tariffs on foreign trade taxes, due to the existence of international agreements.

- **Is this tax beneficial or detrimental to importers?**

For importers, the payment of this rate is harmful, because it is an expense that causes the increase of fixed costs.

- **In the case of a franchise, is the process of importation the same as for any other business?**

Yes, the procedure is the same, because the franchise is an importation for consumption, so it is done in the same way as a small or big business.

- **In relation to the importation of clothing, how much is the value to be paid for the rate?**

From my experience a garment container pays between \$ 1000 to \$ 1200, but SENA E wants to establish a limit of \$700.

Appendix 5: Interview with engineer German Cantos, Customs Agent

- **What is the process to follow for the importation of garments?**

First you must obtain the electronic signature, then you must have the importer registration in the SENA E and the registration in the Ministry of Industries and Productivity. When the garments are in the country, these have to be labelled according to the INEN norm, then the labeling of the garments is inspected. The verification company gives the certificate of conformity if everything is fine, then the ECUAPASS system assigns a gauging channel, which most of the time is physical due to alerts that the garments usually have and finally the authorization for the release is given.

- **What are the requirements that the person who wants to import must have?**

To import any product to our country the interested person must register as an importer in the SENA E.

- **How do you think the new customs service control rate affects the importation of garments?**

Personally, for me and for many of my colleagues and people involved in imports is nothing more than a new camouflaged tax. This new rate punishes legal importers and generates an extra payment for a service that SENA E is supposed to provide without

any type of payment. In addition, it affects the competitiveness of our country and encourages smuggling.

Image 1: Inauguration of “NAF NAF” in Mall del Río



Source: El Tiempo (April 25, 2015)

Retrieved: February 23, 2018

Image 2: Franchisee of "NAF NAF", Mrs. Ruth Flores



Image 3: "NAF NAF", Mall del Río





Image 4: Imported decoration of "NAF NAF"

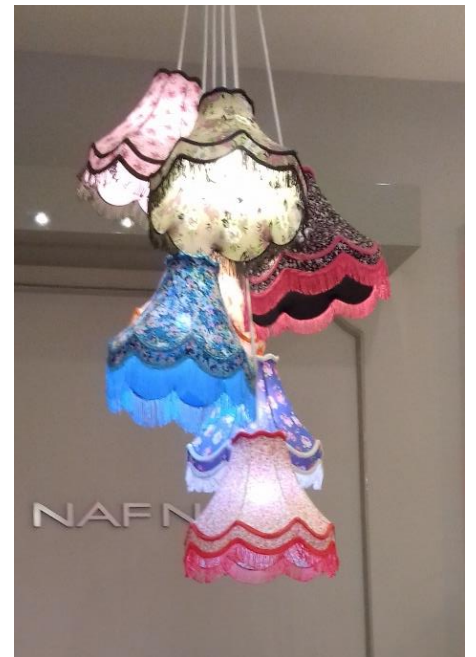


Image 5: Showcase of the month of February of "NAF NAF"



Image 6: Screenshot about the Project of the Commercial Code and its status in process

Es seguro

https://leyes.asambleanacional.gob.ec

Buscar por

Proyecto presentado

Proponente

Comisión asignada

Seleccione una comisión

Año

Buscar

Reiniciar

5

(80 of 220)

Fecha de presentación	Proyecto de ley	Proyecto presentado	Calificación CAL	Primer debate	Segundo debate	Aprobación del Pleno	Objeción total	Ejecutivo objeción parcial	Texto definitivo	Registro oficial	Estado
2015-11-11	Proyecto del Código del Comercio GALO BORJA PEREZ	Pdf	Pdf	Pdf	Pdf						En trámite