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The Importance of Franchise Agreement in the Development Process of Small and Medium-Sized Businesses

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Abstract

Franchise agreements play a significant role in the development of small and medium-sized enterprises (SMEs) by providing access to established business models, recognized brands, and managerial support. This article examines the legal effectiveness of franchise agreements in protecting SMEs and maintaining a fair balance between the contractual rights and obligations of franchisors and franchisees. The research employs qualitative methods, including doctrinal legal analysis, systematic analysis, and critical examination of relevant scholarly literature. The findings indicate that, despite their potential to reduce market-entry risks and promote business stability, franchise agreements may expose SMEs to legal and economic vulnerabilities arising from standardized contractual terms, excessive control, restrictive non-compete clauses, and the disproportionate allocation of economic risks. The analysis further highlights the importance of mandatory legal provisions, the principle of good faith, competition law, and confidentiality obligations in safeguarding the legitimate interests of franchisees. The study contributes to the legal analysis of franchising by examining the protection of franchisees under Georgian law and identifying the contractual and regulatory safeguards necessary to maintain a balance between the parties. The article concludes that the effectiveness of franchising as a mechanism for SME development depends not merely on the existence of a contractual framework, but on its fairness, legal

compliance, and practical implementation. A balanced approach to contractual freedom and legal protection is therefore essential to preserving entrepreneurial independence and supporting the sustainable development of SMEs.

Keywords: Confidentiality, franchise agreement, franchising system, good faith, small and medium-sized businesses

Introduction

In the context of globalization and intense market competition, small and medium-sized businesses face significant challenges, including limited financial resources, lack of managerial experience, and difficulty in establishing themselves in the market. In this context, franchising has emerged as an effective form of business organization that offers small and medium-sized enterprises an established business model, a well-known brand, and a standardized management system (Wright, Johnston & Mackenzie, 2012). The basis of the franchising system is the franchise agreement, which defines the economic and legal relations between the parties and has a significant impact on the development process of small and medium-sized businesses (Mathewson & Winter, 1985).

For small and medium-sized businesses, a franchise agreement creates legal security, as it predetermines the rules of business operation, financial obligations, quality standards, and scope of responsibility. It is these pre-written terms that reduce uncertainty and promote stable operations.

One of the most important functions of a franchise agreement for small and medium-sized businesses is to reduce the risk of entering the market. Unlike an independent enterprise, a franchisee already has access to a well-known brand and a proven business model, which significantly increases the likelihood of success. In addition, the agreement provides the franchisee with managerial, technical and marketing support, which is especially important for enterprises that do not have sufficient experience or resources (Wright, Johnston & Mackenzie, 2012). Thus, a franchise agreement is not only a legal document, but also a development tool that allows small and medium-sized businesses to quickly integrate into a competitive market.

Although franchising is widely recognized as an important form of development of small and medium-sized businesses, practice shows that the franchise agreement often fails to fully fulfill the protective function that it is theoretically assigned. The franchisee, as a rule, is a small or medium-sized enterprise, which, due to limited financial and legal resources, is forced to accept pre-formulated, standard contract terms. This circumstance

significantly limits its ability to participate in the actual agreement on the content of the contract and increases the risk that the contract will contain provisions that limit its entrepreneurial freedom and economic independence. Another important aspect of the problem is the vague definition of the scope of control of the franchisee. In practice, there are frequent cases when instructions issued by the franchisor in the form of recommendations become in fact mandatory. This is particularly evident in the areas of pricing policy, supplier selection and operational decisions. In such circumstances, the franchisee formally retains the status of an independent business, but in reality, loses its freedom of decision-making, which contradicts both the principles of competition law and the goals of SME development.

In addition, the insufficient understanding of imperative legal norms in the practice of contractual relations is problematic. Franchise agreements often contain provisions that go beyond the scope permitted by law, including unjustifiably broad restrictions on non-compete, price fixing or the complete transfer of economic risks to the franchisee (Binford, Bryner & Doroghazi, 2019). These provisions are not only legally questionable, but also systematically weaken the development potential of SME.

Thus, the essence of the problem lies not in the inefficiency of the franchising model, but in the inconsistency of the content and practical implementation of the franchise agreement with the legal and economic principles aimed at ensuring fair competition, freedom of entrepreneurship and the protection of small and medium-sized businesses. The research contribution of this article lies in its examination of the relationship between the contractual structure of franchising and the legal protection of small and medium-sized enterprises within the Georgian legal framework. While existing scholarship has addressed the economic rationale of franchising, contractual relations between franchisors and franchisees, and the role of good faith in franchise agreements, this article brings these issues together through a focused analysis of Georgian private and competition law. It specifically examines the legal implications of the allocation of contractual obligations, pre-contractual disclosure and confidentiality, the limits of franchisor control, and restrictions on the franchisee's entrepreneurial autonomy. By analyzing the relevant provisions of the Civil Code of Georgia alongside applicable competition-law principles, the article seeks to clarify the legal safeguards available to franchisees and identify areas in which contractual arrangements may undermine the intended contribution of franchising to SME development.

Based on the above, the purpose of this article is to critically analyze the franchise agreement from the perspective of the primacy of law and to identify the legal mechanisms that provide real protection to the franchisee.

Methods

This study represents a qualitative research approach based on doctrinal legal analysis to examine the role of franchise agreements in the development of small and medium-sized enterprises (SMEs). The research focuses on the legal framework governing franchising relationships and critically examines the extent to which contractual provisions ensure legal certainty, protect the economic independence of franchisees, and promote fair competition.

The study applies the legal-dogmatic method to analyze the legal principles and rules relevant to franchise agreements, with particular attention to the principle of good faith, mandatory legal norms, competition law, and the protection of contractual parties. This method facilitates the examination of the legal limits of contractual freedom and the mechanisms available to prevent the imposition of unfair or excessively restrictive contractual terms on franchisees.

The systematic analysis method is used to examine the interrelationship between contractual provisions, intellectual property rights, confidentiality obligations, and the economic interests of the parties. This approach helps identify how individual contractual clauses may influence the overall balance of rights and obligations within the franchising relationship.

Furthermore, the analytical and critical methods are employed to assess the potential discrepancy between the theoretical advantages of franchising and its practical implications for SMEs. Particular attention is given to standardized contractual terms, restrictions on entrepreneurial autonomy, pricing arrangements, non-compete clauses, and the allocation of economic risks between franchisors and franchisees.

The research also draws on a review and analysis of relevant scholarly literature to establish the theoretical foundations of franchising and assess its role in SME development. By integrating legal analysis with critical examination of contractual relationships, the study seeks to identify the legal safeguards necessary to ensure that franchise agreements support business development while respecting the principles of good faith, fair competition, and legal certainty.

The findings are synthesized to formulate conclusions regarding the effectiveness of existing contractual safeguards and the importance of a balanced legal framework in protecting the legitimate interests of franchisees.

Franchise Agreement as a Legal Basis for Business Relationships

A franchise agreement is a long-term contractual relationship in which independent enterprises, depending on their needs, mutually undertake to facilitate the production, sale and provision of goods and services by

fulfilling specific obligations (Wright, Johnston & Mackenzie, 2012). The World Intellectual Property Organization defines franchising as a type of contract under which a person (franchisor) who has a developed system for carrying out a specific activity allows another person (franchisee) to use this system in accordance with the franchisor's requirements and in exchange for equivalent compensation. Accordingly, there is no significant contradiction in content between the definitions given, but rather the definition of the World Intellectual Property Organization brings some clarity to the not so simply formulated definition of the Civil Code of Georgia.

The definition of the franchise agreement in US law is interesting, since it was there that its formation as a legal institution was carried out. The California Corporation Code provides an interesting definition of the franchise agreement - franchising is an oral or written contract or agreement between two or more persons, by which the franchisee is granted the right, when carrying out entrepreneurial activities, to use a marketing strategy plan or system for offering, selling and distributing goods (services), the essential part of which was created by the franchisor; The franchise system includes the franchisor's trademark, trade name, as well as logos, other trade secrets, which are also created by the franchisor. The franchisee is obliged to pay a fee directly or indirectly. It is believed that the definition of franchising given was a pioneer, and all subsequent definitions are derived from it, which is why the definitions of franchising by different states have often not been as broad (Kim & Tiwana, 2022).

According to the Civil Code of Georgia, 1. A franchise agreement establishes a long-term contractual relationship between the parties. 2. The parties to a franchise agreement are only enterprises. 3. During a franchise agreement, both parties are burdened with obligations related to the production of goods and the provision of services (Civil Code of Georgia, 1997, Article 607).

In addition to the conceptual features of a franchise agreement, the features identified by the World Intellectual Property Organization are interesting. In particular, these are: 1. Transfer of rights to the franchise system; 2. Origin of long-term contractual relationships; 3. Advantage of the franchisor. The named features of the franchise agreement are mainly practical in nature and, unlike the conceptual features derived from the Civil Code, create a clearer picture of the specifics of this institution (World Intellectual Property Organization, 2019).

Economists consider franchising as a strategy for wealth creation in a dynamic and uncertain environment. For them, it is a form of inter-organizational relations that uses a joint agreement to stimulate entrepreneurial activity. Franchising is a mechanism for stimulating entrepreneurial activity (Khurtsidze, 2005).

Strengthening small and medium-sized businesses leads to the creation of new jobs, the development of local production and the strengthening of the regional economy. Quality standards established through the agreement contribute to the increase in the competitiveness of products and services. In addition, the franchise agreement performs the function of transferring knowledge and experience, which in the long term increases the entrepreneurial culture and improves the quality of business management in the small and medium-sized sector.

Despite its many advantages, the franchise agreement is accompanied by certain limitations. Often the agreement is drawn up in favor of the franchisor, which limits the franchisee's freedom of decision-making. Strict adherence to standards and control mechanisms in some cases hinder innovative approaches and individual business development. In addition, financial obligations can become a heavy burden for a small enterprise, especially in conditions of economic instability. The above circumstances indicate that the balanced and fair formation of a franchise agreement is a decisive factor for the sustainable development of small and medium-sized businesses.

The essence of the franchise system

According to the European Code of Ethics for Franchising, the franchise system includes rights to trademarks, service marks, know-how, business and technological methods, procedural systems and other industrial and/or intellectual property objects, which will be supported by commercial and technical cooperation within the framework defined by the contract (European Franchise Federation, 2021). The franchise system is a system of intellectual property objects that the franchisor transfers to the franchisee with the right to use them. It may include, for example, computer programs, databases, design elements, rights to inventions, utility models, and everything else that is an intellectual property object (Jang (Shawn) & Park, 2019).

The transfer of a franchise system, as a fact, precedes the development of a unified action plan. This plan also includes obligations to be fulfilled in the future that go beyond the scope of the franchise system. Both systems, whether franchising or unified action systems, are created by the franchisor and the franchisee is actually forced to accept them in their finished form, since a new enterprise in a particular field is not actually able to make its own adjustments to it (Khurtsidze, 2005).

The franchise system is the subject of the contract insofar as it is the main structural part of the unified action program. Although the unified action plan is different in different agreements, as is the franchising system, they show external similarity in one or another specific type of franchise

agreement (Khurtsidze, 2005). For example, in service franchising, the franchising system and subsequently the unified action system (program) are always related to the provision of services. As a rule, each party to the franchise agreement is connected to each other by a whole system of rights and obligations. In practice, its volume, which describes in detail the rights and obligations of the parties, sometimes reaches up to a hundred pages. In most cases, we are dealing with such a complexity of the content of the franchise agreement that it has been recognized as a special agreement in legal literature. Franchising is a type of pecuniary agreement. A gratuitous franchise agreement is practically impossible to exist. Thus, under a franchise agreement, a single operating program is transferred to the franchisee in exchange for appropriate compensation. Sometimes a franchise agreement is also referred to as a vertical agreement.

Confidentiality Agreement of the Parties to a Franchise Agreement

In general, the pre-contractual period includes several stages. The start of negotiations and the provision of information is preceded by the use of various pre-contractual mechanisms. Their selection should be made depending on the type of agreement the parties intend to conclude. The most frequently used agreement in a franchise agreement is a confidentiality agreement. Its main purpose is to ensure the confidentiality of confidential information received from each other by the parties during the negotiation process. This is where its name comes from.

However, it should be noted that the positive consequences of concluding a confidentiality agreement can be quite diverse, and sometimes it may even change the franchise agreement to some extent. The requirement for a written form for a preliminary agreement follows from the written form specified for the main agreement and the nature of the information that must be included in this agreement. The parties have a special interest in the written form, so that in the future a written document can be used as evidence in the event of compensation for damage caused by the disclosure of a commercial secret by one of them. A written agreement is the best means of proof in cases where a dispute arises between the parties to the agreement over a particular issue.

A confidentiality agreement is most often used in a franchise agreement. Its main purpose is to ensure that confidential information received from each other during the negotiation process is kept secret. This is where its name comes from (Mathewson & Winter, 1985). The confidentiality agreement of the parties is independent of the franchise agreement that will be concluded later and is characterized by different legal consequences. The confidentiality agreement is not intended to create an obligation to conclude a franchise agreement, but rather to provide legal

guarantees to potential contractors that their commercial or other secrets will not be violated, although it is not excluded that the parties also agree to an obligation to conclude a franchise agreement (Taylor & Harres, 2019).

The UNIDROIT Model Law Commentaries also highlight the importance of a confidentiality agreement. Its function is to allow the process to proceed in order to conduct further negotiations on the provision of information before the franchisor is obliged to assume its obligations (Nix, 2019). If the enterprises no longer wish to conclude a franchise agreement due to knowledge of each other's financial situation or for other reasons, they cannot claim damages from each other by stating that the agreement was not concluded. Instead, the costs that the potential contractors incurred in order to conclude a confidentiality agreement must be compensated (Covic, Petrovic & Covic, 2019). In this case, the costs incurred for the preparation and processing of information occupy a central place. The dissemination of entrusted information is considered a breach of obligation and gives rise to the right to claim damages. The use of a trade secret provided by the negotiating enterprise for one's own purposes is also considered to be a disclosure of information (Spencer, 2008).

The confidentiality obligation specified in the contract reduces the risk of unwanted competition and ensures the protection of the economic interests of small and medium-sized enterprises, especially when the franchisee does not yet have sufficient financial or managerial experience to operate independently in the market (Taylor & Harres, 2019). Such regulation is not only a legal guarantee, but also contributes to the stable development of small and medium-sized businesses, the exchange of managerial and operational decisions with the support of the franchisor, and the creation of a safe environment for integration into a competitive market.

The application of the principle of good faith in a franchise agreement

It is worth noting that the principle of good faith in international trade relations includes two main aspects: the performance of obligations and the interpretation of the contract (Perrigot, Terry & Di Lernia, 2019). In the case of a contract that creates relationships such as franchising, the principle of good faith has a special significance, as it guides the behavior of the parties. It should be noted that in common law doctrine, there are opponents of the application of the principle of good faith to a franchise agreement (Sewu, 2019).

The principle of good faith, in terms of the performance of obligations, is characterized by a threefold effect on franchising. Complementing its regulatory norms in pre-contractual relations, it simultaneously determines the fulfillment of the parties' obligations in the period immediately following the conclusion of the contract and serves as an

instrument for resolving disputes arising from the parties' failure to fulfill their obligations (Floriani, Carnevale & Nakhoul, 2019).

Under Georgian law, the principle of good faith constitutes a general standard governing the exercise of rights and the performance of obligations. Article 8(3) of the Civil Code of Georgia requires participants in legal relationships to exercise their rights and duties in good faith (Civil Code of Georgia, 1997, article 8(3)), while Article 361(2) requires obligations to be performed properly and in good faith (Civil Code of Georgia, 1997, article 361(2)). These general provisions are particularly relevant to franchising relationships, which involve continuing cooperation and a potentially unequal distribution of contractual power. In addition, Article 610 specifically requires the parties to a franchise agreement to disclose relevant circumstances fully and honestly and to preserve entrusted information, even where the agreement is ultimately not concluded (Civil Code of Georgia, 1997, article 610). Read together, these provisions provide a legal basis for assessing the conduct of the parties during negotiations and throughout the performance of the franchise agreement.

The importance of good faith is given considerable attention in the USA, as in continental European countries, at the stage of preparing a franchise agreement. Even after the conclusion of the agreement, the general reservation is undoubtedly of great importance for both common law and continental European countries. Individual provisions of the US franchise offer document describe the rights and obligations of the parties with point-by-point precision, but still leave room for the application of general principles and norms (Ikonomi, 2014). In the case of small and medium-sized businesses, which often enter the market with limited resources and experience, compliance with this principle ensures a balanced and predictable economic environment based on trust between the franchisor and the franchisee. The application of the principle of good faith allows the franchisee to have protected rights in relation to the obligations defined by the agreement (Ikonomi, 2014). For example, compliance with the principle means that a franchisor cannot use control mechanisms to obtain hidden or unfair benefits. This is especially important for small and medium-sized businesses that have less experience in marketing, operations or finance, as acting in good faith practically protects their economic interests and increases their sustainability in the market.

Content of a Franchise Agreement

The conclusion of a franchise agreement and its subsequent legal consequences are reflected in entrepreneurial decisions and the implementation of entrepreneurial activities in general, therefore, the parties are obliged to determine the content of the agreement in such a way as to

maintain contractual equality as much as possible and to give the economically stronger party, which is usually the franchisor, less opportunity to abuse its own advantage. The moral duty to conduct entrepreneurial activities in good faith obliges the parties to refrain from abusing economic power.

The content of a franchise agreement, as a rule, includes conditions relating to: the territorial boundaries of the use of the franchise system; the rights arising from the transfer of a trademark; The duration of the contract (indicating the effective date of the contract and the terms of its renewal); the supply of goods and equipment and general standards for their exploitation; training provided or to be provided by the franchisor; the number of service units, marketing activities; the method of payment of the system fee; the scope of financial control; the transfer of individual rights; termination of the contract and obligations after the termination of contractual relations, in particular, fair competition (Khurtsidze, 2005).

The protection of the franchisee's entrepreneurial autonomy is also relevant after the termination of the franchise agreement. Article 613 of the Civil Code of Georgia provides that the parties must continue to compete loyally after the termination of their contractual relationship. A restriction on the franchisee's competition may be imposed within a defined territory for a period not exceeding one year (Civil Code of Georgia, 1997, article 613). Furthermore, where such a restriction may endanger the franchisee's professional activity, the franchisee must be provided with appropriate financial compensation, irrespective of the expiration of the agreement. These statutory limitations are significant for SMEs, as an excessively broad post-contractual restriction may prevent the franchisee from continuing business activity and recovering the investments made during the contractual relationship.

The protection of the franchisee under Georgian law is further reflected in Article 614 of the Civil Code of Georgia, which establishes the franchisor's liability for the rights and information provided under the franchising system. Where the franchisor culpably breaches its contractual obligations, the franchisee is entitled to reduce the contractual fee, with the amount of the reduction ultimately determined by an independent expert (Civil Code of Georgia, 1997, article 614). This provision is particularly relevant to SMEs, as it provides a specific legal remedy in circumstances where the franchisor fails to fulfill obligations that are essential to the effective implementation of the franchising system. It therefore reinforces the importance of contractual performance and the legal accountability of the franchisor

Fair competition is one of the fundamental principles of market functioning, based on fairness, transparency and honest business conduct.

The protection of fair competition in the franchising system is of particular importance, since this business model unites independent economic entities within the framework of a single brand and standards. Exclusive territorial rights, restrictions on the scope of activity and non-competition conditions defined by the contract are aimed at preventing unfair competition and protecting the interests of partners. For small and medium-sized businesses operating in the franchising system, compliance with the principles of fair competition creates a predictable and stable environment. The uniform standards established by the franchise agreement ensure equal conditions in the market among franchise members and reduce the risk of internal conflicts and destructive competition (Khurtsidze, 2005).

The mechanisms for protecting fair competition in a franchise agreement should be balanced. Excessively strict restrictions may limit the franchisee's entrepreneurial freedom and initiative, which is contrary to the interests of the development of small and medium-sized businesses. Accordingly, the provisions restricting competition in the agreement should serve not to monopolize the market, but to maintain a fair and healthy competitive environment. Integrating the principles of fair competition in a franchise agreement increases the efficiency of the system and builds trust between partners. This is especially important for small and medium-sized businesses, the sustainable development of which largely depends on fair competitive conditions and legally protected relations.

Rights and Obligations of the Parties in a Franchise Agreement

A franchise agreement is based on a system of mutual obligations that determine the economic, legal and organizational relations between the franchisor and the franchisee. The correct formation of these rights and obligations plays a decisive role in the effective functioning and sustainable development of small and medium-sized businesses (Kim & Tiwana, 2022).

The main right of the franchisor is to determine the terms of use of its own trademark, commercial designations, technological processes and business know-how. It is authorized to exercise control over the activities of the franchise in order to ensure compliance with uniform quality standards and maintain the reputation of the brand. In addition, the franchisor has significant obligations that are directly related to the support of small and medium-sized businesses. These include providing the franchisee with comprehensive information, organizing initial and ongoing training, technical and managerial support, as well as developing and sharing marketing strategies. These obligations create the institutional framework within which the franchisee will be able to operate effectively in a competitive market (Jang (Shawn) & Park, 2019).

The main right of the franchisee is to use the intellectual property specified in the franchise agreement. Central to the franchisee's obligations are compliance with the standards established by the agreement, timely payment of fees and royalties, protection of confidential information, and maintenance of the brand's reputation. These obligations ensure the stability of the network and contribute to the observance of the principles of fair competition in the franchising system (Jang (Shawn) & Park, 2019).

The effectiveness of a franchise agreement depends significantly on the balance of rights and obligations of the parties. For small and medium-sized businesses, it is especially important that control mechanisms do not become an overly restrictive instrument of economic independence. Otherwise, the franchisee may find itself in an unequal position, which limits his entrepreneurial initiative and development. An agreement that takes into account both the interests of the franchisor and the real capabilities of the franchisee creates the basis for long-term cooperation (Ikonomi, 2014). In practice, the dominance of control rights by the franchisor is often observed, which leads to an increase in the obligations of the franchisee without a corresponding expansion of his rights. This is especially problematic for small and medium-sized businesses that have limited resources. It is advisable to clearly define the scope of control, liability measures and dispute resolution mechanisms in the franchise agreement.

A franchise agreement, as a private law agreement, is based on the principle of freedom of contract. However, this freedom is not absolute. In modern legal systems, the principle of the primacy of law applies, according to which any contractual provision loses its force if it contradicts imperative legal norms, competition rules or public interest (Ikonomi, 2014).

One of the problematic issues in franchising practice is pricing policy. The franchisor often has an interest in maintaining a uniform pricing strategy within the network, which is understandable in terms of brand image and market positioning. However, from a legal point of view, there is a significant difference between issuing a price recommendation and mandatory price setting.

A relevant legal issue arises where a franchisor seeks to impose a fixed resale price on the franchisee rather than merely recommend a retail price. Although the franchisor may legitimately seek to maintain the consistency and reputation of its brand, contractual control over resale prices may raise concerns under competition law. Article 7 of the Law of Georgia on Competition prohibits agreements between economic agents that have the object or effect of restricting competition, including the direct or indirect fixing of purchase or selling prices or other trading conditions (Law of Georgia on Competition, 2012, article 7). Accordingly, the legality of a pricing clause should be assessed not solely by reference to the contractual

relationship between the parties, but also in light of its potential effect on competition. This distinction is particularly relevant to SMEs, whose ability to make independent commercial decisions may be affected by the contractual control exercised by the franchisor.

According to competition law, the franchisor has the right to offer the franchisee a recommended retail price, but it is not permissible to force him to adhere to a specific price. In the event that the contract or practice actually prohibits the franchisee from changing the price independently, such an action can be assessed as an agreement restricting competition. Where a contractual provision is found to be contrary to mandatory legal requirements or applicable competition rules, its enforceability may be challenged in accordance with the relevant legal framework. Accordingly, the franchisee's protection should be assessed through the applicable legal remedies and the specific circumstances of the contractual relationship, rather than through an automatic assumption that any allegedly unlawful provision may simply be disregarded.

Intangible assets as constituent elements of the franchising system

In the case of different goods and services, the franchising system has a different structure. Based on its content, the franchisee receives intellectual property objects with the right of use (and not ownership). Intangible property goods are property. Therefore, intangible property goods are the property of the franchisor, who is the holder of all rights to them and transfers them to the franchisee on the basis of obligations and legal relations, however, due to their intangible nature, the transfer of intellectual property objects cannot be carried out in the same way as movable property (Ikonomi, 2014). With such a transfer, the franchisee acquires the right to intangible property goods within the limits specified by the contract, while the franchisor retains the absolute right to intangible property goods, as the only entity with all rights to this property.

a) Trademark

A trademark is a symbol or group of symbols that identifies the goods of a particular enterprise, which may be a word or words, human names, letters, numbers, sounds, an image, a three-dimensional shape, including the shape of the goods or their packaging, or other external decoration of the goods using color or a combination of colors. A trademark and a service mark are conventional signs that can distinguish the goods and services of one person from the goods and services of another. A franchise agreement, even with its simplest terms, is a very complex method of transferring a trademark. It is the trademark that is associated with success for a novice enterprise and encourages it to enter into a franchise agreement (Khurtsidze, 2005).

The conclusion of a franchise agreement almost always involves the franchisor “distributing” the rights to a trademark to another party, and the franchisee acquiring the rights to another party’s trademark. The relationship between a trademark and a franchise agreement involves three main aspects, namely:

1. Transfer of the trademark in the form used by the franchisor;
2. Use of the trademark in accordance with the rules specified by the franchisor;
3. Special authority of the franchisor during the protection of the trademark.

The right to use the trademark is not an additional right of the franchisee under the franchise agreement, but is one of the most important elements of the franchising system. However, it should be noted that, despite its special importance, the trademark is not a mandatory element of the franchising system. For example, the transfer of the trademark is not necessary when the franchisee carries out only distribution activities without using the franchisor's trademark and trade name.

The literature identifies five functional features of a trademark:

1. Serves to identify the goods and services of an enterprise and distinguishes them from competitors;
2. Indicates that all types of goods and services are produced by one enterprise;
3. Emphasizes the uniformity of the quality of goods and services;
4. Represents a mechanism for advertising;
5. Connects to the franchising system and indicates its uniformity.

A prerequisite for the transfer of a trademark under a franchise agreement is the registration of the trademark by the franchisor with the authorized body. The fact of registration gives rise to the owner's exclusive right to the trademark. “According to the theory of intellectual property law, a special right is a property right and is a right similar to a commercial property right.

The rules for using a trademark are, as a rule, determined solely by the franchisor. It is desirable to refer to this authority directly in the contract. As for the protection of a trademark, the franchisor, as a person with a special right, may require any other person to immediately cease unauthorized use of the trademark. The franchisee, however, needs special authority for this. The transfer of the trademark must be carried out without defect. The transfer will be defective if the franchisor was not the owner of the trademark and did not transfer it to the franchisee on the basis of a genuine right. Obviously, as an entrepreneur, the franchisor is obliged to exercise caution and demand a certificate of ownership of the trademark from the future contractor. Failure to exercise the necessary foresight by an

entrepreneur may have disastrous consequences for him in the future (Covic, Petrovic & Covic, 2019).

The term “representative mark” is used in US law. It refers to a trademark by which the entire system is known. If the “representative” mark is recognizable, then the right to use it will be the most valuable acquisition for the franchisee.

An example of a “representative mark” is the image of the golden arches used as a trademark by the McDonald’s fast food restaurant chain, which provides information to consumers around the world, including Georgia, that the food on the packaging of which it is marked is from the McDonald’s restaurant chain, that is, the trademark depicted with the golden arches represents the entire system, while the individual units of the system are mostly interconnected by a franchise agreement. The “representative mark” is sometimes not the only trademark included in the system. It may also include other trademarks, which are called secondary marks.

b) Know-how

The legal essence of know-how has proven to be quite difficult to define in legal literature. To date, no ideal or acceptable definition for all legal systems has been formulated; it is different and contrasting within different jurisdictions. The distinction is sometimes formal, sometimes substantive". For example, according to one concept, know-how is everything in the aggregate that constitutes confidential knowledge and carries a certain value for a specific person. According to the same conceptual approach, the main distinguishing elements of know-how are its confidentiality and commercial or technological significance. Know-how is technological, organizational or commercial information of special importance; such significance must be confirmed by the necessary and sufficient measures taken to keep it secret; and finally, it gives rise to the entrepreneur's special right to this information, which is a logical consequence of the first two signs (Covic, Petrovic & Covic, 2019).

The essence of know-how protection is expressed precisely in maintaining its confidentiality. Therefore, its owner must constantly be careful not to allow his valuable knowledge to be entrusted to other persons without special permission for this. A franchise agreement is one of the types of such permission. The franchisor, of his own free will, on the basis of a contract, entrusts his confidential commercial knowledge to the franchisee, who, in turn, undertakes to ensure the maintenance of confidentiality and use the information provided in exactly the manner and for the purpose that the franchisor wishes. The “intrusion” of the franchisee into the implementation of the system and his mastery of secret information does not contradict the legal essence of know-how.

Its main feature is that confidentiality is maintained by mutual agreement of the two parties. The transfer of rights to know-how is not a one-time event. Due to the nature of information itself, it is constantly changing, developing and undergoing improvement, which determines the dynamism of the process of transferring rights to it. It is this that underlies the franchisor's obligation to constantly and within a reasonable time provide the franchisee with information about new developments. As soon as the dynamism is violated, the franchising system will lose its unity, which will make the implementation of the franchise agreement in the future practically impossible.

c) Goodwill

The concept of goodwill, like know-how, is very difficult to define. Its first definition was born in the bosom of common law. Lord Eldon noted that goodwill is nothing more than an assumption that the buyer will return to his old place. Common law was also the first to emphasize that defining goodwill is quite difficult, but despite the difficulty, it still "grabbed" this difficulty and stated that goodwill is the benefit and advantage derived from a positive name, reputation and activity, which attracts customers and distinguishes the activities of the enterprise at the current period and at the time of its establishment. Goodwill is an object of industrial property. The goodwill of an enterprise is a right that arose as a result of the efforts made by the enterprise to make a profit, increase the value of the enterprise and obtain other advantages (Kim & Tiwana, 2022).

It is noteworthy that the legal consideration of goodwill should not be carried out in isolation from the scope of the enterprise's activities. The Georgian legal doctrine expresses the opinion that "goodwill plays the most important role in a franchise agreement. The transfer of a trademark is accompanied by the transfer of goodwill. Along with the right to use the trademark, the franchisee also acquires the goodwill of the franchisor. The integration of goodwill into the franchising system is precisely related to the trademark. Since the trademark is a symbol of goodwill and provides information to the consumer, its protection also implies the protection of goodwill.

In the US common law, goodwill is also considered a product of the franchise agreement. The franchisee increases the value of goodwill by properly fulfilling the obligations assumed. In fact, this approach is justified, although practice may lead to the opposite result. If the franchisor does not fulfill the terms of the agreement, does not adhere to the unified program of operations, and especially does not ensure the maintenance of the quality indicator stipulated in the agreement, the value of the franchisor's goodwill will decrease, a risk that always exists when concluding a franchise agreement. Thus, the transfer of goodwill by contract implies a choice

between two alternatives for the franchisor: to transfer goodwill to the franchisee in the hope of the latter's good faith and wait for the value of the goodwill to increase, or to refuse to conclude a franchise agreement altogether due to the existence of risk. The lack of quality established by the franchisee during the use of the trademark harms not the trademark itself, but the goodwill behind it. Therefore, any form of control exercised by the franchisor that protects the trademark is also aimed at protecting goodwill.

d) Trade dress

Trade dress is a non-functional detail of the goods. In particular, it is the design and packaging of the goods, which indicates the source of origin of the goods and distinguishes them from other goods. For the packaging of the goods to be considered an example of trade dress, it is mandatory that its connection with the goods is unstable and its separation from the goods must be a prerequisite for use. Trade dress can be an image or packaging of the goods with the following characteristics: size, shape, color or color combination, structure, graphics, design, placement of words, decoration on the goods or their packaging. Trade dress also includes building decorations, signs made on the building, all elements of decoration that are related to the activities of a particular enterprise (Kim & Tiwana, 2022).

The franchisor transfers samples and packaging to the franchisee. Trade dress is one of the elements of the franchising system. The transfer of a trade name is carried out in the same form as it will be used by the franchisor. The issue of legislative regulation of trade names has not been resolved in Georgia, the reason for which lies in its very nature. According to common practice, trade names are considered a form of trademark.

The result of this approach is that entrepreneurs register trade dress as a trademark when it serves to identify goods. If the trade dress is registered as a trademark, then in the case of a franchise agreement, the rules for the transfer of trademarks apply to it. If the trade dress is not registered as a trademark, then its role in the franchising system and its impact on the value of the system depend on various factors. In this case, it is important to take into account how distinctive the trade dress is. If it has a so-called “secondary meaning” and can create an idea for the consumer about the franchisor’s goods or services (for example, the identical interior of McDonald’s fast-food restaurants), but it is not registered as a trademark, then the franchisor will definitely include it in the system, although it will still not have a significant impact on the value of the system. At this time, the inclusion of trade dress in the franchising system stems from practical purposes.

In particular, the main feature of trade dress is that it is a part of the goods that bring the goods to the consumer and/or a method of their implementation. Thus, distinctiveness is combined with practical purposes. It

is precisely such a combination that creates the need for trade dress to become a constituent element of the franchising system for its harmonious functioning.

Conclusions

As demonstrated in this article, the franchise agreement constitutes the central legal instrument that regulates these relationships and determines the balance between economic opportunity and legal risk.

The analysis shows that, despite its potential to promote stability, reduce market-entry risks and facilitate knowledge transfer, the franchise agreement often reflects an imbalance of power in favor of the franchisor. Standardized contractual terms, limited negotiating capacity of franchisees and broad control mechanisms may, in practice, undermine the economic independence of small and medium-sized businesses. This creates a contradiction between the theoretical function of franchising as a development tool and its practical implementation. This finding emphasizes the need to ensure that contractual control mechanisms remain proportionate to the legitimate interests of the franchisor and do not deprive the franchisee of the ability to make independent business decisions.

Particular attention should be paid to the role of imperative legal norms, the principle of good faith and competition law. These elements serve as essential safeguards that limit contractual freedom where necessary and ensure that franchising does not evolve into a mechanism of excessive control or market restriction. The principle of the primacy of law plays a decisive role in protecting franchisees, especially in cases involving price regulation, non-compete clauses and the allocation of economic risks. Accordingly, the exercise of contractual rights in franchising relationships must remain within the limits established by mandatory legal provisions, particularly where such rights may affect the franchisee’s economic autonomy or restrict competition.

In this regard, the proper regulation of disclosure obligations and confidentiality requirements is essential for maintaining trust between the parties and protecting the commercial interests of both sides. Both mechanisms reduce the asymmetry existing in the franchising system and ensure the legal protection of small and medium-sized enterprises.

Furthermore, the structure of the franchising system - comprising intellectual property elements such as trademarks, know-how, goodwill and trade dress - highlights the complexity of these agreements and the importance of their proper legal regulation. These intangible assets form the foundation of the franchising relationship, but at the same time require careful handling to prevent misuse and ensure fair distribution of benefits. Therefore, the legal protection of these assets should be considered an

integral part of the contractual framework, rather than merely an ancillary element of the franchise agreement.

In conclusion, the effectiveness of franchising as a tool for the development of small and medium-sized businesses depends not on the model itself, but on the fairness, clarity and legal compliance of the franchise agreement. A balanced contractual framework, grounded in the principles of good faith, fair competition and the primacy of law, is essential to ensure that franchising fulfills its intended role as a driver of sustainable economic growth rather than a source of dependency or inequality.

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