



FRANCHISE BUYER GLOSSARY

The Complete A–Z Reference for Franchise Buyers

100+ essential franchise terms explained in plain language

Covering FDD Items 1–23 · Legal Terms · Financial Concepts · Operations · Territory Rights

Prepared for Prospective Franchise Buyers

How to Use This Glossary

This glossary was created specifically for individuals researching the purchase of a franchise. Whether you are reading your first Franchise Disclosure Document (FDD), negotiating a franchise agreement, or evaluating unit economics, the terminology in this guide will help you navigate the process with confidence and protect your investment.

Terms are organized alphabetically by category. Each definition includes practical context to help you understand not just what a term means, but why it matters to your decision. Pay particular attention to the FDD Items section — every prospective franchisee should understand all 23 items before signing any agreement.

100+

Terms Defined

23

FDD Items Covered

A-Z

Organized Reference

Important Reminder

Always work with a qualified franchise attorney and a CPA experienced in franchising before signing any franchise agreement or paying any fees. This glossary is an educational reference tool — it is not legal or financial advice.

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A — Core Agreement & Legal Terms

Advertising Fund

A pool of money collected from franchisees (as a percentage of gross sales) to fund system-wide marketing, advertising, and promotional campaigns. Also called the Marketing Fund or Brand Fund. Franchisees contribute but typically do not control how the money is spent.

Area Developer

A franchisee who purchases the rights to open multiple franchise units within a defined geographic region, usually under a predetermined development schedule. Often granted sub-franchising rights to recruit other franchisees within their territory.

Area Representative

An individual or entity that acts as a regional representative for the franchisor, assisting with franchisee recruitment, training, and ongoing support in a specific area in exchange for a share of franchise fees and royalties.

Arbitration Clause

A provision in the franchise agreement requiring disputes between the franchisor and franchisee to be resolved through private arbitration rather than a court trial. Typically specifies the location, rules, and arbitration body to be used.

Assignment

The legal transfer of a franchise agreement and all associated rights and obligations from one party (the franchisee) to another (a buyer). Most franchise agreements require franchisor approval before any assignment can occur.

B — Business & Financial Terms

Break-Even Point

The level of sales or revenue at which total costs (fixed and variable) equal total income, resulting in neither profit nor loss. A critical milestone for new franchisees, often reached between 6 and 24 months after opening.

Brand Standards

The specific operational, quality, marketing, and customer service requirements set by the franchisor that all franchisees must follow to maintain consistency across the system. Violations can trigger warnings, fines, or termination.

Build-Out

The physical construction, renovation, and outfitting of a franchise location to meet the franchisor's design, layout, and equipment specifications. Costs vary widely and are included in the initial investment estimate in Item 7 of the FDD.

Business Format Franchise

The most common type of franchising, in which the franchisor licenses not just a product or brand but an entire system — including the brand, operating procedures, training, marketing, and ongoing support. Examples include fast food, fitness, and retail franchises.

C — Key Concepts

Co-Branding

A franchise arrangement in which two or more franchise brands operate within the same physical location, sharing space and sometimes staff. Common in food courts and travel plazas. Requires approval from all participating franchisors.

Conversion Franchise

A franchise model in which an independently owned business is converted into a franchise unit under an established brand. Common in real estate, home services, and hospitality industries.

Copyright

Legal protection for original works of authorship, including training manuals, marketing materials, software, and other proprietary content owned by the franchisor. Franchisees are licensed to use these materials but do not own them.

Corporate-Owned Unit

A franchise location owned and operated directly by the franchisor rather than a franchisee. Used to test new concepts, demonstrate profitability, and provide training. Item 20 of the FDD discloses these numbers.

Cost of Goods Sold (COGS)

The direct costs of producing or acquiring the products or services sold by the franchise. Managing COGS as a percentage of revenue is critical to profitability and is benchmarked by most franchisors.

D — Disclosure & Documentation

Default

A franchisee's failure to meet one or more obligations under the franchise agreement — such as failing to pay royalties, violating brand standards, or missing reporting deadlines. Most agreements require written notice and a cure period before termination can occur.

Development Agreement

A contract between a franchisor and an area developer specifying the number of franchise units to be opened, the geographic territory, and the timeline for development. Typically includes milestone requirements and financial penalties for missed targets.

Development Schedule

The timeline within a development or area representative agreement specifying when each franchise unit must be opened. Missing development schedule milestones can result in loss of territorial rights or agreement termination.

Disclosure Document

Another name for the Franchise Disclosure Document (FDD). Required by the FTC and state franchise laws to be provided to prospective franchisees at least 14 days before signing any agreement or paying any fees.

Dispute Resolution

The process specified in the franchise agreement for resolving conflicts between the franchisor and franchisee. May include mandatory mediation, binding arbitration, or litigation in a specified jurisdiction.

Due Diligence

The comprehensive investigation and research process a prospective franchisee should conduct before purchasing a franchise. Includes reviewing the FDD, validating with current franchisees, consulting an attorney and accountant, and analyzing the market.

E — Earnings & Economics

EBITDA

Earnings Before Interest, Taxes, Depreciation, and Amortization. A key financial metric used to measure a franchise unit's operating profitability and cash flow, and is commonly used when valuing a franchise business for sale.

Encroachment

The establishment of a competing franchise unit (by the franchisor or another franchisee) within proximity to an existing franchisee's location, potentially reducing sales. Franchisees should carefully review encroachment protections in the franchise agreement.

Equity

The ownership value of a franchise business, calculated as total assets minus total liabilities. Building equity over time is one of the key wealth-building advantages of franchise ownership versus employment.

Estimated Initial Investment

A detailed breakdown of the total costs to open a franchise, disclosed in Item 7 of the FDD. Includes franchise fee, build-out, equipment, inventory, working capital, training expenses, and other pre-opening costs.

Exclusive Territory

A defined geographic area within which the franchisor agrees not to open or license another unit of the same brand. Provides competitive protection for the franchisee, but must be clearly defined in the franchise agreement.

F — Franchise Disclosure Document (FDD)

FDD — Item 1

Background information about the franchisor, its affiliates, and the business being franchised, including how long it has been operating.

FDD — Item 2

Business experience of the franchisor's key executives, including names, titles, and prior employment history.

FDD — Item 3

Litigation history — all pending, settled, or prior lawsuits involving the franchisor or its principals.

FDD — Item 4

Bankruptcy history of the franchisor, its affiliates, or principals within the past 10 years.

FDD — Item 5

Initial fees payable to the franchisor, including the initial franchise fee and any other upfront payments.

FDD — Item 6

All other fees, including ongoing royalties, marketing fund contributions, technology fees, training fees, and audit fees.

FDD — Item 7

Estimated initial investment — a detailed table of the full cost range to open a franchise unit.

FDD — Item 8

Restrictions on sources of products and services — identifies required vendors and any approved supplier lists.

FDD — Item 9

Franchisee obligations — a summary table of all duties required of the franchisee under the agreement.

FDD — Item 10

Financing — discloses any financing offered by the franchisor and its terms.

FDD — Item 11

Franchisor's obligations — what the franchisor promises to provide, including training, support, and marketing.

FDD — Item 12

Territory — describes the type and scope of territorial rights granted to the franchisee.

FDD — Item 13

Trademarks — lists all registered marks licensed to the franchisee and any ownership disputes.

FDD — Item 14

Patents, copyrights, and proprietary information licensed to the franchisee.

FDD — Item 15

Obligation of the franchisee to participate personally in the operation of the franchise.

FDD — Item 16

Restrictions on what the franchisee may sell.

FDD — Item 17

Renewal, termination, transfer, and dispute resolution provisions.

FDD — Item 18

Public figures associated with the franchise.

FDD — Item 19

Financial performance representations — optional disclosure of average or projected revenues, expenses, or profits. Not all franchisors provide Item 19 data.

FDD — Item 20

Outlets and franchisee information — number of units opened, closed, transferred, or terminated over the last 3 years, plus a list of current and former franchisees.

FDD — Item 21

Financial statements — audited financial statements of the franchisor for the past 3 fiscal years.

FDD — Item 22

Contracts — all agreements to be signed by the franchisee.

FDD — Item 23

Receipt — signed acknowledgment that the franchisee received the FDD at least 14 days before signing any agreement.

Financial Performance Representation (FPR)

Any statement made by the franchisor about actual or potential revenues, sales, income, or profits of franchise units. If included, it must appear in Item 19 of the FDD. Making oral FPRs not in the FDD is illegal.

Franchise

A legal and commercial relationship in which a franchisor grants a franchisee the right to operate a business under the franchisor's brand, systems, and support in exchange for fees and royalties.

Franchise Agreement

The legally binding contract between franchisor and franchisee that governs the terms of the franchise relationship, including duration, territory, fees, obligations, renewal rights, and termination conditions.

Franchise Disclosure Document (FDD)

A legal document mandated by the Federal Trade Commission (FTC) that franchisors must provide to prospective franchisees. Contains 23 items of material information about the franchisor, the franchise system, and the franchise agreement.

Franchise Fee

A one-time upfront payment made to the franchisor for the right to use the brand and system. Disclosed in Item 5 of the FDD. Does not include build-out, equipment, or other opening costs.

Franchise Rule

The FTC regulation (16 CFR Part 436) that requires franchisors to provide a complete FDD to prospective franchisees at least 14 calendar days before any agreement is signed or money is paid.

Franchisee

An individual or entity that purchases the rights to operate a franchise business under the franchisor's brand and system.

Franchisee Advisory Council (FAC)

A representative body of franchisees elected by the franchise system to communicate with the franchisor on operational, marketing, and strategic matters. Strength of the FAC is a key indicator of franchisee-franchisor relationship health.

Franchisor

The company or individual that owns the brand, trademarks, and business system and licenses them to franchisees in exchange for fees and royalties.

FTC (Federal Trade Commission)

The U.S. government agency that regulates franchise sales nationwide through the Franchise Rule, requiring franchisor disclosure via the FDD.

G — Growth & Operations**Grand Opening**

The formal launch event for a new franchise location, often supported by the franchisor with marketing materials, co-op funds, and field staff. A well-executed grand opening is critical to establishing early momentum and customer awareness.

Gross Sales

The total revenue generated by a franchise unit before any deductions. Most royalty and marketing fund fees are calculated as a percentage of gross sales.

Gross Profit Margin

Gross sales minus the cost of goods sold, expressed as a percentage of gross sales. A key benchmark for franchise operators to track against system averages.

H — Human Resources & Hiring

Home-Based Franchise

A franchise model operated primarily from the franchisee's home rather than a commercial location. Common in business services, coaching, cleaning, and personal care industries. Lower overhead but requires strong self-discipline.

I — Investment & Fees

Initial Franchise Fee

See Franchise Fee. The upfront, one-time payment made at signing for the right to use the brand and system.

Initial Investment

The total estimated cost to open a franchise, as disclosed in Item 7 of the FDD. Includes all costs from signing to opening day, including franchise fee, real estate, build-out, equipment, training, and working capital.

In-Term Covenant Not to Compete

A contractual restriction preventing the franchisee from owning or operating a competing business during the active term of the franchise agreement.

L — Legal & Licensing

License

The legal permission granted by the franchisor to the franchisee to use its trademarks, systems, and proprietary information within the scope of the franchise agreement.

Liquidated Damages

A predetermined amount of money specified in the franchise agreement that the franchisee must pay if the agreement is terminated early, compensating the franchisor for losses without requiring proof of actual damages.

Local Advertising Requirement

A minimum amount franchisees must spend on local marketing and advertising in their own market, separate from contributions to the system-wide advertising fund.

M — Marketing & Brand

Marketing Fund

See Advertising Fund. A pooled fund financed by franchisee contributions used to support brand-level advertising and marketing initiatives.

Master Franchise

A franchise arrangement in which the master franchisee purchases the right to develop and sub-franchise an entire country or large region. The master franchisee acts as a mini-franchisor within their territory.

Multi-Unit Franchise

A franchise arrangement in which one franchisee operates two or more units of the same brand. Multi-unit operators often receive volume discounts on fees and are considered more attractive to franchisors.

Mystery Shopper

A third-party evaluator hired by the franchisor to anonymously visit franchise locations and assess compliance with brand standards, customer service quality, and operational performance.

N — Non-Compete & Obligations

Net Worth

Total assets minus total liabilities. Franchisors typically require prospective franchisees to meet a minimum net worth threshold as part of the qualification process, in addition to liquid capital requirements.

Non-Compete Covenant

A contractual clause prohibiting the franchisee from operating or being involved in a competing business during and/or after the term of the franchise agreement. Scope (geography, duration, activities) varies widely.

Non-Disclosure Agreement (NDA)

A confidentiality agreement sometimes required before a franchisor shares detailed financial or operational information with a prospective franchisee. Should be reviewed by an attorney before signing.

Non-Traditional Location

A franchise unit operating in a non-standard venue such as an airport, hospital, university, stadium, or military base. Often subject to different lease terms, hours, and operational requirements.

O — Operations

Operations Manual

The confidential, comprehensive guide provided by the franchisor detailing all aspects of running the franchise — including procedures, recipes, staffing, marketing, equipment, and customer service standards. Franchisees receive access but do not own it.

Owner-Operator

A franchisee who is actively involved in the day-to-day management of their franchise unit, as opposed to a semi-absentee or passive investor model. Many franchisors require or strongly prefer owner-operators.

P — Performance & Profitability

Personal Guarantee

A legal obligation in which the franchisee (and sometimes their spouse) agrees to be personally liable for the debts and obligations of the franchise entity. Common in franchise agreements and commercial leases.

Point of Sale System (POS)

The technology platform used to process sales transactions, track inventory, manage scheduling, and generate financial reports. Most franchisors require franchisees to use a specific POS system approved for the brand.

Post-Term Covenant Not to Compete

A contractual restriction preventing the franchisee from operating a competing business for a specified period (typically 1–2 years) and within a specified geographic area after the franchise agreement expires or terminates.

Protected Territory

A defined geographic area within which the franchisor agrees not to open or license competing units. See also Exclusive Territory. Protection levels vary — some territories protect only physical locations while others also cover online sales or nearby openings.

Profit and Loss Statement (P&L;)

A financial report summarizing revenues, costs, and expenses over a specific period. Franchisees are often required to submit P&Ls; to the franchisor on a regular basis as part of their reporting obligations.

R — Renewal & Rights

Receipt (FDD Item 23)

The final item in the FDD — a signed acknowledgment by the prospective franchisee confirming they received the FDD at least 14 calendar days before signing any agreement or paying any fees.

Registration State

One of the approximately 14 U.S. states that require franchisors to register their FDD with a state agency before offering or selling franchises in that state. Registration states include California, New York, Illinois, and Maryland, among others.

Renewal

The process by which a franchisee extends their franchise agreement beyond the initial term. Renewal rights, fees, and conditions are disclosed in Item 17 of the FDD and the franchise agreement.

Renewal Fee

A fee charged by the franchisor when a franchisee renews their franchise agreement at the end of the initial term. May be a flat fee or a percentage of the then-current franchise fee.

Right of First Refusal

The franchisor's contractual right to match any bona fide offer to purchase the franchisee's business before the franchisee can sell it to a third party. A key term to review in any franchise agreement.

ROBS (Rollover for Business Startups)

A legal financing strategy that allows prospective franchisees to use retirement funds (401(k), IRA) to invest in a franchise without paying early withdrawal penalties or income taxes. Requires careful legal and tax structuring.

Royalty Fee

An ongoing fee paid by the franchisee to the franchisor, typically calculated as a percentage of gross sales (usually 4–12%). Paid weekly or monthly in exchange for the continued use of the brand and system support.

S — Support & Systems

SBA Loan (Small Business Administration)

A U.S. government-backed loan program commonly used by franchisees to finance their initial investment. The SBA 7(a) and SBA 504 loan programs are the most commonly used for franchise financing.

Semi-Absentee Franchise

A franchise model in which the owner is not involved in day-to-day operations and instead employs a manager to run the business. Typically requires a more established management team and higher working capital reserves.

Site Selection

The process of identifying, evaluating, and securing a physical location for a franchise unit. Most franchisors provide site selection assistance and must approve the chosen location before a lease is signed.

Soft Opening

A low-key launch of a franchise location before the official grand opening, used to train staff, test operations, and work out any issues before full-scale marketing begins.

State Franchise Laws

State-level regulations governing the offer and sale of franchises. Approximately 14 states have registration requirements, and many states have relationship laws governing how franchisors may treat existing franchisees.

Successor Agreement

The new franchise agreement offered to a franchisee upon renewal of their existing term. May contain updated terms and conditions that differ from the original agreement.

System Fund

See Advertising Fund or Marketing Fund — the collective pool of franchisor-managed marketing and technology contributions from all franchisees across the system.

T — Territory & Transfer

Technology Fee

An ongoing fee charged by some franchisors to cover the cost of proprietary software, POS systems, apps, or digital tools provided to franchisees as part of the franchise system.

Term

The length of time a franchise agreement is in effect — typically 5, 10, or 20 years. At the end of the term, the franchisee may have the right to renew under then-current terms and fees.

Territory

The defined geographic area in which a franchisee is authorized to operate. The scope and exclusivity of territory rights are disclosed in Item 12 of the FDD and are one of the most critical terms to review.

Trade Area

The geographic area from which a franchise location draws the majority of its customers. Used in site selection, competitive analysis, and market planning.

Trademark

A brand name, logo, slogan, or other identifier that is legally registered and owned by the franchisor. Franchisees are licensed to use the trademark but must comply with all brand standards and cease use upon termination.

Training Program

The initial and ongoing instruction provided by the franchisor to teach franchisees and their staff how to operate the business. Disclosed in Item 11 of the FDD. Typically includes classroom, online, and in-field training components.

Transfer

The sale of a franchise unit from an existing franchisee to a new buyer. Subject to franchisor approval, transfer fees, and the new buyer meeting all qualification requirements. Disclosed in Item 17 of the FDD.

Transfer Fee

A fee paid to the franchisor when a franchisee sells their unit to a third party. Compensates the franchisor for administrative and training costs associated with approving the new franchisee.

Turnkey Franchise

A franchise model in which the franchisor handles some or all aspects of setting up the location (construction, equipment, staffing) so the franchisee can open immediately. Typically commands a higher initial franchise fee.

U — Unit Economics & Validation

Unit Economics

The financial performance metrics of an individual franchise unit, including revenue, gross margin, labor costs, occupancy costs, royalties, and net profit. Understanding unit economics is critical before making any investment decision.

Unit Franchisee

A franchisee who owns and operates a single franchise location, as opposed to a multi-unit operator or area developer.

V — Validation & Value

Validation

The process of speaking directly with existing (and former) franchisees to verify claims made by the franchisor about the business opportunity. One of the most important steps in franchise due diligence. Contact information for franchisees is disclosed in Item 20 of the FDD.

Vendor

A supplier of products, equipment, or services used in the franchise operation. Many franchisors require franchisees to purchase from approved or required vendors to maintain quality and brand consistency (disclosed in Item 8 of the FDD).

W — Working Capital & Wrap-Up

Working Capital

The funds available to cover day-to-day operating expenses during the ramp-up period before a franchise unit reaches profitability. Most franchisors recommend maintaining 3–6 months of operating expenses in reserve at opening.

Working Capital Reserve

See Working Capital. An essential component of the initial investment estimate in Item 7 of the FDD that is often underestimated by new franchisees.

Your Franchise Journey Starts Here

This glossary is one of many tools designed to help you make a confident, informed decision when evaluating a franchise opportunity. Knowledge is your greatest asset in the franchise buying process.

Always consult a qualified franchise attorney and CPA before signing any agreements.