

# BUYING A FRANCHISE

Many would be entrepreneur's consider investment in a Franchise system to be the safest entry into business. On the face of it they are probably right. However, buying a franchise is a decision of cost vs. benefit and risk vs. return just like any other business. Importantly, because of the system itself there are a lot of additional things that need to be investigated.

Below is a **checklist**  of most of the essential things to consider:

## Your Desire, Experience and Finance

- Consider the rationale for investing in a franchise. Does it make sense?
- Why are you considering investing in a franchise? Financial reward, prestige, nothing else to do, security before retirement, flexibility in leisure vs work?
- Why a franchise vs an independent business?
- What level of income do you need the franchise to deliver?
- How many hours are you willing to devote to the franchise?
- How many years do you wish to own the franchise?
- Will the franchise be your sole income source?
- Will this be the first of many franchises? Same franchise chain?
- How is the franchise to be purchased? Company, partnership or sole trader?
- Have you the support of your spouse and family?
- Have you owned a business previously?
- What experience or knowledge can you put into the business, if any?
- Can you afford to lose totally all the money you invest in the franchise? How much can you afford to lose?
- Do you have the funds to invest in the franchise?
- In what field do you wish to operate - retail vs service vs wholesale vs manufacturing?
- In what fields do you have experience?
- How long can you afford to live off your savings while you investigate, are trained in, then operate the franchise to profitability?

## Finding the Right Franchise

- What is the franchisor's background?
- How long has the franchisor been operating?
- How many franchisees are there? What is the rate of growth like?
- Are you comfortable with the experience that the franchisor is bringing to the table?
- What intellectual property is owned by the franchisor, if any? Is the brand trademarked and protected?
- How detailed is the Operations Manual, if any?
- Do some background searches such as googling and company searches to back up your knowledge.
- Do you require training and support for the establishing and then operating your franchise? What are the formal training requirements, if any, compared to the competitors like?
- Are there any licenced or technical requirements that you feel that you do or can meet?
- Running a franchise, or any business for that matter, requires you to be good in both the professional aspects of the franchise as well as a good business manager. What business management training, support and tools do you get?
- What is the branding of the franchise like? Is it a new franchise or an existing one? If it is new it may not be able to compete against the better recognisable brands. If it is an

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existing one it may be tired and stale. The brand / products or services may also be losing or growing in terms of fashion. Is it 'faddish' or a stayer?

- What happens if the franchisor fails? Can you continue to trade? What happens to the brand?
- What happens to the site leasing if the franchisor fails?
- Can you access product if the franchisor fails?
- Do you know what the business plan of the franchisor is? What growth plans do they have? Does it include your franchise or area of operations?
- Does the franchisor continually improve systems and products / services? If not why?
- How much do you have to invest up front? Consider all the other costs such as legal, stamp duty, and the time between signing up and getting your first share of trading profits.
- How can you prove to yourself that the franchise is going to be profitable? Has the franchisor provided any profit forecasts? Do the forecasts include all your other incidentals like loan repayments?
- How can you verify the validity of the franchisor's forecasts? Have you considered financial benchmarks?
- Can you work in a franchise for a day or two or more to get an understanding ie try before you buy?
- Can you afford to pay yourself a decent salary out of the profits of the franchise as well as a rate of return on your investment?
- What controls does the franchisor have over your franchise, such as site approval, appearance, what products and services you can offer, restrictions on who you can source supplies from, and restrictions on where you can trade?
- How easy is it to renew your franchise agreement? What is the time frame of the franchise agreement before renewal? Does it cost anything to renew?
- How easy is it for the franchisor to terminate the franchise agreement?
- Consider developing an exit plan before you enter a franchise.

## The Finance Requirements

- What are the upfront cost?**
- Franchise fee?
- Other up front costs to the franchisor such as training etc?
- Other up front costs to other parties such as shop fit outs?
- Initial cost of stock?
- Up front insurance costs?
- Consider all the grand opening cost and other up front promotional activities.
- Consider also the cost of technology, such as telecommunications and computer.
- Factor in the cost of professional advice.
- Other incidental up front costs such as legal and stamp duties?
- Do you need to pay for any business licences? Road traffic reports? Development applications to councils?
- How long will it be before you can draw money out of the business? The cost of living will have to be factored into your upfront costs since you will have to pay for it. It is prudent to consider not drawing any money out of the franchise for the first year - but can you afford this?
- Do you have adequate borrowing capacity? Does your family agree with the borrowing?

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## What are the ongoing costs?

- What are the ongoing royalty payments? How are they calculated?
- Is there a marketing levy or advertising fee to the franchisor? How is it calculated?
- What are the terms of trade with the major suppliers? Can you get credit or is it Cash on Delivery?
- Professional accounting and bookkeeping costs.
- Insurance.
- What staffing requirements are there? Have you looked at other franchisees to see whether what you have been advised makes sense? Or will you need more staff?
- Will you be managing the franchise directly or will you hire a manager? Does this differ with the financial forecast from the franchisor?

## Review the Franchise Documentation

- Have you read all the Disclosure Documents, Confidentiality Agreements, Franchise Agreements and other disclosures that the franchisor have provided? As a prospective franchisee you are entitled to receive a copy of the franchise code and a disclosure document no less than 14 days before entering into an agreement. Seek the services of of a good lawyer.
- The disclosure document should disclose:
  - The business name, name of the franchisor, directors, contact details and business experience.
  - Current proceedings against the franchisor.
  - A list of existing franchisees including contact details.
  - Trademarks and other intellectual property.
  - Details of the franchise site and territory.
  - Marketing or other cooperative funds.
  - Prepayments and establishment costs.
  - Arrangements for the supply of goods & services.
  - The obligations for the franchisee and the franchisor.
  - Financial details, which may include earnings information.
- Read and understand the disclosure document.
- Consider the experience of the directors and other executives of the franchisor. Do they have what you regard to be adequate experience?
- What is the legal history of the franchisor like? The disclosure document should disclose the type of any litigation that has been and is currently being sought. Discuss this with the franchisor. Importantly, discuss this with some of the current franchisees. Is there any dissension with the franchise chain? Do a google search too.
- Has the franchisor or the directors or executives ever had any bankruptcy or liquidation or administration problems in the past?
- What restrictions do the franchise agreements impose on you? Are they reasonable?
- What is the site or territory that you can operate? How was it chosen? Can you review the demographic mapping results if any that was used to select the site or territory?
- Do the agreements explicitly state what happens to you should the franchisor fail?
- What restrictions do you have if the agreement is terminated by the franchisor?
- Can you continue to operate your business should the agreement be terminated?
- What happens to the brand should the franchisor fail?
- What restrictions do you have when considering selling your franchise? Do you have to give a slice of the sale proceeds to the franchisor when selling?

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- Who has to pay for the training for any new staff or owners if you sell?
  - What does the agreement say with regards to adequate and appropriate professional training and support? Is it in accordance with what you have been verbally advised by the franchisor?
  - What level of advertising and promotion are you required to undertake in addition to the payment of your royalties and marketing levies?
  - Is there clarity with regards to who does what when advertising and promoting?
  - If you pay into a national marketing fund do you know how much is spent in your territory? Is it equitable?
  - What direct local marketing does the franchisor do for you?
  - If the franchisor receives and rebates or commissions for placing advertisements or for selling off areas of the website do you get a benefit?
  - Contact a cross section of both current franchisees and former franchisees. Are / were they happy with the level of support provided by the franchisor?
  - Why did the former franchisees leave?
  - Would the franchisee recommend the franchise as a business investment?
  - Does the franchisee consider that the franchisor honours its obligations?
  - Was the franchisee's training adequate?
  - What problems did the franchisee initially encounter before becoming profitable?
  - How long was it before they were profitable?
  - Did the franchisees earn a good salary and profit, or did they simply work hard for long hours for a low wage?
  - Some franchise chains have rules of thumb to determine the value of a franchise. For example weekly sales X a multiplier. What is their understanding of valuing a franchise in the chain?
  - Is there a high franchisee turnover?
  - Why are there so many failures in the franchise chain, if any?
  - Be sure you receive adequate professional advice from both legal and financial experts.
  - Check your facts.
- Once you have completed the above checklist commence doing a plan for your business if you are proceeding.**
- If you are proceeding, ensure you obtain professional legal and financial advice.**

The above is just a summation of some of the useful points to check when considering the investment in a franchise. We advise that you obtain professional assistance in regards to any specific financial and investment undertaking and that the above is only being made available for discussion purposes only and so therefore we do not accept any responsibility or liability in the use of the above summation.

If you have any queries, please do not hesitate to contact our offices.

## Disclaimer

This guide and the information contained herein, is generic in nature and a summary only and should not be used in any detailed or specific circumstances. We recommend you contact a professional before proceeding.

For more information please feel free to contact us at [www.farmilo.com.au](http://www.farmilo.com.au)

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