

Buying a Franchise

Buying a franchise is unlike buying a conventional business. As a franchisee, you enter a long-term relationship with your franchisor and you will be obliged to run the business in accordance with their system. To a large extent your success will depend on the success of the franchisor.

Before you buy a franchise, you need to assess all information, and decide whether you are personally cut out to be a franchisee. You need to weigh up the advantages and disadvantages, be aware of the taxation implications and have carefully read and understood the franchise agreement.

Warning Signs

Most franchisors are open and honest with you. However, you should be wary of those franchisors (or master franchisees) who:

- ▶ *are reluctant to provide anything in writing.*
- ▶ *are reluctant to give details of other franchisees within their system (required by the code).*
- ▶ *require full up-front payment for the business to be made before any information is released.*
- ▶ *claim that you can make large amounts of money quickly and with little effort – that is, it looks too good to be true.*

What is franchising?

Franchising is one of Australia's fastest growing business sectors. A franchise is an agreement under which a franchisor licenses a franchisee to operate a developed method of doing business that is identifiably associated with the franchisor. The franchisor provides ongoing guidance, systems and assistance in return for periodic payment of fees and/or purchases. There are two basic kinds of franchises:

A business format franchise: in which the whole business concept is licensed, including the name, appearance and method of carrying on the business.

A product franchise: in which the product is manufactured and/or supplied by the franchisee.

Before entering a franchise agreement ...

Before you enter a franchise agreement, obtain information on:

- ❑ Demand in the marketplace for the service or goods on offer.
- ❑ A complete description of the business.
- ❑ The track record of the franchisor and current motives for franchising.
- ❑ What the franchisor has to offer by way of name, product, reputation, site location, advertising budget and back-up.
- ❑ How other franchisees are faring in the same business.
- ❑ Evidence of the franchisor's strategic plan, ie where the business is going.
- ❑ The fees involved, ie up-front capital and percentage of takings which you have to pay to the franchisor for the continuing right to operate the business.
- ❑ Terms of sale for goods supplied by the franchisor and if you can purchase stock from outside the franchise network.
- ❑ The franchise agreement document and the period of the franchise.
- ❑ Obligations on both parties when the franchise is terminated, the number of agreements terminated recently and the reasons.
- ❑ Territorial rights, ie exclusive or otherwise.
- ❑ Whether there is a Franchise Operations Manual.

And what about you?

Consider the above information in the light of your own strengths and weaknesses and your expectations:

- ❑ Do you have the type of experience required? Are you ready for the hours and commitment needed?
- ❑ Will you be comfortable with the amount of control the franchisor will have?
- ❑ Is your financial position strong enough to see you through the first year?
- ❑ Are you suited to the industry and to the franchise company?
- ❑ Are you physically capable of the work required?

If you have any serious doubts on any of these points, think further and explore alternatives.

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Franchising and tax

- ❑ The initial franchise fee and any renewal fee will generally be regarded as a capital asset and is not deductible.
- ❑ An agreement to purchase a franchise often contains provisions covering the ongoing payments to the franchisor of royalties or levies. These can be deductible in the year that they are incurred.
- ❑ Fees paid for ongoing training provided by the franchisor will generally be deductible
- ❑ Interest paid on loans to pay the franchise fee or buy equipment may also be tax deductible.

More Information

SOURCES OF INFORMATION

Visit the NSW Department of State and Regional Development small business website for more information on business management issues, and for more general business information:

www.smallbiz.nsw.gov.au

For franchising matters in general, contact the Franchise Council of Australia Ltd on 9264 4077 or www.franchise.org.au

For the Franchising Code of Conduct and the Franchisee's Guide, visit www.accc.gov.au

WHO SHOULD I TALK TO?

For advice and protection in buying a franchise, you should seek the services of a solicitor, accountant or business adviser.

Your local Business Advisory Service can offer you one on one advice on buying a franchise. Call 1300 650 058

Advantages of franchising

- ❑ Easier access to finance with the support of the franchisor.
- ❑ Direct benefit from the franchisor's advertising and buying power.
- ❑ Use of an already established business name.
- ❑ Management and industry knowledge back-up.
- ❑ Reduction of business risk.

Disadvantages of franchising

- ❑ Payment of fees and/or percentage of turnover and future resentment of same.
- ❑ Loss of some independence through franchisor control of management techniques.
- ❑ Unreliable franchisor.
- ❑ Over-dependence on the franchisor who may make mistakes.
- ❑ Reputation of a franchise may be affected by factors beyond the franchisee's control.

Franchise agreement

A franchise agreement is a written document outlining the rights and obligations of both the franchisor and the franchisee. It is a legal contract and much care should be given to its contents, for ultimately it contains the rules and regulations from which your future income will result.

Operations Manual

The Operations Manual sets out in detail how the franchise is to be run - leaving no room for misunderstandings or misinterpretation. Every member of the franchise, although independently owned, must work to the rules set out in the Operations Manual. Unity is an important factor in a successful franchise.

The Franchising Code of Conduct

On 1 July, 1998 the Franchising Code of Conduct, which protects the rights of franchisees and sets out the obligations of franchisors, came into effect. All franchise businesses are required by law to comply with the Code. By improving the disclosure requirements of franchisors and prohibiting "unfair" conduct, the Code has brought about significant change in the way franchise business is conducted.

The Code has been prescribed under the Trade Practices Act 1974, and the Australian Competition and Consumer Commission (ACCC) has the responsibility of enforcing the Code.

To assist franchisees in understanding the Code, the ACCC provides the Franchisee's Guide to the Franchising Code of Conduct. Go to www.accc.gov.au and select Small Business Easy Access Point.

The Code also provides mediation procedures where disputes cannot be resolved within the franchise system. Contact 1800 150 667 or visit www.mediationadviser.com.au