

Franchising is a business system that delivers products and services. It involves one party (a franchisor) granting a licence to another party (a franchisee) to trade under the name of the franchisor. Franchising is essentially a marketing concept – a way of delivering products and services to the marketplace under the franchisor's trademark or other commercial symbol. In return for use of the franchisor's trademark, the franchisee pays a fee before starting the business. This fee may relate to the initial capital investment, goods or services, training or royalties.

Franchise businesses are becoming increasingly popular in Australia. They are an excellent way of owning your own business while enjoying the security, reputation and experience which the franchisor and other franchisees within the system can offer.

#### Evaluating a franchise opportunity

Franchises appeal to would-be entrepreneurs who want to be in their own business – but not completely on their own. Franchise businesses can be highly successful but there are many pitfalls and each opportunity must be carefully evaluated.

#### The franchisor

The franchisor may be well known and have a good reputation, but take nothing for granted and look below the surface. Check the franchisor's financial standing and business reputation with a credit agency. A good way to make an assessment is to examine disclosure documents, which a franchisor must give you under the Franchising Code of Conduct. Check the retail lease to see that the landlord grants the intended franchise use. For example, if you are buying a food franchise in a shopping centre, ensure that the shopping centre owner will grant permission for such use.

#### The franchise

The position of the franchise in the market in which it trades is a vital consideration. You should not only look at the particular franchised business in relation to its own competitors, but also make an assessment of the prospects for the overall industry or trade.

Where there is a lease, find out:

- Does the lease permit assignment to any permitted assignee of the franchisee?
- Does it coincide with the franchise term?
- Does the lease term provide sufficient time for recovery of capital outlays?

#### Other/existing franchisees

The experience of other franchisees within the system is an excellent way of determining the highs and lows of being a franchisee within the group. Request from the franchisor a list of all franchisees and call as many as you possibly can. If the franchisor only gives you a select list of names, this should raise some concerns.

#### Financial matters

The financial aspects of evaluating a franchise include the amount of fees payable, turnover, profitability levels, return on investment and potential growth in value of the business. A prospective purchaser should clearly establish what their total investment will be, what their investment buys and what return, apart from wages, is expected. While there are no guarantees of any return on an investment in a franchise, prospective franchisees should compare the expected return from a conventional investment i.e. term deposit, debenture, against the return from the franchise.

#### The franchise agreement

The franchise agreement details the terms and conditions of the franchise arrangement. Every franchise agreement is different, but its main purpose is the same. The franchise agreement will usually deal with franchise fees and how and when payments are to be made. It will set out the territory in which the franchisee can operate, and it will contain controls to protect the franchisor's intellectual property. It will outline how the contract can be terminated, and it will stipulate the number of years for which the franchisee is given the right to own and operate the business. As franchise agreements are drawn up by franchisors they are usually silent in terms of detailing the obligations of the franchisor.

#### Evaluating the agreement

Don't just have the agreement inspected by your accountant or bank manager. Take the trouble to have a lawyer to go through it with you thoroughly. It is also a good idea to have it reviewed by a franchising consultant. Pay particular attention to provision in the agreement affecting termination, transfer and renewal of the franchise. Franchisors generally reserve the option to buy back an outlet on termination of the contract and once the franchisee has made the outlet a success, there is a natural incentive to do this - at the lowest price.

#### The franchise territory

The size of the territory and the number of competitors in it may determine the success or failure of a franchise business. Find out answers to questions such as:

- What specific territory is being offered and is it clearly defined?
- Is there a choice of territories?
- What competition would be met in marketing the product or service in the designated territory today and in (say) five years' time?

#### Before you buy a franchise:

1. Get familiar with the Franchising Code of Conduct.
2. Don't rush in too quickly:
  - Assess the sort of business you want to work in.
  - Assess your skill level and suitability.
  - Consider your lifestyle needs.
  - Be aware of the risks.
3. Think carefully about whether you are suited to a strict franchising structure
4. Be wary of franchisors that apply pressure to "sign up" franchisees
5. Research and have a business-like attitude towards making your decision to buy a franchise
6. Decide how much you can afford to pay for a franchise business
7. Make a shortlist of franchisors and follow a strict process of due diligence in evaluating them
8. Ensure that you understand and scrutinize termination clauses in franchise agreements.
9. Understand that franchising is about franchisor and franchisee relationships – be prepared to give and take.
10. Consult with a legal advisor with experience in franchising-related law before signing any document.

## Conclusion

From a franchisor's perspective, franchising allows rapid expansion with limited capital and provides motivated owner-operators. It spreads the organisation's image and advertising dollars and allows bulk buying. There are some businesses, which can be franchised, but there are many which cannot.

Businesses which cannot be franchised include those, which rely on the charisma of the owners, businesses, which are dependant on 'arts rather than sciences', and businesses with low barriers to entry e.g. those, which any competitor can enter easily and inexpensively.

Kelly and Chapman can assist you if you are considering buying a franchise, before you start negotiating – contact Mr. Vujnovic of our office today on (03) 9557 2915 or by email [mv@kellyandchapman.com.au](mailto:mv@kellyandchapman.com.au) or visit our website [www.kellyandchapman.com.au](http://www.kellyandchapman.com.au).

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