IS FRANCHISING FOR YOU?

While buying a franchise can sometimes seem like the safest, easiest route into small business ownership, as with anything, there are always risks. Make sure you weigh it all up before you sign on the line.

BY JOHN CORIAS

Imagine starting your very own business where someone else organises all your training, OH&S policies, stock management, business registration and setup. Your business is instantly well known by the public and market research is taken care of. And your shopfront, branding, website, advertising and merchandising? That's all looked after by someone else too.

You may be thinking, "Where can I sign and how soon can we start?" The 600,000 Australians who own franchises all asked the same question. Franchising in Australia contributes 14 percent of the national GDP and is often seen as a good way to have your own business without all of the hassle of starting one from scratch.

According to the Franchising Alliance, "franchising is a method of growing a business whereby a franchise owner (franchisee) is granted, for a fee, the right to offer, sell or distribute goods or services under a business system determined by the business founder (franchisor). The franchisor supports that franchised business group by providing leadership, guidance, training and assistance, for which they receive ongoing service fees."

Just as starting any small business is fraught with potential dangers, franchised businesses have their own particular set of risks that need to be carefully investigated when considering buying a franchise. Here are some of the main benefits, disadvantages and considerations that you should assess before buying a franchise.

BENEFITS

Buying a franchise is a major decision. The commitment in capital and borrowings can be significant. Therefore the benefits of such a big investment need to far outweigh the disadvantages. Some of the benefits for franchisees can include:

- A new franchise will already be known thanks to the franchisor's marketing campaigns, established brand and reputation. In comparison, a brand new business will take quite some time to develop a good reputation in the area of trade.
- Market research is normally already done by the franchisor.
- The franchisor will provide assistance with site selection, lease negotiation, site development and shop front design based on the experiences of other franchisees.
- Marketing campaigns are already established before your franchise even begins giving you a head start on the marketplace.
- Franchisors almost always provide training and ongoing support for new franchisees, especially critical for anyone who is not trained in the field of the franchise.
- There is no need to research potentially risky new products as this is done by the franchisor before going to market.
- The purchasing of stock is often centralised. This streamlined process may help the franchisor obtain better prices and prevent wastage by ordering correct stock levels based on experience.
- Standard procedures, operating manuals, best practice models and stock control systems are already established and have been tested over time by the franchisor.
- Often franchise models will have their own tailor-made business management software that can often assist in the smooth running of the account side of the business. This is especially helpful for those who are running a small business for the first time.

DISADVANTAGES

As opposed to starting a brand new business, a franchise has restrictions, structures, fees and systems out of the franchise owner's control. For this reason, there are many risks and disadvantages to evaluate prior to committing to purchase a franchise. Some of the disadvantages can include:

- Franchise fees such as royalties, advertising levies and rental structures can all be so prohibitive that they end up with very little profit at the end of the day to take home.
- Franchise agreements tend to be watertight legal documents that enforce that you are in business until the agreement has run its course. In contrast, a brand new business allows you to determine your own exit strategy.
- Franchisors will restrict what products can be sold, even if your particular location may require something a little different.
- Some franchisors direct their franchisees to order stock from preferred suppliers. However, this may not be the most cost effective option and limits your control over supply chain agreements.
- If you are starting a small business to exercise your freedom and have autonomy, you may end up feeling like you're in an employee/employer relationship. Decisions require the approval of the franchisor and you must operate within the restrictions of an operations manual.
- Initial commencement franchise fees can be quite high, and while the training, technical support and initial marketing are looked after you cannot assume that it is complimentary. You will pay for it. If you sell the business you often need to pay a fee to the franchisor as outlined in the franchise agreement.
- Ongoing franchisee fees, normally labelled as franchise fees, royalty fees or marketing fees can range from 10% to 20% of a business' turnover which is quite a large chunk of your cash flow.
- Finance can also be hard to source as the reputation of the franchisor very often impacts their franchises, regardless of the franchisee's individual reputation and even if your particular site is a guaranteed winner. This is where it is true in franchising that the 'sum of the whole is greater than the individual'.
- The only way to grow your business will be to add a second franchise, as the size, location and product range will be limited by the franchise agreement.

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CONSIDERATIONS

It is important to remember that franchising is not a guarantee for success, no matter what your potential franchisor may suggest. There will always be a series of risks and rewards that must be carefully weighed up before investing your valuable time, money and resources. If you are considering getting into a franchise business you must have a clear understanding of what you hope to achieve from the venture and know whether or not the business model is aligned with your goals as an individual or family.

As a partner in a small business accounting firm, I have seen many great success stories. However, for every success story there is also a family that has invested their whole life into a franchise only to lose everything they had. For this reason, you must dig below the surface of any franchise opportunity to assess its viability and suitability. Investigate the franchise system, franchisor, territory and industry and seek advice from current franchisees. Make sure you select the current franchisees to talk to, not the franchisor.

Before entering into any franchise agreement, have the franchisor give you a copy of the Franchising Code, a disclosure document and a copy of the final franchise agreement. Along with your accountant and solicitor have a detailed look at the agreement to understand the details of what is included in the sale, your rights and obligations and the fees that you will need to pay upfront and on an ongoing basis.

While it is clearly not in the financial interest of the franchisor for a franchisee to fail, it is important to realise that franchise systems are set up to benefit the franchisor, and sadly not always the franchisee. Franchise agreements tend to be complex watertight legal agreements that will almost always see any disagreements end in the franchisor's favour. For this reason you must seek independent expert accounting advice and legal counsel to reduce the risk involved in buying a franchise business.

By taking a thorough look at the common risks, benefits and disadvantages, much of the risk can be removed in order to own a franchise that is a successful small business with many advantages. DB

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