

FAST FACTS 14: FRANCHISING

Franchising is one of the fastest growing business sectors in Australia. Franchising is a unique way of doing business, built on mutual trust. The growth and development of franchise systems is dependent upon the relationship between a franchisor and its franchisees.

Before entering into a franchise agreement you should consider the following:

The franchise

- How long has the franchise been operating?
- If it is a new system, how can projected sales be verified?
- Is the intellectual property of the franchise protected?
- If the product is to be manufactured by someone other than you, ask the manufacturer how its price will be established.
- What is happening in the industry sector?
- What are the competitors doing? If there are no obvious competitors, what are the chances of them arriving after you have made an investment and how will that affect your business?

Your investment

- Establish what your total investment will need to be, what your investment buys and what return, apart from wages, is expected. While there are no guarantees, prospective franchisees should compare the expected return from a conventional investment (ie, term deposit, debenture) with the return from the franchise.
- If equipment is required to be purchased from the franchisor, are these prices comparable to the open market?
- The same applies to supplies purchased from the franchisor. Does the franchising agreement prevent you obtaining supplies from another source?
- How are the royalties calculated? If royalties are charged as a percentage of gross sales, make sure these are not out of line with the sales volume and projected net profits for the franchise.
- Ask to see validated profit figures of franchisees operating on a level of activity you can reasonably expect.
- How is the wages component of costs made up? An important incentive for a company to become a franchisor in the first place is that it is a means of ensuring enthusiastic, energetic managers of branch outlets. However, the profit projections may assume exceptionally long hours at effectively low rates of pay for the franchisee proprietors. There is nothing wrong with this, as long as the prospective franchisee recognises it and takes it into account when calculating the return on investment. Owners' wages, at a realistic level, should be deducted from the income.
- Ensure the franchisor details all the outgoings – including items such as power and delivery vehicles.

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- Are you just buying yourself a job?

Franchise agreement

- Don't just have the agreement inspected by your accountant or bank manager. Take the time to have a good solicitor, preferably one who specialises in franchising, to go through it with you thoroughly.
- Pay particular attention to provisions 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

- What is its potential? Take the time to do your own research as well as analysing the franchisor's information.
- What specific territory is being offered and is it clearly defined? Are there other competitors in the area?
- Do you have a choice of territories? What are the advantages/disadvantages of each site?
- What competition would you meet in marketing the product or service in the designated territory today and in the future – in 5 or 10 years time?
- If the franchisor says a market survey indicates given potential, get a copy and investigate the reputation of the organisation that prepared it. Particularly note the assumptions behind the survey conclusions and, if possible, talk to the researchers responsible.
- Are you protected from the possibility of the franchisor selling additional franchises with the territory at a later date?
- Are there any limitations upon you if you desire to open additional outlets in the territory, or even another territory at some future time?
- Has a specific business site within the territory been selected? If not, how will this be decided?
- Whose name will the lease be in?

Is franchising for you?

- Am I genuinely enthusiastic about the business and the business system?
- Am I physically and emotionally equipped for the work and confident about my management ability or potential?
- Am I suited to spending my business life working with this particular franchisor and selling this particular product or service to the public?
- Do I seek complete business independence? (If yes, you are more likely to find it in an enterprise other than franchising).

Conclusion

There are many businesses that can be franchised – and there are many which cannot. Businesses which cannot be franchised include those which rely on the charisma of the owners, businesses which are dependent on 'arts' rather than 'sciences', and businesses with low barriers to entry (eg, those which any competitor can enter easily and inexpensively).

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Franchising allows an organisation with the correct character and culture to expand rapidly with limited capital and provides motivated owner-operators. It spreads the organisation's image advertising dollars and allows bulk buying.

Ensure you are familiar with the new Franchising *Code of Conduct*.

Need further information?

Franchise Council of Australia

W: www.fca.com.au

Department of Employment, Workplace Relations and Small Business

Franchising *Code of Conduct*

W: www.dewrsb.gov.au

And, finally, ensure that you get advice from an experienced business adviser who thoroughly understands franchising.

For more information refer to other Fast Facts in this series or contact:

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