

How to buy a franchise – not!

You hear some interesting comments when talking to potential franchisees, as **Tim Kilham** reports.



“It’s a great brochure they have given me – lots of pictures and in colour. And the franchisor and the broker are very nice people as well. I think I’ll buy this franchise.” Don’t laugh, it happens! Plenty of people buy a franchise without carrying out proper due diligence checks.

Most of the franchise businesses on offer are reasonable businesses – at the right price. Most of the people – in fact the vast majority of people – trying to sell you a franchise are honest and reputable. You must however do your homework. It never fails to amaze me when I come across people who will put considerable thought into spending \$1500 on, say, a new television set or digital camera (and rightly so), but who will spend \$200,000 on a business based on a glossy brochure and one or two brief chats with a franchise broker or franchisor.

I repeat, don’t laugh, it happens!

“I won’t bother to go and see a lawyer. I’ve read the documents and anyway, it’s not going to help to see a lawyer because the franchisor is not going to change anything in the franchise agreement.”

It may be that some franchisors will not change anything in their franchise agreements, but most will if your lawyer has a good

point to make. However, even if the franchisor refuses to change the documents, a lawyer can point out the onerous and perhaps unfair clauses in the franchise agreement to you, so at least you are aware of the risks that you are taking if you choose to enter into the franchise. And besides the franchise agreement, there will be other documents and contracts that need checking, such as confidentiality deeds, guarantees, leases, etc.

“I won’t bother to see an accountant because I have been through the figures in the disclosure document and I know how much I’m going to make.”

What you see is not always what you get. There are commercial risks to be weighed up and return on investment to be considered. The right structure – company? trust? partnership? – and commercial contract can minimise taxation. It is not only profit that needs to be considered,

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but also cashflow, particularly where working capital is involved. There may be hidden costs. An accountant is ideally placed to assist you in the process of purchasing a franchise and helping you to determine the right price to pay. An accountant is usually the best person to guide you through the acquisition process.

“OK, I’ll use an accountant and lawyer. I’ve got an accountant – he does my tax return each year – and I will use the lawyer who handled my father’s estate.”

Your current accountant and the lawyer you’ve met once or twice may be the ideal people to help, but then they may not. Are your current accountant and lawyer used to dealing with commercial matters, and particularly with franchising matters? You do not want to be paying your accountant and your lawyer to learn about franchising at your expense when they peruse the franchise documents. You may pay more to consult a lawyer or accountant experienced in franchising, but they will be able to go through the documents in half the time, make sense of them more quickly and help you to ask the right questions. You pay peanuts and...

“This is a great franchise. It must be, just look at the disclosure document, it shows that I will make \$120,000 a year, and it’s only going to cost me \$150,000 to buy the business.”

Yes, at clause 19 the disclosure document does show a bottom line of \$120,000 for a model franchisee. **You**, however, are not a model franchisee, but you are you with your own particular facts and circumstances. Read the disclosure document carefully. It probably excludes the following expenses:

- ▶ interest, because the franchisor has no way of knowing whether you will be borrowing money or using your own resources and therefore what your interest will be
- ▶ owner’s wages, because the franchisor has no idea of the wages you will be paying yourself
- ▶ depreciation, because the franchisor does not know if you will be buying or leasing assets and therefore whether depreciation will apply
- ▶ tax, because the amount of tax that you will pay depends on your own structure and unique circumstances.

Factor these amounts in and the \$120,000 profit becomes a much smaller amount. Is it still worthwhile to buy the business? Quite possibly, but you should establish a more likely bottom line so you can confirm whether or not you should go ahead and, if so, what price you should pay.

“My friend bought one of these franchises, and she did well, so I reckon it’s a great franchise for me.”

Most franchisors and franchise systems are honest and reputable. Notwithstanding this, it is important that even in a large, honest and reputable franchise system, you ensure that

you are the right person, in the right location and that you pay the right price. In any system there are good and bad franchises, depending on location, the operator and many other factors. Don’t assume that because somebody else in the system has been successful so too will you be. I act for three different franchisees in a particular food franchise. One of these stores is a top performer in this system, one is an average performer, and one is near the bottom. And the top and bottom stores are owned by the same person!

“I’m not sure if this is the one I want and I might be paying too much, but there are three other people looking to buy the franchise and if I don’t buy it now then they are going to.”

So be it. As any person who has ever tried to buy a house and been outbid by somebody else knows, it’s disappointing at the time, but there is always another ideal house for you to purchase. It’s the same with a business. If somebody else buys the business before you, you will be disappointed for a while, but you will get over it and there will be another business – the right business – out there for you.

“If the financial figures I’ve been given are wrong or if I don’t make as much money as I expect, then I will sue the franchisor and get my money back – I’ve got the Australian Competition and Consumer Commission behind me, anyway.”

Yes, you can sue. But you might not win. If you do, it may be a Pyrrhic victory. A legal battle is never a pleasant process for anybody. If you don’t think it is the right franchise, then don’t buy it. Don’t rely on fighting a franchisor or a legal battle to get your money back.

“It’s a proven fact that franchised businesses are more successful than non-franchised businesses so I can’t go wrong. And the franchisor will help me if I don’t do as well as expected.”

Yes, franchised businesses are less likely to fail than non-franchised businesses. Yes, the franchisor will help you if the business is not performing to your expectations. But not all franchises succeed, and don’t expect miracles from the franchisor. You need to be committed to the franchise, to believe it can work and to be prepared to work very hard to make it successful. Buying a franchise, even one in a large franchise system, is not a guarantee of success.

“She’ll be right, mate.”

Perhaps. Perhaps not. ●



Tim Kilham is an accountant who specialises in advising people on the purchase of a franchised business. He has advised many people on the purchase of a franchise. There are many more franchisees who have not sought advice from him or any franchise specialist before acquiring a franchise! Tim is a partner with McLean Delmo & Partners and can be contacted on (03) 9819 4666. He was formerly a partner with

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