

# What is a Franchise?

A franchise is a business arrangement that allows a business to operate under the name of an established brand, like Macdonald's.

Today there are many examples of franchising, and it is particularly prominent in the food, service and retail industries.

The franchisor (the company owning the established brand name or the rights to use the name) grants the franchisee (the entity wishing to set up business) the right to sell or produce the brand name product. For example, an independent bottling company can produce a brand name soft drink in return for a fee or royalty.

## *Advantages*

- The product name is already established.
- There is an immediate entry into the market.
- Sharing the advertising/marketing expenses among a large number of franchisees.
- Often a lesser initial capital investment.
- Readily available knowledge and market research about the product.
- An ability to compete with large companies.
- A potentially good alternative for entrepreneurs who want continuing guidance from experienced operators.
- Operators are often highly motivated.
- Innovative marketing techniques thrive in a franchise environment.
- Combined purchasing powers.

## *Disadvantages*

- Sometimes the initial set up costs are high (such as fitout requirements).
- Franchisees must comply with the procedures imposed by the franchisor (including hours of operation, obligations to use certain suppliers and staff procedures) – franchisees generally do not have the scope to modify the franchisor's procedures.
- Ongoing training and staff development, and compliance with franchisor requirements can be costly and time consuming.
- Ongoing costs charged by the franchisor can be prohibitive.
- Reliance on the expertise and assurances of the franchisor.
- Complicated agreements to be understood before signing.
- Some franchisors take a more serious position in relation to their ongoing responsibilities to franchisees than others.

- To many franchises may be sold in the same region diluting the potential of any particular franchise.
- Complexities surrounding termination of franchise agreements.

### Checklist

Before signing any franchise agreement or other documents you will need professional advice.

Make sure you check the following.

- The accuracy of all representations made in any disclosure documents provided by the franchisor (see below).
- The franchisor's financial position.
- Whether the franchise is expert in the business or whether its main business is selling franchises.
- The company records of directors' interests etc.
- Whether the franchisors are approachable and will continue to be so after you sign the agreement, and whether you will be happy to be in a long term relationship.
- Whether established franchisees are happy with their franchise and the activities of the franchisor.
- The strength of the major competition in the market.
- Whether the market is already saturated (look at the recent history of the oversupply of service stations for an example of this).
- Who has the legal responsibility for problems with the product.
- What the total investment will be, and whether there are hidden costs and ongoing fees charged by the franchisor.
- Whether some items (like equipment) and the product itself must be purchased from the franchisor.
- The exact nature of any royalty rate that must be paid to the franchisor, and exactly how it is calculated.
- Whether projected profits and costs are validated by independent means.
- The franchise agreement thoroughly, preferably with a legal expert, and the rights of the franchisor to end the agreement.
- Whether you are sharing regions with other franchisees, the distance between them, and any guarantee you have against the franchisor if they sell another franchise in your territory.
- Whether any market survey used to identify a new territory is compiled by a reputable organisation.

## Where can I get help?

There are many complicated issues related to franchising. Because of this the Franchising Code of Conduct makes it compulsory for a franchisee to get proper professional advice before signing any franchise agreement.

We can:

- draft and advise on franchise documents; and
- act in disputes regarding franchises.

## For further information, contact:

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