

UNDERSTANDING
THE RISKS AND REWARDS
OF FRANCHISING

A PUBLICATION BY



Introduction

The rewards and benefits of franchising are well publicised. The Australian franchise sector features around 1,200 different franchise systems and more than 70,000 franchisees. Many of these systems have achieved outstanding success, and thousands of franchisees can tell stories of how franchising has helped them achieve great personal rewards. But not all franchise systems achieve the same level of success, and not all franchisees succeed.

The purpose of this publication is to provide a simple, plain English guide to the risks and rewards of franchising. It is not intended as a comprehensive guide, but rather a starting point to ensure you understand the fundamentals of franchising.

What is franchising?

Franchising is a way of doing business. So you could open your own chicken business, or you could buy a franchise to operate under a common and hopefully well known brand. Unlike setting up your own business, in a franchise the franchisor owns the name, brand and system, and you as a franchisee are given the right for a limited period to use them. The franchisor may also organise products, equipment, a lease of premises and other things, depending on the nature of the franchise. You will typically pay for these rights.

Not all franchisees are the same

Franchises come in various shapes, sizes and forms. Some franchises offer a lot of support, others are set up on the basis that the franchisee does not obtain support. There are different fee structures, different lengths of the agreement, different terms and conditions. That is why it is important to shop around, check out websites such as www.franchise.org.au and get expert advice from people who understand franchising to assist you to determine what suits you best, and if you are getting a good deal.

Franchising can deliver great benefits

From a franchisee's perspective, in an ideal situation a person with little or no prior business experience can learn core business skills and have access to a business model that has proven successful in other locations or areas. Franchisees can have access to a strong brand, obtain initial and ongoing training, have access to product or technical assistance, benefit from group purchasing and collaborative marketing, acquire unique or distinctive products or services, save on set up and other costs, gain access to sites not normally available to small businesses, obtain finance more easily and have the capacity to obtain business support from the franchisor and other franchisees.

There may be other benefits such as administrative assistance, access to franchisor services, research and development and benchmarking. Ultimately a franchise system can only be successful if its franchisees succeed, so the franchisor has a vested interest in franchisee success.

But there can be disadvantages

On the flipside of the franchising, there is usually less autonomy and more operational restrictions on franchisees, there are fees to be paid, and some of the expected benefits may not be as great as anticipated, or indeed the franchisor may fail to deliver to the franchisee's expectations. The interdependent nature of the franchise relationship can have adverse consequences for franchisees if the franchise system fails and the franchisee is un-

able to continue in business. Franchise systems where the franchisee is dependant on the franchisor for product supply or other things beyond the brand and the system may require additional due diligence.

Do franchised businesses fail?

There are lower risks involved in buying a franchise compared to starting your own business, but like any business there are still risks. And franchised businesses and indeed whole franchise networks can fail, just like other businesses. Sometimes businesses fail because the franchise system is not successful, but more often they fail for the same reasons other businesses fail – lack of capital, economic downturn, lack of management skills of the operator, borrowings too high, increased competition, changed customer preferences or poor customer service skills.

What are the major risks?

Franchising is not risk free. It is not like working in a job. Entering any small business, including a franchised business, carries with it a degree of risk. Businesses take time to get established, so you need to have adequate working capital and perseverance for the first year or two. Some geographical areas are more affluent than others, there are different ethnic mixes, some areas have greater competition and some locations are better than others. And the economy has its ups and downs. If you are the first franchisee in a system it stands to reason that your level of risk is higher than for later franchisees, but the reward may also be higher. If there are more successful franchisees in a system the degree of risk is reduced, but there are still risks relating to the locality or geography of the business. Plus it is important to check that the underlying business is not a fad, but has substance and long term customer appeal.

Many of the risks that relate to franchised businesses apply to all businesses. Each situation will be different, but the following tips may help you cover some of the possible risks:-

- Have someone independent give you an honest view as to whether you will be suited to operating a franchised business. It is a lot different to being an employee or a manager, so make sure you are ready to be very hands on.
- Assess your health and lifestyle aspirations to ensure you will be able to cope with the stress, the long hours, the staff issues and the workload.
- Few franchises are back office jobs, so ensure you are as good at selling, can manage staff and you enjoy dealing with customers face to face every day.
- Be aware that the financial rewards may not be as great as you hoped, particularly in the early years - the franchise might not work as well in your area, the location may not be as good as others, or there might be stronger competition, higher costs or different local market conditions.
- Don't stretch to buy a franchise you cannot afford, and make sure you have enough capital to cover the working capital needs of the business, particularly during the start up period or during any downturn.
- Check your partner and family are supportive, particularly if you need to spend a lot of time in the business or the financial return is not as expected.
- Understand that things can change - the franchisor may become insolvent, change ownership, change strategic direction or acquire another business, which may affect you as a franchisee.
- Discuss with the franchisor the factors relevant to whether the franchisor may extend your franchise at the end of the fixed period.
- Make sure that the lease term is not too short, and be aware that the landlord may not extend your lease or you may not be able to afford rental increases.

- Consider if the shopping centre will attract enough customers, the site is right, and the shopping centre does not plan to renovate the centre or relocate you.
- Ensure the Franchisor will provide the nature and level of support you need.
- Understand that as a franchisee you will not be able to be too entrepreneurial or stock different products, as the franchisor will usually want you to follow the system. Franchising is a team game, so make sure you are happy to follow team rules even if you don't necessarily agree with them.

Be realistic in your assessment

When you are looking into franchising, don't be blinded by the theory. Check out whether the franchise system delivers the advantages listed above. Speaking with existing franchisees will give you the best guide. And if the business is more captive than normal, check out the franchisor more carefully to ensure they are strong.

Buying a franchise is a serious decision. If the business is successful it could secure your financial future and provide you with a wonderful sense of achievement. **If not, you could lose your house and everything you own, and damage your health and relationships with others.**

There is a very strong correlation between franchisees who fail, and those who fail to make proper enquiries about the franchisor and the business. Take your time, read all the documents carefully, talk to other franchisees and assess your own financial resources and capabilities to deal with the requirements of the franchised business. If you follow the process recommended in the Franchising Code of Conduct your risk is substantially reduced.

Where to get information

The Franchisee's Guide produced by the Franchise Council of Australia provides a comprehensive explanation of franchising, and explains how to evaluate a franchise, what questions to ask, and what to expect from your franchise relationship. For a copy of this Guide, or for more information, go to www.franchise.org.au. The Australian Competition and Consumer Commission has some materials on franchising, and you may find the ACCC website at www.accc.gov.au helpful. These days searching the internet will also turn up a wealth of information.