

EPISODE

152



The top legal tips when buying a franchise

The Deal Room Podcast

Episode 152 – The top legal tips when buying a franchise

Note: This has been automatically transcribed so will be full of errors! We are not providing it to you as a word-perfect version of the podcast but just as an easy way to provide you with a different way to be able to see or scan what kind of information that might be relevant to you if you are the kind of person that likes a transcript.

Transcript

Joanna:

Hi, it's Joanna Oakey here and welcome back to The Deal Room podcast, a podcast proudly brought to you by our commercial legal practice Aspect Legal. Now today we have on the show the fabulous Nicole Segal from our very own Aspect Legal here to talk to us all about franchising, and in particular, the top legal tips when buying a franchise. So if you're looking at potentially acquiring a franchise, or you're just interested in finding out a little bit about the process and tips and tricks, then this one is for you tune in to this whole episode with our very own Nicole from Aspect Legal talking about the top legal tips when buying a franchise. Here we go.

Joanna:

Wonderful. Nicole, thank you so much for joining us on The Deal Room podcast today.

Nicole:

My pleasure.

Why should you buy a franchise?

Joanna:

Brilliant. Okay, so let's get stuck into it. So of course today we're talking about the top legal tips when buying a franchise, but maybe let's step back one. Before we talk about the legal tips in buying a franchise. Let's talk about why someone who is looking to get into a business might consider buying a franchise rather than a non franchised business.

Nicole:

Okay, great question. So there's many reasons somebody would buy a franchise. In some respects, it's actually easier for someone to buy franchise than to start their own business the franchise would already have their own brand and their own systems and their own marketing campaign and their own way of doing it. Franchisees usually have a high rate of success than a startup business, most startup businesses fail. But franchisees, because of the marketing the system, the brand, the awareness, some they can be quite successful. And franchisees often have an established reputation, image proven work practices, advertising, and often you can learn from the franchisors own experience. So they may have had a number of franchisors and made mistakes along the way and given those tips to the franchisee, so they don't make the same mistakes. franchisors also generally provide assistance in identifying suitable business locations. So when a franchisee is looking to set up a franchise all might know the area might know the main roads might know the shopping centers might know the places nearby to avoid. So that's also a really good incentive.

Joanna:

I guess there's two types of franchises that you can start a greenfield site. So you can start a new site, or you can buy an existing franchise as well. Right. So there's those two elements, but maybe it's Sorry, I cut you off, let's finish this, but then maybe let's come back to looking at, you know, what are the benefits of the established franchisee versus, you know, buying that business versus just, you know, taking a franchise in a Greenfield site? So, but sorry, I interrupted you, Nicole, very rudely. I will let you continue, so, why might we buy a franchise in the first place?

Nicole:

Franchisors also generally provide ongoing support training knowledge. And they might have specific business models that can really tailor it or be specific to the franchisee, and buying a franchise might be cheaper than setting your own business. Yeah. So when you start your own business is obviously huge amount of costs involved. But the franchise model might be more streamlined, you might know exactly what the cost will be, with a franchise costs as well as the startup costs, the rental costs, all those needs to be taken into account. So coming back to your question, with the franchise, he could either buy an existing business, for example, that's already in the shopping center, they might already have a great reputation, they might have existing customers, and they are well known so that's a huge advantage.

Joanna:

You know what you're getting effectively.

Nicole:

Absolutely, you know, what you're getting, and customers may not even realize that there's been a change of ownership, it's just could be pretty streamlined. Otherwise, you can actually just start up a new franchise in a different area or different territory, and then start from scratch, create it from scratch, and then get your own client or customer base that way.

Joanna:

Obviously, you know, the benefits of buying as we said, the established business is that it's already up and running, you know the performance in the geographic area, you know, it takes the guesswork away.

Nicole:

Absolutely.

Joanna:

In that sense, but you know, I guess they you're having to pay a bit more because you're actually having to buy the established business but certainly that's the benefits of it. It's there you can see how it operates.

Nicole:

And you're buying the grid goodwill often, when you're buying in the industry.

Top tips when buying a franchise

Joanna:

Yeah so you've got your client base up and running. Exactly. From a funding perspective, I think that, you know, that can also be something that's an assistance, because he's something that you can prove that already has accounts that run with the business. Okay. So then let's talk about what are the top tips when buying a franchise? And I guess the corollary of that is when things go wrong, what should we be looking out for? What are the tips,

Do your research

Nicole:

so the first thing I would do, or advise a client to do is you obviously need to do your research, you really need to understand the franchise business, I you should talk to existing franchisees, if possible.

Joanna:

You know what, that's such a good point and it should be obvious shouldn't it? but I feel like that something that isn't necessarily obvious to people and it. It's a good point, because there's people who are in there, who are working the system and can tell you their honest opinion on how, how the system's working for them.

Nicole:

Absolutely. And when you actually get into the franchise model, the franchisor has to give you a disclosure document, which actually lists all the names and addresses of the existing franchisees. So it could be pretty easy. So you can ask them basic questions, you know, have you earned the income you thought you would make? How long has it taken to recover your investment costs? What's the training been? Like? What marketing support? Has there been? Did it meet your expectations? Would you recommend it to your friends? So, you know, there's really a lot of information you can actually gain from just doing proper research.

Joanna:

What a fabulous tip, I love it, Nicole? What else? What else have you got in there in your bag of tips?

Fully understanding the figures

Nicole:

Well, you obviously need to consider the cost. So work out your finances. So there's always going to be upfront costs, there's going to be ongoing costs. And these might include ongoing monthly royalty fees, marketing fees, there might be product fees if you're purchasing products from the franchisor your rental costs, because it's a franchisee by your agreement might actually require you to get audited reports, the franchisor is clear and exactly how much income the business is generating. So all these fees are really critical for you to understand, is the business going to make you money? And is it worth it?

Joanna:

Excellent. Okay. And so and I guess some of this is part of that due diligence that you'll want to do at the beginning. So lately, um, you know, and I guess also understanding the franchise agreement, and understanding the franchisor as well must, you know, also plays a large role?

Have a trusting relationship with your franchisor

Nicole:

Absolutely. Because, look, there have been many situations, for example, the last few years esic recently investigated retail food group, and that owns glory jeans during that King brumbies and classes pizza. And while there were no enforcement measures taken many franchisors complained that retail food group really, the whole model was to take all the money away from the franchisees and many franchisees lost their life savings, their home, their marriage, the house, their everything, so it's really important that you, I guess, have a trusting relationship with your franchisor and a good lays a good relationship with the franchisor. And if it works, well, everyone should be making money, it shouldn't just be the franchisor making money and a franchisee you know, working their guts out and losing it should be the franchisor making money, because other franchisees are making money. That's that's the balance that obviously isn't there for a successful franchise model.

Joanna:

So apart from, you know, fully understanding the figures, which I think is a great

point of yours, I'm fully understanding your rights and obligations under the franchise agreement that your point about, you know, get talking to other franchisees is such a good one, because you can really start to and the questions that you gave us, I think, are a great insight into how you really understand what will this look like, if you're, you know, when you're running that business, and what do you think, you know, on reflection, were the things that the franchisees who had bought into some of these franchise groups that have have hit the media, what do you think perhaps, fell down in what could what could have been warning signs for them in moving into these businesses that it was, it was a franchise that had risk for them you

Warning signs of purchasing a franchise with risks

Nicole:

I think the warning signs may have been that they didn't speak, because now so many are coming out to complain about, you know, the huge problems with the business model. But all these businesses look fantastic. And we all grew up with, you know, brumbies or glory jeans or whatever it may be. And it just, it's so recognizable, you immediately seeing that it will be a great business. Yeah. So I think it's really about digging deeper and understanding what actually happens and doing the maths in terms of how much money do you need to actually bring in to actually generate an income without it going back to all the fees and charges and royalties? Yeah,

Joanna:

yep. Yep. That is such a good point. And, you know, if you cast your mind back, Can you think of any examples that you've seen of some great examples of positive stories of clients you've dealt with who bought into a franchise or an existing business in a franchise and then, you know, really kick some goals? And I must say, I'll throw in here first, I've had a lot of discussions recently with franchisees who've bought into certain franchises and it's just worked so well, that they then go and buy multiple locations, the same franchise, and I know that that must be a signal and perhaps in part of your due diligence as well being aware of how many multiple franchise owners there is within the franchise, because maybe that's a bit of an indication that people are getting in seeing it works.

Positive franchise stories

Nicole:

yeah, absolutely. And the converse side of that, is the litigations. In the disclosure document, you see how many franchisees are buying multiple franchises, but then the franchisor has to disclose the litigation? And obviously, there's a lot of litigation against a franchise or that's a big red flag. And do you really want to getting involved with them?

Joanna:

Yes, that's such Another good tip you have given us today, Nicole, I love it. Okay, well, and of course, as I do, I cut in and I just had so many questions, but how about you continue on? Are there any other tips that you feel like you haven't?

Understanding the territory you are buying

Nicole:

Yeah, well, it's also obviously important to understand the territory. So the way both franchises work, is that you have specific geographic area that you can trade in not all franchises have that model, for example, 711, you know, particularly in the CBD, there's often a 711 across the road from each other. And you know, it's just good luck, which side of the road people literally walking on, so that that might be okay, for those sort of high volume areas, but you know, in my not so just really understand what territory you're buying, how exclusive is it and how large it is. So that's obviously going to impact your business. And by the same token, you need to look at the restrictive covenants. So after some franchises are terminated, you may not be able to operate a similar business for a similar amount of years. So that might be okay, say you have a Toyota franchise. And once the agreements finished, you're not going to be able to be have a Toyota dealership, that might be okay. But if you have a accounting franchise, for example, and you're an accountant, then you've got to think very carefully. Well, after that franchise agreement ends, you might be banned, or, or restricted from providing accounting services for a number of years in a specific geographic region. And that might be where your livelihood is, and your skill base. So I think you need to be very careful,

Joanna:

such a good point, isn't it? And I guess that's about that comes back to as well getting the right advice from someone who understands what it is that you're entering into, in the context of the broader perspective of what you might want to be doing in the future as well. So, you know, it's sort of this, this commercial legal approach about Firstly, understanding what's there. Secondly, understanding what is common in the industry. So I think that's a useful you know, that that also talks to the benefits of, you know, getting advice from people from people who actually understand franchising and what your particular situation looks like in comparison to the norm. So that you have, you know, that opportunity. If there is the opportunity of negotiation, then you have a strong footing for that. And if there isn't, then at least you know, where you stand.

Nicole:

Absolutely. And obviously, speaking to a lawyer is critical in all these. Lawyers are going to carefully review the franchise agreement, the disclosure documents, they'll advise you of the risks and the pitfalls. They'll also identify all the fees in the document. Sometimes people or disclosure documents can be 50 to 100 pages. So sometimes people may not be aware of all the fees and a good lawyer will obviously be able to negotiate with the franchisor and get you a better deal. So then that's could make all the difference.

Joanna:

That's such a good point, I just want to, you know, I just want to highlight that, because this is another point, I think sometimes people misunderstand and feel like, because the agreement comes to them in a certain way that's it, you know, that often is the opportunity for negotiation as well. So it's about understanding that element. And I just wanted to highlight that.

Nicole:

Absolutely. Look, everything's negotiable. Every agreements negotiable, whether you're negotiating with McDonald's, or the government or whoever Optus or Telstra, whoever it is, there's always room for negotiation. And I think people shouldn't be scared of negotiating and lawyers, obviously very used to it. That's what we do all day, every day. So we were trained to it to do to negotiate and excellent negotiation can really save you a huge amount of time and money at the end of the day.

Joanna:

Brilliant. Excellent. Okay, wonderful. Well, is there anything else that we have missed out on there, in terms of tips that we have when you're looking to buy a franchise,

Nicole:

I also think it's very important to not only understand the business model, but just to really work out if a franchise is the right franchise for the time or the territory that you read, for example, I think about 15 years ago, Starbucks was obviously massively popular in America and overseas, and in Melbourne, no one has a huge coffee culture. And all of a sudden, Starbucks just popped up everywhere. And they probably thought this is a great business model, we do coffee, they know coffee, this is just gonna, you know, make the bucks. And you know that what they didn't take into account that Melbourne people are coffee snobs.

Joanna:

Hahaha

Nicole:

Yeah, they used to the European style coffee, and all these huge men of Starbucks, they came in, and they all failed. And they disappeared, and many people would have lost a huge amount of money. So just because things work really well, in America or somewhere else, it doesn't necessarily mean it's going to translate to the territory. And the other thing is the time, for example, you know, in the early 2000s, blockbuster was such a huge franchise, everyone knew their name. If I was hiring DVDs and videos, I know right? And you used

Joanna:

to go in there really fun to spend ages looking through which one would you take out, and then you can only have it for a number of days. Oh, my goodness.

Nicole:

And that was part of the fun in itself going to blow us out almost as good as saying the movie. But when Netflix approached them blockbuster many years ago and said, let's try and do a deal. blockbuster just didn't understand the model. They didn't understand why people would want to watch movies over their computers or their laptops or TV ad, they just kept up with the same model. And that's obviously led to its downfall. So I think, yeah, when you're buying an existing franchise, you need to look at the history. But you also got to realize that the history doesn't always it won't always translate to sales in the future, and edit an existing franchise like blockbuster, they should have been more astute and looked at different opportunities and more competition and maybe change their business model. That might have been helpful.

Joanna:

Absolutely fascinating. Nicole, thank you so much for taking us for a walk through this area. And obviously, you know, there's a lot to think about when you're buying any sort of business, but even more so when you're buying a franchise, just from the perspective that there's often a lot more paperwork. There's a lot of paperwork when buying franchises. I feel like the franchisors have competitions to see who can get the longest agreement.

Nicole:

It is true. I guess one of the advantages for a franchisee it's highly regulated. So if there is a dispute, it's very clear under the franchise code, what you need to do, how you can sell the business all that is quite highly regulated and it is there to protect the franchisee so a lawyer that's experienced franchisor would know there and could really help some franchisees even negotiate the franchisee or, you know, get out of certain messes that they're in.

Joanna:

Brilliant. Well, wonderful. Thank you so much, Nicole. It's been so great to have you here talking about all of this area that obviously you know, inside and out. I really enjoyed having a walk back through memory lanes of blockbuster. Yes, yes. Fabulous. Well, wonderful. Thank you very much for coming on to the show today. Nicole.

Nicole:

Thank you for having me.

Joanna:

Well, that's it for this episode of the deal room podcast. With our very own Nicole Siegel from Aspect Legal talking all about the topic.

Legal tips when buying a franchise. Now if you'd like more information about this topic, or if you would like to get a download of the checklist of the things that Nicole Segal talked about on this episode, and more for you to look through, if you're looking at buying a franchise, then check out our website at the deal room podcast.com. There, you'll be able to download a transcript of this podcast episode. And you'll also be able to download that checklist that I talked about directly from the website and of course, will link straight through to that in our show notes as well. And via our website, you'll also be able to find details of how to contact Nicole and our other legal Eagles at Aspect Legal.

If you or your clients would like to discuss any legal aspects of sales or acquisitions of franchises, or indeed any other business, we've got a number of great services to help businesses both on the acquisition side and on the exit side. So don't hesitate to get in contact today. Well that's it. I hope you enjoyed listening into this episode. We'll definitely have Nicole back and we'll talk in the next episode that we have Nicole on about the top legal tips in selling a franchise so look out for that. But in the meantime, hope you're having a fabulous morning, afternoon, evening, wherever you are, and you're listening to this. And we'll look forward to having you back for our next episode of The Deal Room podcast. You've been listening to Joanna okie thanks again. See you next time.