



The Deal Room Podcast

Episode 229 – Acquiring a franchise vs standard business? - key differences you need to know

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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 talking about what is different between acquiring a franchise versus a standard business. So we really get stuck into what some of the benefits are, what are some of the things to be aware of what some of the most critical parts of the franchise agreement are, and we also talk about some changes to the franchising code of conduct this year. So if you are interested in buying a franchise business, or you're interested in franchising, business, sales and acquisitions, then this episode is for you. Here we go with our discussion with Nicole.

Joanna:

Hello, Nicole, and welcome back to The Deal Room podcast. It's so good to have you on the show.

Nicole:

Great to be here.

Joanna:

Wonderful, wonderful. Okay. Now today, of course, we are talking about the difference between acquiring a franchise versus a standard business. So why don't you take us through it, Nicole? What is the difference between acquiring a franchise as opposed to acquiring a standard business?

Nicole:

Well, the major differences are that franchise, franchises have more fees, more rules, and importantly, more support, and hopefully a great brand. So when you're buying into a franchise, hopefully, you're buying an existing product with a great support network behind you, as opposed to buying your own business and then starting from scratch.

Joanna:

Yeah, absolutely. Because and I guess this is the thing with franchises, isn't it? There we're talking today about the difference between acquiring a standard business versus a franchise. But I guess it is that third option of Greenfield. So just starting a business from scratch. And so we talked, we talked many times on these podcasts about the benefits of buying a business as opposed to starting a business from the ground up. And here we're talking, we're sort of taking it one step further buying into a franchise versus a standard business as an alternative as well for starting from scratch. So one of the things is so we talked about, obviously, there are more rules. So we'll talk about that in a moment. Because I think that's really important for buyers to understand. Let's talk maybe about some of the things that buyers should be on alert for as they're looking at buying a franchised business, maybe take us through what those are.

Nicole:

Okay, so there's a number of things buyers have to be aware of, they need to be aware that they have to strictly comply with the operating procedures, and they have limited flexibility and limited discretion when supplying their products or services. They can't make any changes to the franchise system, all changes that come coming from the franchisor and they don't really have the control the franchisor has the ultimate control so I'll speaking to a franchise, potential franchisee the other day, and his buying a Jim and I went through the franchise agreement with him which was so long and he actually would have said is got a managerial role and McDonald's and he said, Oh, this is nothing compared to McDonald's. We know you know, a Big Mac in Sydney has to be the same as a Big Mac anywhere in the world. So the advantages for a purchaser when you're buying, going to the bank, the neck, you know what you're getting, but from the business owner, there's so many rules and intricacies that they need to strictly comply with. Otherwise, they could potentially be in breach.

Joanna:

And when you say in breach, I guess what we're talking about here is in breach of their agreement, their franchise agreement.

Nicole:

Yeah, so there are so many rules for franchisors. So there's of course, the franchise agreement, which is often about 100 pages. And franchisees really need to understand what this agreement contains. And it really it's always drafted in favour of the franchisor and it basically explains all the rules that the franchisees must abide by, which is really, essentially complying with all the franchisor's terms conditions. is complying with their policy complying with their auditing system, the IT system? Or this? The branding, of course. So there are those rules. And then there's a franchising code of conduct, which is legislation that both parties must comply with.

Joanna:

Brilliant, Okay, wonderful. And obviously, we're talking at the moment about the franchise agreement. So let's stick with it. What do you think are the critical parts of a franchise agreement for a buyer to be thinking about looking at inquiring into when they're thinking about buying this particular franchise versus another, or indeed, versus a standard business? That's no franchise?

Nicole:

So some of the political compliant components of the territory, where are they actually getting? How far is the reach of that particular territory, for example, if you are buying a convenience store, you might want a huge amount, a large amount of territory, but if you're buying in the CBD, for example, you might not get that such a big territory, there might be a very similar convenience store across the road. So it's really important to understand what your territory is, and how far your reach is, as opposed to a standalone business. If you have a standalone gym, for example, in Sydney, you can target all of Sydney, but if you have a standalone franchise, you might only have two or three suburbs, and there might be another similar franchise, 510 kilometres down the road. So you can really only market towards your small reach. So that's a really important restriction that franchisees need to be aware of. And, of course, franchisees need to be aware of the fees, when they have their own business, or the fees go to you. And then you have to work out your expenses, etc. When you're a part of a franchise, of course, you have to pay franchise fees, royalty fees, license fees, it fees, marketing fees, service fees, admin fees, you know, there's a whole range of fees, and then that you need to be aware of, and that needs to be accounted for.

Joanna:

Wonderful. And of course, you know, franchisors have been in been under a lot of publicity in recent years in relation to, you know, this concern about fees needing to be paid versus what the franchisees are receiving for their fees. I guess you've seen it all, Nicole in these franchise agreements, you know, and what do I think many franchisees come in just thinking, well, this is how it is take it, you know, take it or leave it and of course, dealing in a particular franchise, that is often the case that the franchise or isn't going to be highly negotiable in relation to terms, but I think it's a mistake, to think that just because one franchise or takes a certain position in the terms, that that is the same position that any franchise or that might take so you know, you have these positions where perhaps there are a number of franchises that are giving franchising as a whole, a bad name, but you need to make sure you're not just signing up to the terms that are dictated by a franchisor without fully understanding what those obligations will mean for you. Do you have any examples thereof clauses that you've seen, that you ultimately feel should be a, you know, maybe even a deal killer or something that that, that buyers should really be super careful about when they're assessing a franchise business to purchase?

Nicole:

Yeah. 100% Well, first of all, franchisees need to realize that all deals can be negotiable, just because a franchisor might be a big franchisor with a brand well known, a good lawyer will be able to get on the side of the franchisee and negotiate certain causes, and it's often a given take. franchisors are keen to continue the business, and franchisors want more franchisees, so, they are keen to negotiate So, you can negotiate terms, including how wide the area is, as I said, how you can negotiate fees, some franchisors say no, this is the fee Take it or leave it but some franchisors are willing to negotiate fees and also the Accept proceeds provisions in the termination some franchise agreements with attendees and that might be a bit long for someone entering into the franchise system. So they might think maybe I want a five-year term and another option of five years so you can absolutely with the help of Booker's lawyer he can absolutely negotiate critical franchise terms that protect the franchisee.

Joanna:

Okay, wonderful. All right. So we've talked about some of the things to be aware of around when you're buying a franchise, and we've also touched on the benefits. So the benefit of there being systems that are in place there being, you know, a franchise or in place to help potentially support you in the business, whatever other benefits are there of buying a franchise business? So one of the key benefits, do you think that that, you know, buyers should bear in mind?

Nicole:

So the key benefit is the branding. The key benefit is if you bind to a franchise with a good brand, yet, you should have a group of customers willing to say, Okay, well, there's a, you know, this type of restaurant, I've gone to this restaurant all over Australia, potentially all over the world, I know what I'm getting, I trust this brand, I'm happy to get my sandwich or coffee, or whatever it is, from that particular business. Another huge benefit of franchises is that they have their own system, and they have their own operating procedure. And some people have worked for another company for a number of years, and they want to take the plunge and start their own business, but they don't really have the business experience where a franchise system because they have all the business experience, they can say, you know, this works, this is how you should do it, and really give them good guidance. Another benefit, of course, is the marketing systems franchisor, there's a pool of money that goes into marketing. And hopefully every year everyone uses that, and he's able to make more money and grow the brand. So that's a huge advantage. Another advantage is potentially cheaper supplies. So if you're buying from the franchise, the cost of the coffee, or the cost of the bread, or the cost of the meat or whatever, you're selling costs of gym equipment, whatever it may be, there should be bulk discounts because there's so many of them. So it's bulk discounts so can be a huge cost saving for a lot of businesses.

Joanna:

Brilliant. Okay, wonderful. Now, before we leave this topic, I think it'd be great if we could maybe have a bit of a chat about the changes to the code of conduct this year. And maybe if you can kick it off by talking about what the code of conduct is, why should we care?

Nicole:

Okay, well, there's a franchising code of conduct, and it's really to protect both parties to an agreement. The franchising Code of Conduct has huge penalties for franchisors that breach the code, and this can be in the hundreds of 1000s dollars. And that's one of the changes to the code recently, which is that franchisors are more penalized if they breach the code. So, part of the code is has been amended to improve access to information for the franchisees and prospective franchisees they really understand all the financial details, nor the rights or the history of the business. This includes all details of other franchisees who left the franchise system, details of the mediation how much litigation the franchisor was in, and these can be big red flags, if you're entering in wanting to enter a franchise system and you see that hold on 20% of franchises have been in dispute in court in the last year and you know, 15% have left the franchise system, that's a big red flag. So that's really important information for our franchisee to be aware of. And also, the franchise code is really to protect the franchisees that have these good faith obligations, that the franchisor must act in good faith when dealing with a franchisee and of course, the crux of any good franchise system is that everyone benefits its not that the franchisor is making all the money and screwing the franchisee it really shouldn't be each party helping each other. And if the franchisees are happy, hopefully, the franchisor is happy and everyone's making money together. And other changes to the code include improving access to justice and more efficient dispute resolution processes, which are really important when such big money's involved. And franchisees have historically had such limited power. So it really does help the franchisee

Joanna:

and in those latest changes, what are those changes? So just as a quick high level, what practically does it mean?

Nicole:

So practically, it means that if the franchisor is breaching the code, they have to pay really hefty penalties that were already included in the franchise code, but if franchisors are having to pay, you know, you know, up to 800 \$900 million for breach then there's more leverage for a franchisee to say come to the table, sit with me act in good faith, let's negotiate a settlement. Otherwise, I'm going to complain to the ACCC. And this is potentially you know, Tara Wouldn't for your brand and for your system. So I think in terms of fairness, it's really helped franchisees.

Joanna:

I guess within that wherever there's some strengthening of these codes of conduct, of course, you know, it becomes potentially even more attractive for buyers to come into a system that has this sort of regulation around it. So, you know, obviously, I can say there are benefits to the industry as a whole. Alright, Nicole, a huge thank you for your time today. Any parting words for our listeners who might be considering purchasing a franchise as opposed to a standard business?

Nicole:

Well, I think what franchisees need to do if they are considered considering purchasing a franchise as opposed to standard businesses is speak to other similar franchise franchisees. One of the beauties of the disclosure statement is they have to list all the franchisees and their phone numbers and email addresses. So get on the phone, and ask up other franchisees, how easy is this franchise to deal with? Have you had any issues? How long did it take to turn a profit? What are your known, strengths and weaknesses of being in the franchise? Would you want to have another franchise? Why why not? So it really should be some kind of community where you can really ask the really important questions before you know putting so much money into a similar business.

Joanna:

Love that Nicole. Just a huge thank you for coming onto the show today. And we will of course, put in our show notes details of how you can contact Nicole and the rest of our Legal Eagles Aspect Legal if you're thinking about buying a franchise or indeed selling a franchise business, Nicole a huge thank you for coming onto the show today.

Nicole:

Thank you.

Joanna:

Well, that's it for this episode of the dayroom podcast. We hope you're now primed for your next deal with these pointers and have enjoyed these fascinating insights. Now if you'd like more information about this topic, then head over to our website at thedealroompodcast.com, where you'll be able to download a transcript of this episode as well as access any contact details and any other additional information we referred to today's podcast. Now if you'd like to get in contact with our guests today and the services they offer, you can go ahead and check out our show notes for a link right through to them and their details. You can also book indirectly with our Legal Eagles at aspect legal. If you'd like to soundboard your next steps, discuss a legal question or find out more about how we can assist whether that's with buying or selling a business or perhaps somewhere in between. Now, don't forget to subscribe to The Deal Room Podcast on your favourite podcast player to get notifications whenever a new episode is out.

Joanna:

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