



Buying a franchise

The purpose of this brief guide is to highlight the important considerations in buying a franchise.

If you want to go into business but do not have a specific business idea of your own, or would prefer someone to have done most of the groundwork for you, you might find a franchise is just what you are looking for.

Franchising has grown steadily in the UK and at the last count there were 842 different franchise systems operating nationwide contributing £11.8 billion to the country's GDP (see panel).

FRANCHISES IN THE UK

Franchises form a significant part of the UK economy with:

- 842 franchise systems
- 34,000 individual franchise units
- 465,000 full and part-time employees
- An average turnover of 335,000
- A combined contribution to GDP of £11.8 billion

Source: 2010 NatWest/BFA Franchise Survey

WHAT IS A FRANCHISE?

In the broadest sense, a franchise is an authorisation to sell another company's goods or services in a particular place.

The term 'franchising' can be used to describe a number of business relationships including licensee, agency, and distributor arrangements, but for the purposes of this guide it will be used to refer to what is known as 'business format franchising'.

A business format franchise is one in which the franchisor grants a license to a franchisee allowing them to use their business idea, usually in a specified geographic area.

The arrangement allows the franchisee to trade under the franchisor's trade mark or trade name using an established and proven business model while benefiting from various forms of support (see below).

In exchange, the franchisee pays the franchisor an initial fee as well as ongoing management service fees - usually based on a percentage of annual turnover or mark-ups on supplies - and agrees to certain restrictions in their business activities.

ADVANTAGES AND DISADVANTAGES

In some ways a franchise offers the best of both worlds - an individually owned, locally based business with the benefits of an established brand and the economies of scale of a large, national or even international network.

Moreover, because both sides invest in the venture and both stand to profit from it there is a shared motivation to make the franchise as successful and as profitable as possible.

If you buy a franchise you specifically benefit from:

- An established brand that the franchisor is committed to protecting and developing
- A business model that has proven itself in the marketplace
- A franchise package that usually includes operations manuals, bookkeeping and accounting systems, training assistance, and marketing guidance
- Assistance with setting up and ongoing support
- A reliable source of supply
- Any advertising and promotion conducted by the franchisor

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Possible disadvantages might be:

- Restrictions on how you can run your business with a potential inflexibility in adapting to local conditions
- The possibility of actions by other franchisees or even the franchisor damaging the brand
- Costs higher than you wish to commit to over the long term
- Difficulty in selling the business further down the road because the franchisor will need to approve any future buyer

GETTING STARTED

Buying a franchise is a long-term commitment and you should not rush into it. Careful thought and due diligence are essential at every stage.

If you think the basic model is right for you, the first step is to identify a specific franchise system to buy into. A good starting point is the British Franchise Association, which provides useful information on their website at thebfa.org. They also organise regular franchise exhibitions where you can meet various franchisors and see for yourself what is involved. Other websites you might visit are whichfranchise.com and franchiseinfo.co.uk. You can also consult magazines such as Franchise World, Dalton's Weekly, and Business Franchise Magazine.

A word of warning: Unfortunately, there are many disreputable schemes masquerading as legitimate franchises so be sure to check the credentials of the franchisor carefully and make sure they are a member of a professional body with an established code of ethics such as the British Franchise Association.

RESEARCH

Once you have identified a franchise system that suits your needs, you will need to research it thoroughly.

Ask to see information on how long it has been running, how many franchisees there are, how successful they have been, etc.

Obtain a copy of the operations manual and the franchise agreement (see below) and check them carefully.

Do not rely only on the information provided by the franchisor but try wherever possible to refer to independent, verifiable sources.

In particular, try to obtain reliable information on the general market for the product or service the franchise provides, the strength of any competitors, and the reputation the franchise has among customers, suppliers, and other businesses.

The franchisor should also provide you with a list of current and past franchisees and you would be well advised to visit as many as you can – failures as well as successes – and see for yourself what is involved.

We cannot over emphasise the importance of due diligence at this stage or the need to take appropriate professional advice.

THE FRANCHISE AGREEMENT

If you are satisfied with the results of your investigation, ask to see a copy of the franchise agreement and read it carefully. Be warned, these agreements can be weighty documents - often thirty pages or more and sometimes as long as eighty pages!

The agreement is a legal contract that sets out the obligations of both the franchisee and the franchisor. Among other things, you will need to pay particular attention to:

- How long the agreement is for
- What the initial and ongoing fees will be

- What territorial rights you will have and whether they will be exclusive
- What restrictions will be placed on the way you run the business
- What support you will be provided with at the outset and on an ongoing basis
- What legal and other compliance issues will be involved in running the business
- How you can terminate the agreement prematurely if needs be, or how you might sell on the franchise in the future

You should have the agreement checked by a solicitor who has experience in dealing with franchises. You can obtain a list from the BFA. We strongly advise against signing or paying anything until the agreement has been checked and approved by a qualified solicitor.

Note that franchise agreements are usually standard contracts that apply uniformly to all franchisees, so don't expect to be able to make changes to suit you. In the rare event that a modification is agreed this will usually be contained in a binding side letter that is signed at the same time as the agreement and attached to it.

THE BUSINESS PLAN

Once you are clear about the franchise you want to buy the next step is to put together a business plan drawing on the results of your research.

This will include among other things:

- The proposed structure of the business - sole trader, partnership or limited company.
- The premises from which you will run the business and how you intend to acquire them – should you purchase or lease?
- The number of employees needed whether full or part time – how they will be trained and supervised, remuneration and tax arrangements, etc
- How the venture will be financed – how much capital you will provide from your side, how much you will need to borrow, how any loans would be secured, etc
- Realistic cash flow projections for the first three years
- How any legal and compliance issues will be addressed

RAISING FINANCE

On the basis of your business plan you can then draw up a proposal to submit to a lending source such as a bank.

Notwithstanding the present lending conditions, most major banks and other lending sources will tend to give serious consideration to a well thought out proposal for buying a franchise.

As a general rule, you can expect a bank to loan up to 70 percent of start up costs for an established franchise system and 50-60 percent for a new system.

HOW WE CAN HELP

We can help at every stage of the process, from choosing an appropriate franchise through research and due diligence to preparing a business plan, setting up the business structure and approaching lending sources.

If you think franchising might be right for you give us a call and arrange a preliminary discussion to see how we can help.