

Franchising



New South Wales
Department of State and
Regional Development

What is franchising?

A franchise is a contract, agreement or arrangement between two or more persons in which one or more of the following obligations exist:

- The right to use a trademark or trade name
- The expectation that prescribed marketing, business or technical plans/systems will be followed
- Marketing, business or technical assistance during the operation of the agreement.

The 'franchisor' is the seller and the 'franchisee' the buyer.

Franchising is not a business itself, but a way of doing business.

Business format franchising requires a unique relationship between the franchisor (the owner of the system) and the franchisee (the owner of the individual outlet), which is commonly referred to as a "commercial marriage".

This ongoing business relationship includes the product, service and trademark, as well as the entire business concept itself from marketing strategy and plan, operational standards, systems and formats, training, quality control and ongoing assistance, guidance and supervision.

In short, it provides small business (the franchisee) with the tools of big business (provided by the franchisor)

It is also a Win-Win relationship where the franchisor is able to expand its market presence without eroding its own capital, and the franchisee gains through access to established business systems, at lower risk, for their own commercial advantage.

The "commercial marriage" between franchisor and franchisee is ultimately a legal relationship, with the full obligations and responsibilities of both parties outlined in a highly detailed franchise agreement. This commercial contract varies in length and conditions from one system to the next, such that it would be almost impossible for any two franchise systems to have identical agreements. It is also a Win-Win relationship where the franchisor is able to expand its market presence without eroding its own capital, and the franchisee gains through access to established business systems, at lower risk, for their own commercial advantage. The "commercial marriage" between franchisor and franchisee is ultimately a legal relationship, with the full obligations and responsibilities of both parties outlined in a highly detailed franchise agreement. This commercial contract varies in length and conditions from one system to the next, such that it would be almost impossible for any two franchise systems to have identical agreements.

ADVANTAGES

For the franchisee

- A franchise gives access to the franchisor's experience and the factors which have led to the success of the business.
- A franchise provides the opportunity to trade in a larger business with the support of extensive cooperation marketing arrangements such as advertising/promotion, which may normally be beyond the financial and organisational capacity of an independent small business.

A franchise provides the opportunity to expand the business without major capital investment and the risk of over extending management capacity.

- A franchise provides a structure for recording transactions, financial management and control and operations manuals; this can be a major benefit for people who have not previously operated a business.
- A franchise provides access to ongoing management assistance and training which can reduce the risk of failure or enhance the prospects of business growth.

- The profitability of successful franchises may be higher than that of an independent small business because of the quantity purchased, and group discounts on goods and services to the group.
- The franchisor provides market research and development of new and/or complementary products which means that the franchisee can keep up-to-date with the best products and trends in the industry.

For the franchisor

- As franchisees have their own money invested in the business, the franchisor obtains conscientious and dedicated personnel who work hard in their franchised outlet, thus keeping the standard of excellence for the franchisor.
- The franchisor can achieve bulk product/service discounts allowing the business to be more profitable.
- A network of outlets means a broader market impact, ensuring a higher profile in the market with limited financial outlay for the franchisor.

Franchises create long term, high volume customer base for the franchisor's product.

DISADVANTAGES

For the franchisee:

- The terms of the franchise agreement may place franchisees in a position where they cannot achieve the return on investment they expected.
- Assistance promised by the franchisor to the franchisee does not always occur.
- Threat of termination by the franchisor may be used as a lever against franchisees, putting them at a disadvantage in negotiations and forcing them to accept company decisions which they see as disadvantageous.
- Some franchisees have been falsely persuaded they can make quick profits with little work.
- There is a risk that the franchisor may not be able to support the franchisee because the product is new, and the systems are untried or undercapitalised.

The franchisor may have no interest in the franchise other than selling as many outlets as possible in as short a time as possible, and may sell outlets which have little chance of success.

- Poor performance or illegal activities by fellow franchisees and/or the franchisor will have negative impacts upon the franchisee that operates under the franchise 'brand name'.
- The franchisee may be closely controlled by the terms of the agreement. Some franchisees feel hampered by the constraints and resent the ongoing payments.

For the franchisor:

- Franchisees may not operate their business up to the franchisor's standards, thus risking the franchisor's name goodwill.
- There is a risk that a franchisee may use the systems and knowledge of the franchisor and set up in competition.
- A dishonest franchisee may try to understate gross revenue to limit fees paid to the franchisor. Maintaining a motivated and dynamic relationship with the franchisee over many years may be very difficult.

Buying a franchise:

In Australia today there is a franchise operating in almost every type of business category, with varying levels of complexity and cost.

Prior to buying a franchise, potential franchisees should do the following:

1. Assess your reasons for wanting to own a business
2. Assess the lifestyle and income implications of owning and operating a business;
3. Assess the franchise opportunities consistent with 1 and 2 above.
4. Build your understanding of the franchise relationship
5. Narrow your franchise search to a few systems, then request further information.
6. If appropriate, and you are comfortable with the decision, select a system and commence the application process.

7. Ensure you have adequate borrowing capacity, including working capital, to successfully establish this type of business.
8. Be sure you receive and evaluate all disclosure material during the application process.
9. Be sure you receive legal and accounting advice from lawyers and accountants with franchise experience before making any final commitment.
10. Use the cooling-off period to check your facts and figures and determine if you still want to proceed.

Background Research:

If you are curious about franchising, following are some suggestions that may help supply the answers you need. The Franchise Directory: (www.franchise.org.au) is a comprehensive web based listing of more than 400 franchise systems in Australia.

Get Advice

It is always essential that anyone considering becoming a franchisee receives competent professional advice from qualified and experienced advisors.

The Franchise Council of Australia (FCA) can direct potential franchisees to accountants and lawyers who are members of the Council and who specialise in franchising.

The BEC offer highly skilled and experienced professionals who will be able to work with you to decide if franchising is right for you. If it is, we will help you to make it happen!

Franchising Code of Conduct:

The franchise industry has been regulated by the ACCC since 1998. A cornerstone of the regulation is the Franchising Code of Conduct.

The Franchising Code of Conduct was created to assist the ongoing relationship between the franchisee and franchisor.

The code ensures that franchisees are informed of all the relevant facts when starting their business, and that they have access to a fast and relatively inexpensive way of resolving any disputes that arise.

Issues covered include:

Disclosure of pertinent information regarding the Franchisor, Conditions contained within the Franchise Agreement, and Complaint handling and dispute resolution procedures.

For further information please refer to the following websites:

<http://www.fca.com.au>

<http://www.accc.gov.au>