HOW TO BUY A FRANCHISE

Ten step guide to buying a franchise

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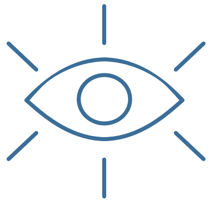
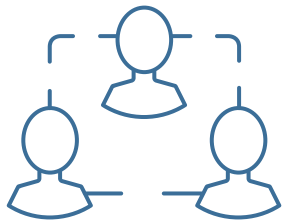
Introduction

Many Canadians dream of buying their own franchise business, but beyond the dream it's essential to weigh up the pros and cons of running a franchise compared to starting a business from the outset.

There are definite benefits to buying into an established brand, as a result of opening a new branch or taking over an existing one. However, it's important to treat purchasing a franchise branch like buying any other business by:



Getting it valued



Obtaining guidance from your accountant, lawyer and advisers.

Conducting thorough research on the business opportunity.

You'll also need to consider the location, fees, contract terms and the start-up costs involved before signing up to an agreement.

At Meridian, we've created this franchise guide to help you assess whether becoming a franchisee is the right option for you.

In this ten step guide we'll discuss the franchisee-franchisor relationship, the benefits and costs of franchise ownership, controls you'll likely face, how to lower your risk and select the right franchise, the documentation involved, and how to finance your investment.

Ten step guide to buying a franchise

Step one:	Find out if franchising is for you
Step two:	Consider the franchisee-franchisor relationship
Step three:	Weigh up the benefits of franchise ownership
Step four:	Assess the costs of being a franchisee
Step five:	Take into account the controls of becoming a franchisee
Step six:	Select the right franchise for you
Step seven:	Lower your risk
Step eight:	Analyse the disclosure document
Step nine:	Negotiate the franchise agreement
Step ten:	Bankroll your franchise

Step one: Find out if franchising is for you

You could describe a franchise like a lease because you're essentially buying the right to use the franchisor's system for a specific period of time. Following the end of your 'lease', you may have the right of renewal to continue trading under the franchisor's brand, or you might have to close the business.

Franchising is an agreement that lets one party (the franchisee) conduct business under a certain brand name, while following a particular business model that's been created by another party (the franchisor).

Conduct a self-assessment

When you're deciding between a franchise model and a traditional business model, first self-assess whether franchising is right for you. Ask yourself:

1. Can you follow a ready-made system while respecting the rules of the franchisor?
2. Do you need independence and freedom to experiment, to create, and to make your own choices?
3. Do you prefer some level of guidance to start up and operate your business?

Ultimately, you'll have to approach the decision to enter a franchise carefully while ensuring you've covered all the bases.

Find out more about franchises at the Canadian Franchise Association.

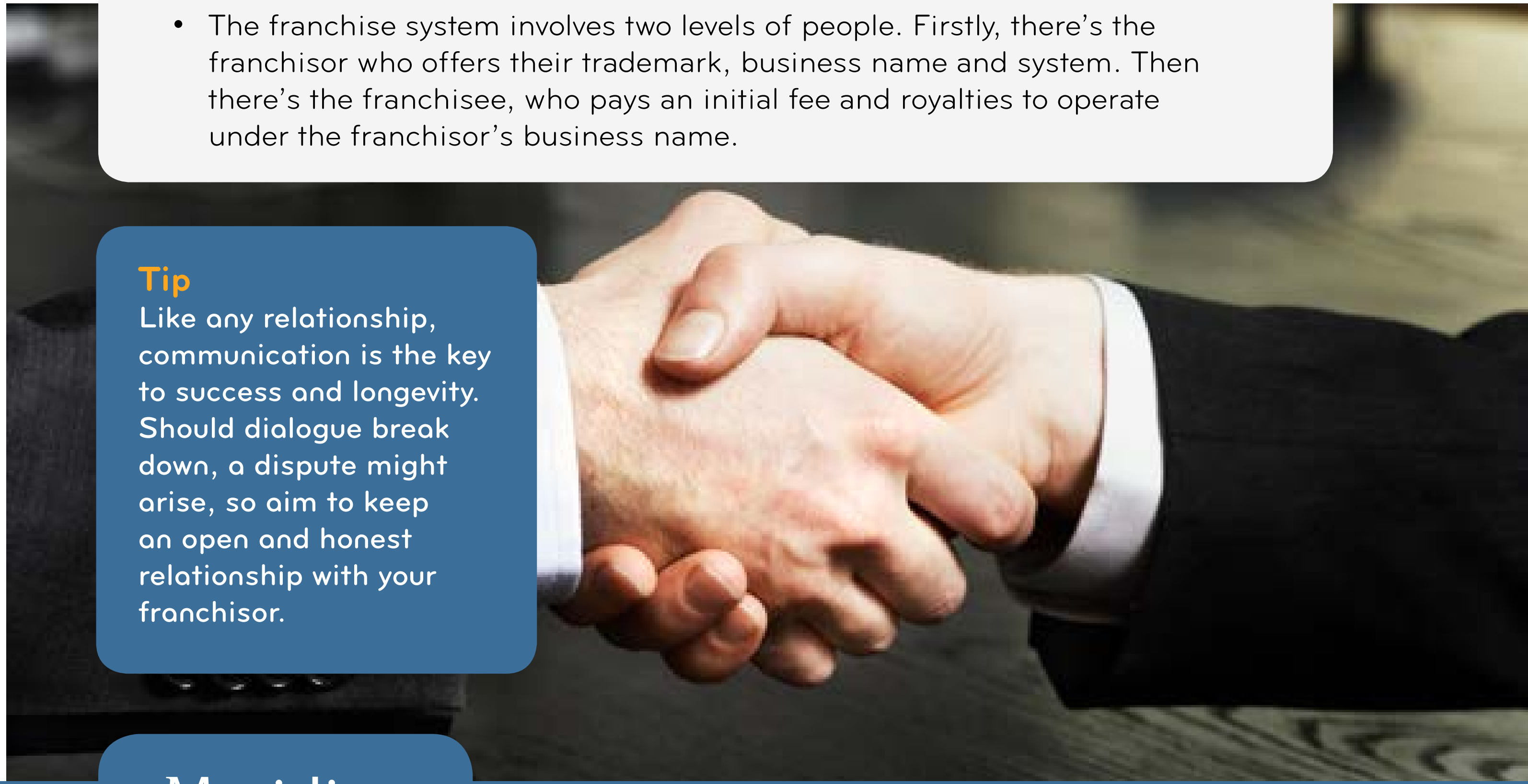
Step two: Consider the franchisee-franchisor relationship

A franchise offers prospective entrepreneurs a uniform system that's well established. The franchisor (company owner) and the franchisee (operator of a branch of the franchise) need to work together with a proven business model to be successful.

Similarities to a partnership

Acquiring a franchise is similar to entering into a partnership because:

- The experience, skills and desire to work hard (by both franchisee and franchisor) will ultimately make it profitable or not.
- It's like a hybrid business model, filling the gap between working for someone else and working for yourself.
- The franchise system involves two levels of people. Firstly, there's the franchisor who offers their trademark, business name and system. Then there's the franchisee, who pays an initial fee and royalties to operate under the franchisor's business name.



Tip
Like any relationship, communication is the key to success and longevity. Should dialogue break down, a dispute might arise, so aim to keep an open and honest relationship with your franchisor.

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Why the relationship is so important

The relationship between franchisees and franchisors has sometimes been called a ‘commercial marriage.’ In many ways this is true, though there’s a clear senior partner (the franchisor).

For the franchise location to work and become successful, it will depend heavily on the franchisee-franchisor relationship. The entire base of the relationship is defined in the franchise agreement, where both parties can refer to their rights and obligations.

Should a poor franchise result (partly due to a relationship breakdown), it can have an adverse effect on the franchise as a whole and even other franchisees.

Finding a franchise with relationship potential

Strong franchisee-franchisor relationships are built on clearly defined roles, along with trust, consistent behaviour and support. Try to:

- Find a company culture in line with your own beliefs, business philosophy and goals. You don’t need to be 100 percent compatible but there are some areas where you’ll need to see eye-to-eye.
- Look for a franchisor who will support their franchisees through prosperous and difficult times. Are they willing and able to help you succeed?
- When issues come up, you’ll want to be able to communicate them through the right channels. For instance, instead of discussing problems with other franchisees, it may be better to go directly to the franchisor to find a solution.
- Respect the franchise agreement. Follow the agreement, know your role within it, and stick to it.

Step three: Weigh up the benefits of franchise ownership

When you’re thinking about whether to buy into a franchise or start up a business from the outset, be sure to weigh up the advantages of franchise ownership.

Consider the following benefits of franchising.

Support and advice

The franchisor can offer their expert advice and guidance as you start up, along with support as you progress. This can be invaluable for a franchisee who’s completely new to business.

Types of support might include:

- Site selection – assistance finding an optimal location.
- Operating manuals – through an established business model.
- Access to market information – using the success of other franchises within the business.
- Recruiting and managing staff – tapping into the knowledge of other franchisees and the franchisor.

Tip
Franchise support is a major benefit that you can’t tap into when starting your own business, while being part of a network of franchisees allows you to share ideas and learn from each other’s mistakes.

Training

Training is also a common component in franchises, so even if you have little experience in a particular industry, you can get up to speed with a proven training program.

Less likelihood of mistakes

Trial and error learning is minimized as you follow the franchise's operating manual. There's less likelihood of you making the mistakes that a new business owner going it alone would make.

Economies of scale

Economies of scale are in your favour if your franchisor buys in bulk. If the size of the franchise group is significantly large, you may have access to supplies at discounted rates.

Minimal wastage

Stock and equipment supplies probably won't incur wastage thanks to the franchisor's knowledge of what and how much to buy.

Established brand

You'll have a known reputation and brand when launching, meaning that your customers will generally be more comfortable purchasing from you. They know more or less what they're going to get.

A recognized brand name is also valuable when it comes to negotiating a lease, hiring staff, and discussing contracts with suppliers or distributors. For example, well-known pizza chains like Pizza Hut and Boston Pizza can always tap into a younger job seekers market when looking for staff.

Powerful advertising behind you

You'll likely have the power of the brand's national and regional marketing and advertising behind you. The business as a whole will probably be advertised more often and to a wider audience, which can only benefit your franchise branch.

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Lower start up costs

A franchisor's proven system should be able to guide you towards making the most efficient use of investment funds, whether that be for premises, stock levels, machinery, or computer equipment.

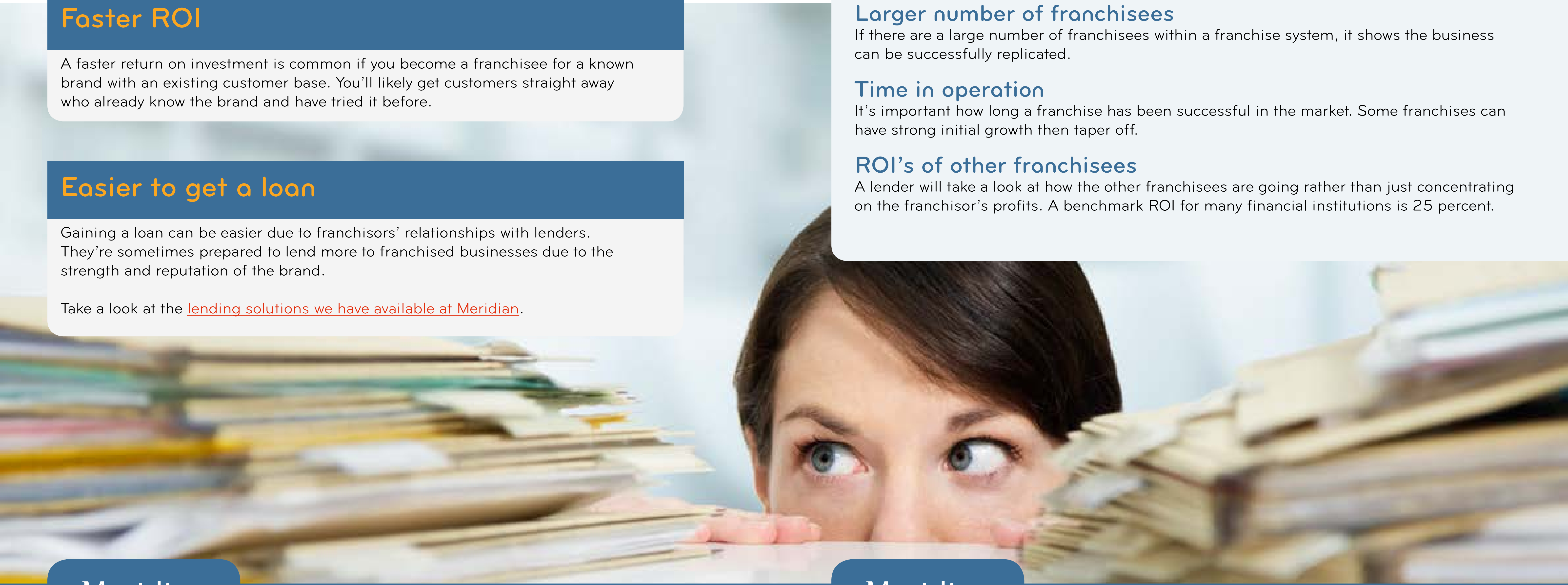
Faster ROI

A faster return on investment is common if you become a franchisee for a known brand with an existing customer base. You'll likely get customers straight away who already know the brand and have tried it before.

Easier to get a loan

Gaining a loan can be easier due to franchisors' relationships with lenders. They're sometimes prepared to lend more to franchised businesses due to the strength and reputation of the brand.

Take a look at the lending solutions we have available at Meridian.



How a financial institution will assess the viability of a franchise

So how do lenders assess whether they'll back a franchise system? Three main factors found in successful franchise systems that financial institutions like to see are:

Larger number of franchisees

If there are a large number of franchisees within a franchise system, it shows the business can be successfully replicated.

Time in operation

It's important how long a franchise has been successful in the market. Some franchises can have strong initial growth then taper off.

ROI's of other franchisees

A lender will take a look at how the other franchisees are going rather than just concentrating on the franchisor's profits. A benchmark ROI for many financial institutions is 25 percent.

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Step four: Assess the costs of being a franchisee

A franchisor normally makes their money through fees paid by their franchisees. There are usually a number of fees charged so it's vital you know about each one.

Franchises come with fees

To use the franchise business's name you'll have to pay some fees, namely:

- **An initial franchise fee** – a one-time cost to use the franchise's brand, operating system and to receive support. This could include costs for an operating license and start up training.
- **Royalty payments** – these are ongoing and are typically between 4-8 percent of your gross revenue. For example, Subway franchisees pay a royalty fee of 12.5 percent each week, of which 4.5 percent goes towards advertising.
- **Advertising fees** – these may also be required and can include market research, merchandising, public relations and advertising campaigns. Marketing is generally done at a local, regional or national level. A franchisee committee will often have their say in how the money is spent.
- **Insurance** – make sure you check if there are any insurance fees to pay and exactly what those fees cover.

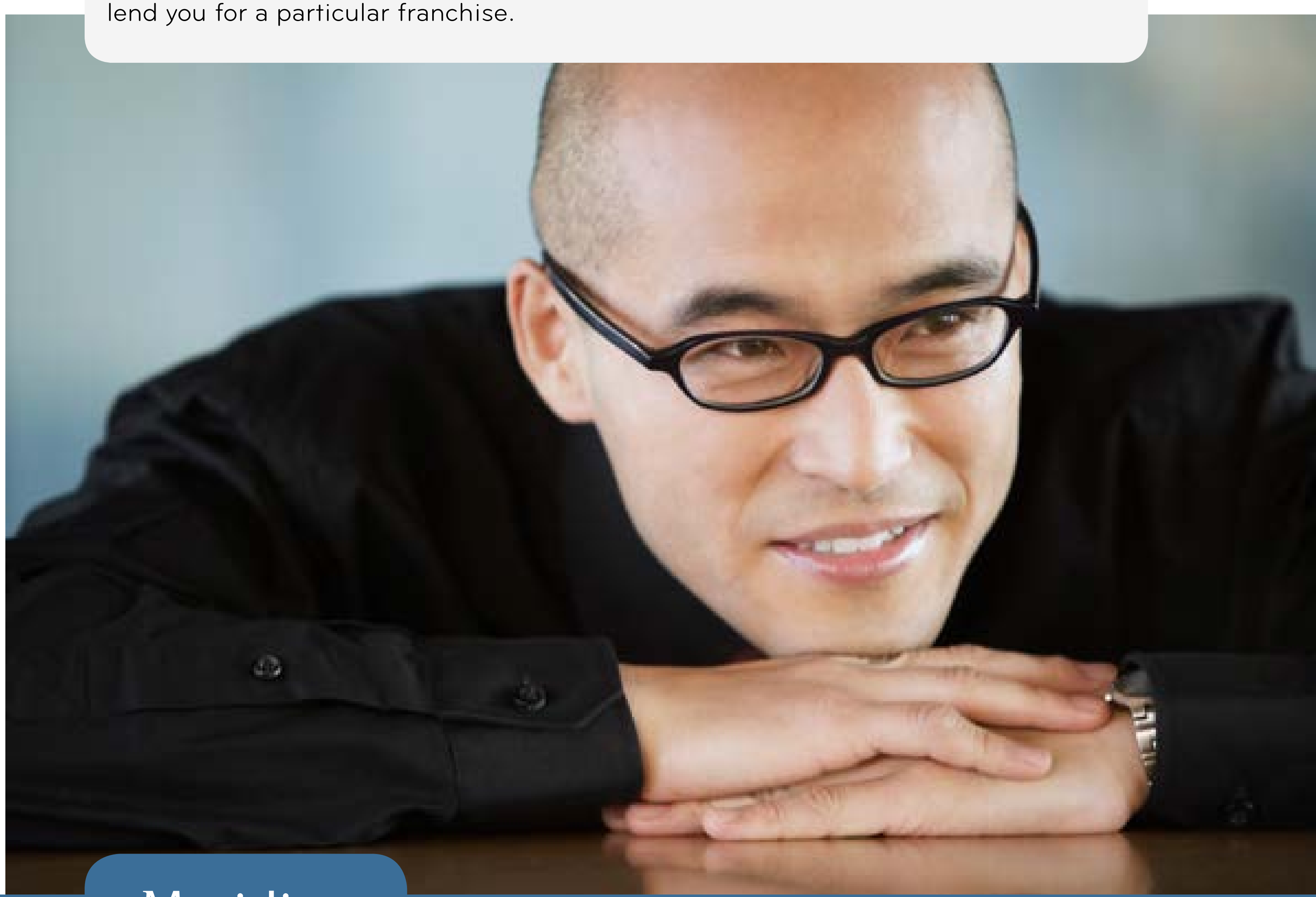
Tip
Other ongoing fees that you may be obligated to pay for can consist of future training, accounting services, and conferences. You can also expect to pay the establishment costs of the business, which could cover items like stock, office equipment, machinery and signage.

What can you afford?

Franchises can vary in affordability, both from different start up costs and continuing fees. It's a wise idea to work out early what kind of franchise you can afford and whether you'll need to obtain finance.

Depending on the franchise you're considering, your financial institution might lend you up to 60 percent of the cost of the business.

Contact one of our business advisors at Meridian to find out how much we could lend you for a particular franchise.



Step five: Take into account the controls of becoming a franchisee

When you start up your own business you're in control of every aspect of it. However, when you buy into a franchise, you'll have to sign an agreement declaring that you'll follow the rules set out by the franchisor.

Disadvantages of running a franchise unit

You may be restricted by certain controls when you license a franchise, such as:

- Your location – it will probably have to be pre-approved by the franchisor. You could find yourself in a situation where you find a perfect location (in your mind) that's turned down by your franchisor.
- Your contract – you'll want to know the timeframe of your contract (and whether a renewal is guaranteed). When you buy into a franchise system, you're buying the right to use the business format for a specified length of time. If your franchise outlet goes well, your franchisor will usually extend your contract, though it will probably include fees and conditions.
- Limitations – on what you can and can't do in a franchise, ranging from products and services to store design, and operating hours to pricing. These limits should be carefully considered when you decide how much freedom you want within the franchise.
- Restrictions – for store territory or geographical area. Be aware of any area restrictions placed upon where you can't sell your franchise's goods or services. Is your territory exclusive? Can it be lost or decreased? For example, KFC currently has a number of franchisee opportunities in the US and Canada, but only in certain territories.

Remember, you'll be in control of the culture and values you establish at your franchise outlet, and you'll be able to decide who to hire and let go. However, you'll need to keep to the rules of the franchisor's operating system.

Tip

Be careful of US franchise agreements that haven't been revised to Canadian laws. Occasionally US-based franchisors overlook modifying their agreements to fit the laws of Canada, which could cost you extra money if you haven't addressed this issue before signing the franchise agreement.

Step six: Select the right franchise for you

One thing you'll need to determine early on is the type of franchise that's best for you – but what kind of franchise arrangements are there?

Types of franchise arrangements

Franchising can describe an array of different business structures such as agencies, co-operatives and dealerships. However, the most common type of franchise is the business format franchise, and within that format there are a few variations like:

- Master franchising – where the national franchisor lets a 'master franchisee' sub-franchise the system to other franchisees, usually in a defined territory or country. For example, Subway is an internationally recognized master franchise.
- Turnkey franchising – in this form of business format franchise, the franchisor provides each franchisee with fully fitted-out, leased premises rather than just specifications of what they require. Retail franchises tend to be developed in this manner.
- Unit franchising – here a national franchisor grants a franchisee the rights to operate an outlet, or in a territory. McDonald's is a well-known unit franchise.
- In-store franchising – when a store leases some space to another franchise system to use to develop an outlet within that area. For example, a department store may lease some space to a coffee franchise to create a win-win situation for both businesses.

Tip
Don't forget to visit local franchised outlets, look at franchise handbooks, attend franchising exhibitions and talk to franchise brokers.

Choosing a franchise that suits you

When it comes time to choose a franchise that best suits you, consider:

- The demand for the goods or services – is demand continuing to grow?
- The likely competition – both competing companies and other branches of the franchise. How many outlets are there in your region?
- The background of the franchisor – such as how long the owner has been in the franchise business.
- The level of support you'll receive – like training, start up assistance and ongoing help.
- The prospects for growth – whether there are opportunities to expand your territory or buy into another franchise branch in the future.

Make the most of available franchise information

It's vital you have a clear idea about which type of franchise you prefer to operate. Consider the industries that appeal to you and the kinds of businesses you could see yourself operating.

Some useful sources of franchise information are:

- The Canadian franchise magazine – where you can look through a directory of franchises throughout Canada.
- Canadian franchise opportunities – a comprehensive guide for finding franchises for sale.
- FranchiseCanada magazine – published by the Canadian Franchise Association. You can subscribe to the print or digital editions.

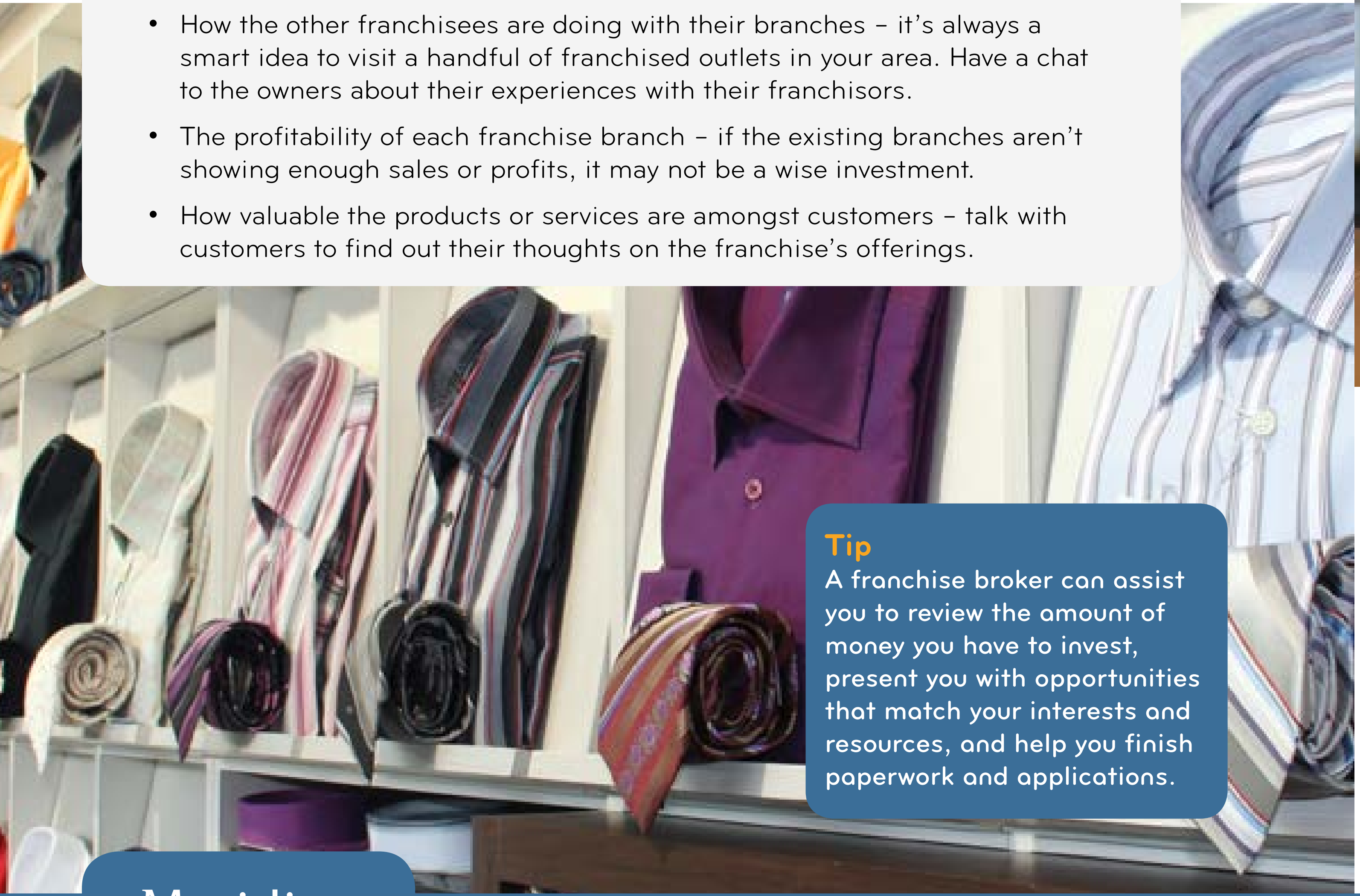
Step seven: Lower your risk

Choosing to apply for a franchise is a big decision and you can't be certain it's the right one until you start doing business as a franchisee. Nevertheless, you can lower the risk of making a poor choice.

Get to know the franchise

Spend time getting to know the franchise and its owner in order to find out as much information as you can, such as:

- How the other franchisees are doing with their branches – it's always a smart idea to visit a handful of franchised outlets in your area. Have a chat to the owners about their experiences with their franchisors.
- The profitability of each franchise branch – if the existing branches aren't showing enough sales or profits, it may not be a wise investment.
- How valuable the products or services are amongst customers – talk with customers to find out their thoughts on the franchise's offerings.



Tip
A franchise broker can assist you to review the amount of money you have to invest, present you with opportunities that match your interests and resources, and help you finish paperwork and applications.

Meet the franchisor

When it comes to assessing a franchisor and their organization, a face-to-face meeting is essential. If you don't live in the same city as the franchisor, you'll probably have to meet first with a broker or local representative.

As the evaluation process advances aim to keep in contact with the franchisor, so you can reinforce your interest in the franchise.

The main points you want to look for when you do get to meet the franchisor are their business experience and how successful the franchise has been up to this moment.

Vital questions to ask franchisors

Franchisors are busy people so you'll only have limited time to ask the questions you really need answers to – make sure you ask the right ones, such as:

- How many years has the franchise been operating and how many Canadian outlets are there?
- Who are the main competitors?
- What are the leading industry trends?
- Are there any major threats to the franchise on the horizon?
- What are the top selling products or services and are there any plans for future offerings?
- What's the franchise marketing budget and how is it distributed?
- Are there any restrictions on conducting your own promotional campaign?
- What set up and ongoing costs are involved?
- What are the training requirements for franchisees?
- What will be your actual role in the day-to-day operations of the franchise?
- What are the projected sales, profits and ROI figures for this franchise outlet?
- What help is provided to find a location, negotiate a lease, hire staff, promote the franchise, and launch the business?
- How often do you keep in touch with franchisees?
- What length of time is the franchise contract and what are the options for renewal?

Step eight: Analyze the disclosure document

Before you decide to invest in any franchise, make sure you've seen a copy of the franchisor's disclosure document.

Is the franchisor a member of the CFA?

Franchisors who are members of the Canadian Franchise Association (CFA) have to follow its code of conduct by providing a disclosure document outlining a summary of information of the franchise opportunity, including:

- **The franchisor** – their business and franchise experience, any partners and existing franchisees.
- **Nature of the business** – describing the type of franchised business being offered.
- **The investment** – you'll need to put forward to become a franchisee.
- **Outlets** – listing the existing franchise outlets while also mentioning any that have closed in the last two years.
- **Legal action** – information about existing lawsuits, along with any prior bankruptcies or insolvencies, have to be provided.
- **A signed certificate of disclosure** – should be inserted in the disclosure document.

The franchisor can also choose whether or not to give an earnings claim, detailing a range of actual or potential income, costs or sales.

Canada has had franchise legislation in place since Alberta chose to introduce it in the early 1970s.

Time to review

As a prospective franchisee, you'll be given some time to review the disclosure document and investigate the franchise.

You should be given at least 14 days to examine the offer with your lawyer, accountant, and any other business advisors. Check the disclosure document for details of how much time you have.

Take a look at the CFA disclosure document guide for more comprehensive information.

Step nine: Negotiate the franchise agreement document

At the legal heart of every franchise is the franchise agreement. It's something you'll likely come across early when assessing a franchise. Make sure you fully understand it before you consider negotiating, or signing.

Contents of a franchise agreement

A franchise agreement is the foundation of your business, so it's important that you're familiar with the key features in it. Some of those aspects include the:

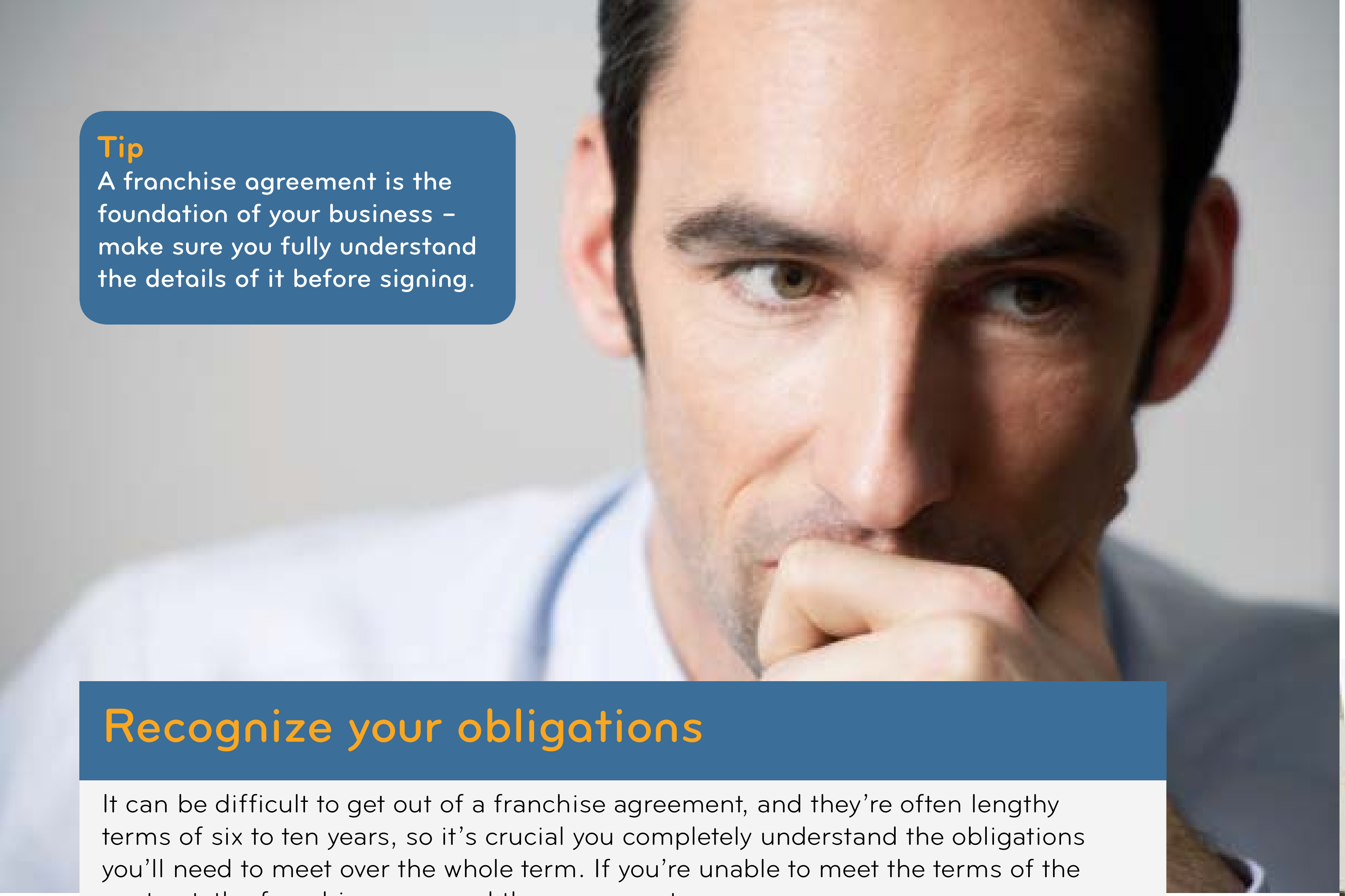
- Rights and obligations of both parties.
- Length of time the contract will last.
- Territory or area (if relevant) given to the franchisee.
- Costs involved and how they're calculated.
- Provisions and values of the franchise.

Ensure you read every franchise agreement with care, and have your lawyer go through each one clause-by-clause to check you understand all of its provisions.

Check what's up for negotiation

Lawyers, representing the interests of the franchisor, write franchise agreements. Most sections are beyond negotiation, but check with the franchisor if they're willing to negotiate on any aspects of the agreement before hiring a lawyer. You may be able to negotiate:

- The renewal of the contract.
- Protection of your geographical area or territory.
- Transfer of ownership details.
- Advertising funds.



Tip
A franchise agreement is the foundation of your business – make sure you fully understand the details of it before signing.

Recognize your obligations

It can be difficult to get out of a franchise agreement, and they're often lengthy terms of six to ten years, so it's crucial you completely understand the obligations you'll need to meet over the whole term. If you're unable to meet the terms of the contract, the franchisor may end the agreement.

Be prepared for franchisors who are reluctant to make any changes to their agreements. It might be because the franchisor is unable to make changes as they're tied to an overseas form of the agreement, or they want to have consistency amongst their franchisees.

If the franchise is becoming profitable and the franchise relationship is strong, both the franchisee and the franchisor will probably want to renew their agreement.

Step ten: Bankroll your franchise agreement document

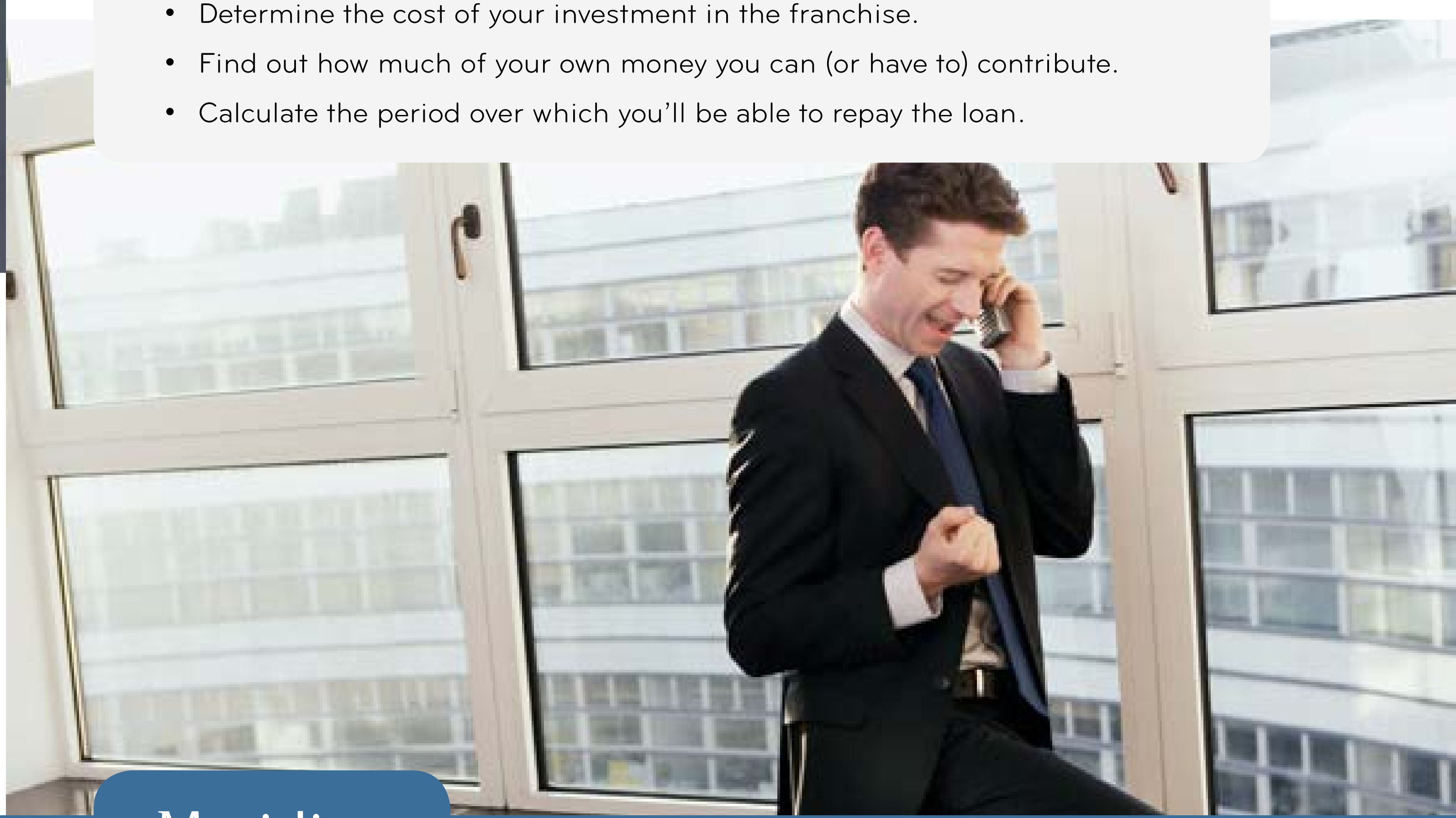
Once you've made the decision to go ahead and accept a franchisor's offer to run a branch (or area) of their franchise, you'll need to come up with the financing.

Prepare your financing proposal

If you can find a reputable franchise with a respected franchisor, they'll be able to help you prepare your financing proposal should you need to visit a financial institution. However, you'll probably have to invest some of your own money as part of a minimum investment set out by the franchisor.

Make sure you:

- Determine the cost of your investment in the franchise.
- Find out how much of your own money you can (or have to) contribute.
- Calculate the period over which you'll be able to repay the loan.



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How to finance your franchise

When approaching your financial institution for financing, there are a few items you can prepare to make the process a lot easier to get a positive outcome. They include:

- A statement of your personal financial position – outlining your assets and liabilities, monthly income and expenses.
- A business plan – so the financial institution can understand your long-term goals and business strategy. Download our business plan template from our Small Business Resource Centre site.
- A cash flow forecast – projecting the expected cash moving in and out of your franchise over the coming year.
- Your work and business history – which you should be ready to discuss.

Take a practical approach

It's important not to over-extend yourself when seeking finance, so preferably speak with an accountant that specializes in franchise advice.

Be sure to give yourself plenty of time to apply for finance, perhaps even a few months before you're due to start work as a franchisee. Time will let you set up your accounts, work through any issues, get the loan approved, and test your payment facilities.

Contact one of our business advisors at Meridian to set up an appointment.

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