Good time to buy franchise in 2012?

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For many of Australia's 69,000 franchisees, franchising is all about taking advantage of the brand and enjoying the fruits of working for yourself. The sector enjoyed explosive growth. But there are traps for the unprepared. An investor needs to carefully evaluate the risks as well as the benefits of buying a franchise especially at this time of global economic uncertainty.

Last year (2011) saw an increased number of new franchises on offer and high activity in resales of established franchises; in particular in the fast food and general food outlet sector. This year looks like more of the same. There are benefits in investing in a franchise business but conditions in the current environment, that is, in the early part of 2012 and beyond where a Global Financial Crisis MARK 2 looms as a possible eventuality and where local conditions may be impacting on potential franchisees.

A snapshot of the current environment

Economic conditions in early 2012 may be viewed as good or bad depending on where your investment dollars are placed. The biggest concern facing investors in franchise businesses as far as external, macro-economic factors are concerned can be succinctly summarised as:

- Continued instability in the Euro zone leading to some nervousness in capital markets
- A sluggish U.S. economy which shows some signs of recovery (underemployment rates decreasing)
- Concerns over a slowdown in China's appetite for Australia's resources (a slowdown in their growth)
- A marked shift amongst consumers to "shop" online.

These concerns may remain unresolved. What is clear is that some retail businesses are suffering particularly in the fashion and discretionary categories. However, growth in a number of franchise systems appears unabated suggesting that their 'numbers' continue to be attractive to potential investors and migration to online does not appear to have dented discretionary food spending. For example Pie Face and Bakers Delight have each signalled growth plans in recent times.

Franchise Council of Australia executive director Steve Wright says that it is a mixed bag at the moment. "We're seeing continued growth in revenues for many systems but there is anecdotal evidence of reluctance on the part of banks to lend or at least lift the hurdles, in relation to new territories or green field sites."

Growth sectors

Recent research reveals that the many niche sectors such as childcare and home services are experiencing above average growth rates due to a range of factors such as Australians working longer hours and thus franchises offering services that support these conditions will continue to grow.

In a report by KordaMentha, it suggests that bigger is often better in franchising and also food niches are doing well at this time. Fresh, healthy, organic are strong themes in food retailing trends. Staples such as pizza – La Porchetta, and gourmet styles (such as Crust) - are still growing as well, according to Wright.

Research, research, research

Research is essential. Opinions will vary as to which particular franchise constitutes a good investment but what is clear is that an investor should do adequate research. This can mean examining the Franchising Code of Conduct because the code requires franchisors to disclose specific information about their business to its potential franchisees. It is an invaluable document that should be studied before buying into a franchise or entering into a franchise agreement. You can download this document from the Australian Consumer and Competition Commission website (*www.accc.gov.au*). The code has teeth and is administered by the ACCC, which will investigate any franchise complaints. This is one benefit of buying into a franchise system that other business may not offer.

An investigation by an investor would scope what franchises are available. There are literally hundreds of different franchises at all levels of investment ranging from low budget cafes through to up market restaurants and everything in between.

Key success drivers

- Location, location, location
  You need to do extensive research to find a location that is suitable for your business and a rental that is reasonable for you to make the profit that you have aimed for. Finding the 'right' balance is not easy and be prepared to negotiate with the landlord or its managing agent.

- Brand and reputation of the franchisor
  The brand and reputation are keys to a successful franchise business. The reason is simple; because consumers know the brand and what to expect from it. Therefore, usually consumers are more likely to purchase with minimal or no effort from the franchisee.

  However, some investors will shy away from the huge franchisor because they see themselves as a powerless franchisee and therefore have less negotiating power or even less attention from the franchisor. On the contrary when the franchise system is too small, there may be higher risk that the system can experience difficulties or fail.

- Revenue and profitability
  One of the benefits for an investor in a franchise is that usually there will be financial data available from other franchisees as a point of reference to provide a guide as to what they can reasonably expect to earn from their investment. Thereby, allowing the investor to make an informed decision based on the return of investment (ROI).

- Support from franchisor
  An investor would benefit from a system which demonstrates it will provide support to its franchisees. For example marketing collateral, corporate advertising to establish the brand, support from a central call centre (such as referrals) and the level of promotion that the franchisor would provide for its franchisees.

- Cash flow
  Cash flow management is one of the most crucial factors in any business success. Business needs to have sufficient working capital to ensure they have the cash to pay employees' wages, suppliers and other expenses. Just projecting the profitability on paper is not enough as it does not take into consideration the timing of cash receipts and payments. As a minimum, we recommend a 12 months cash flow budget to be prepared as well.

The fine print

Experienced investors do their research before committing to an investment. Similar to any other investments, the investor must do the same for a franchise business. Apart from checking the revenue and profitability etc, the investor must carefully read and understand the franchise agreement. The agreement is the legally binding document that cements your relationship with the franchisor and therefore we strongly recommend that you seek professional advice to assist you. Some of the key questions you need to ask:

- Is the segment growing or diminishing?
- Does the franchisor have a strong brand recognition and reputation?
- What is the franchisor's point of difference in this segment?
- What percentage of ROI could a new franchisee reasonably expect?
- What is the upfront and ongoing investment in terms of working capital expected of a prospective franchisee?
- Describe the support systems that are in place to assist franchisees to be successful.
- Do you have access to existing and previous franchisees that you can speak to?
- Is the franchisor's business accredited by a bank?
- How would disputes be resolved should there be a disagreement?

Conclusion

In our opinion, investors can benefit from buying the 'right' franchise business that suits their needs. Like all investments, we strongly recommend sufficient due diligence and research to be conducted prior to committing yourself taking into consideration of your personal circumstances.

We would like to speak to you and assist if you have any questions or concerns. Contact us now for your **complimentary** and **no obligation** first meeting to discuss on how we can assist you.

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