FRANCHISING START-UPS

Franchising is opening the door to thousands of would-be business owners, attracted by the prospect of buying into proven systems.

There is no doubting its popularity. According to the Franchise Council of Australia, franchising has been growing faster than any other business sector over the past four years and now employs around 600 000 workers.

Complaints about franchising have declined since a mandatory code of conduct, administered by the ACCC, was introduced in 1998.

But significant risks still remain for investors who fail to properly consider what is needed to run a successful franchise.

A group of ill-prepared, cashed-up workers all too willing to invest their life savings has emerged, and many of them find out too late that not everyone is cut out to run a successful franchise.

Owning a franchise can be a highly rewarding way to make a living for many Australians, but it can also lead to financial ruin if not done properly.

The risks include scams and bogus business schemes, as well as structural issues, which, if not addressed, can bring an entire system down.

The ACCC has taken several cases to the Federal Court, and actively scans newspaper advertisements to detect and shut down unscrupulous operators before they can start claiming victims.

In April this year the court found directors of the Photo Safe and Data Vault franchises had misled 37 small business investors. Each had paid up to $160 000 for photographic and imaging service businesses that gave little or no return on their investment.

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The ACCC also obtained court orders earlier this year against a fertiliser spray franchisor after it was agreed the company had made lofty promises to potential franchisees with little evidence to back those claims.

Those investors could have spared themselves a lot of pain had they sought professional advice before handing over their savings.

Reaching inexperienced, aspiring franchisees is a challenging task for organisations like the ACCC, which is now resorting to placing advertisements in the businesses-for-sale columns of newspapers to warn investors against rushing into franchise businesses.

Legitimate, sound franchise businesses can take around five years to become established and begin returning a comfortable profit, even in well-established models with good brand recognition.

Potential franchisees should consider that they will be limited in their ability to make changes to their stores or products. As part of buying into a franchise, they agree to comply with the franchisor's business model and they will not have the same freedom as the owner of an independent small business.

Of course these limitations must be weighed against the advantages that come with being part of a proven system—namely staff training, established supply chains and the support of the parent company.

These are important considerations for first-time business owners, and it is worth their while to ensure that the franchise they are considering has appropriate support mechanisms in place.

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But some franchisors give in to the temptation of growing their chain of stores too quickly, sometimes signing up as many new entrants as they can without giving much thought to the future. Eventually they are unable to support all their franchisees.

This type of poor planning leads to owners being burned as the franchise's entire business system collapses beneath them.

A key resource for prospective franchisees is a disclosure document, which must be given to them no fewer than 14 days before any non-refundable money is handed over or before the agreement starts.

This disclosure document contains critical information on the financial health of the franchisor, some information on marketing and advertising funds and details of how many other franchisees have terminated or not renewed their agreements in the past three years.

Potential investors also need to think long term, especially about the type of products they will be selling. Market trends change and there are no guarantees that what is selling well today will be as popular in five years' time, when tastes may have changed.

When banks look at funding a franchise, they are likely to view it as no less risky than any other small business. Potential franchisees should take exactly the same line.

A good starting point for researching a first-time franchise investment is the ACCC's *Franchisee start-up checklist*, (see p. 15) available on the ACCC website or by calling the small business helpline (see p. 19 for contact details).

Potential franchisees should consider taking three important steps:

Speak to franchisees who have been in the business for at least one year. This will yield valuable information about what to expect and will test claims made by the franchisors.

Engage a legal or business advisor to cast an expert eye over a business to advise on its viability and the likely financial implications. This advice is especially useful for those with little previous small business experience and could save would-be buyers much more than it costs.

Read all relevant material thoroughly and compare different systems. Organisations like the ACCC and the Franchise Council of Australia provide a broad range of information to help potential franchisees.

Potential franchisees should also consider:

Whether the franchise agreement limits how close their co-franchisees can set up in opposition to them.

The level of support and back-up provided by the franchisor.

Potential cyclical downturns in a market that could threaten the viability of their business.