Philip Morrison,
Managing Partner, Franchise Accountants

FIVE BASES TO BUYING A FRANCHISE BUSINESS

A common and fundamentally important question I'm asked many times a week is "Do you know a good franchise system to buy?" The answer to buying a good franchise system hinges upon five key elements or 'bases' which will be discussed below

Buying either a new franchise business opportunity or an existing franchise business can be likened to playing softball. You need to navigate your way around all bases to find the right franchise business that works for you, and be successful! So it is with buying a franchise you need to successfully negotiate in each base to be successful in choosing a franchise business that works for you.

Navigating through the process of selecting and buying a business can be a challenging process. The stress of not knowing what you don't know can be reduced by taking good advice, relevant research and following due process.

Do you know a good franchise system to buy? is a question I'm asked many times a week with clients seeking advice on buying a franchise business. The answer to this question is dependant on a number of various elements.

So what are the five bases to methodically evaluating a franchise business? The following are five fundamental bases I'd suggest you must pass in making your decision on buying an existing franchise business.

Base One: Suitability

Is franchising right for you?

Do you like working with prescribed systems? Can you work as part of a team? Are you able to take instruction? When you purchase a franchise business you are subscribing to participate in a brand which requires conforming into a prescribed format and systems of doing business. If you don't like this type of environment then maybe purchasing a franchise business is not the right fit for you.

Do you know the industry?

Are your skill sets or competencies consistent with what is required to run a successful franchise business? How much support or training is offered to up skill you? It is important that you consider these questions and the industry the franchise operates in. A lack of industry experience is not fatal, but it is important that you get the right support and training

What are your reasons for wanting to go into business?

Do you have the support of your family? Will it generate the lifestyle you seek? Do you want to work in the business? Full time or part time? What hours do you expect to work? Does it provide an exit plan? Will you achieve the financial rewards you require?

Do your home work and ensure the franchise business meets these criteria. Just like buying a pair of shoes, they need to not only be your size but also be the right fit and serve the right purpose or function e.g . high heel shoes may fit you but are not right for running in. Chances are you will be spending a lot of time in your business so make sure it suits your needs.

Base Two: Affordability

You can eliminate a lot of wasted time by working out up front what you can afford. Having the right debt to equity ratio is a major factor in buying a successful franchise business. The debt loading can be likened to setting the 100m hurdles; you need to be able to clear them in the normal stride of your business. If they are set too high you will be uncompetitive and crash out. The benefit of purchasing an existing business is that you

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can calculate with some certainty the cash generation. In accounting speak this is often called EBIT. This is an acronym for earnings before interest tax and depreciation.

Taking a conservative approach is the best approach. Allowing for some 'what if' analysis for some contingencies is an important discipline. You can liken it to stress testing, for example: What if sales drop by 10 to 20 per cent? What if the gross profit margins fall by five to 10 per cent? Can the business afford the debt repayment? What is the breakeven point in the business? These are all critical factors to know before you commit.

The recent down turn in the economy has put stress on highly geared businesses and often the only way out is to sell the business. In cases like these often a bargain can be picked up to the discerning buyer. Allowing enough working capital for seasonal swings in a business should also be factored into your workings. Seeking professional advice from a franchise experienced accountant is recommended – they can not only advise you on the above factors but also benchmark the performance with other like franchise businesses.

Base 3: Viability

Just as with buying a home or car there can be many reasons business are for sale. These reasons can be:

- the business owners or partners may have poor health
- looking for a change of direction or lifestyle reasons
- lost the passion and energy
- in financial distress because of over borrowing (insolvent or undercapitalised).

Regardless of the reason a business is for sale, it needs to be evaluated on its merits. You need to run a ruler over it to see if it financially measures up. Other factors specific to the franchise need to be considered such as - Is the franchise owner operated or managed? What are the dynamics of the industry the franchise operates in? What is its past trading performance? Have there been any shifts in the market? What is the strength of the brand? - can also have a bearing.Is the business viable? Simply put, is more money coming in than going out? The other questions to ask is: Is the future earning power of the business sustainable? Are there any large capital commitments that you will be responsible for as a franchisee? e.g. refurbishment commitments.

Looking at current liquidity, profitability and the future sustainable income patterns need to be carefully evaluated.

Base 4: Bankability

There are some guidelines which banks apply when financing an existing franchise business. Not all banks are the same. Use banks with a proven track record in franchising. They understand the franchise systems, performance, default rate and the risk profile of the franchise. Whether the franchise system is new or proven can also have a bearing on the lending profile of a franchise system. Accordingly, new unproven systems require more capital and security and possibly higher interest rates than a proven stable franchise system. Some franchisors may consider offering vendor finance to an approved franchisee where bank finance is not approved in the early stages of a franchise system's growth.

All banks will require a potential franchisee to provide a budget and cash flow forecast prepared by an accountant. This forecast will flow on from the affordability and viability phase of your due diligence process. 'Cash is king' to the funding any business. These forecasts need to realistic and based on solid assumptions which reinforces the wisdom of using accountants with proven franchise knowledge. Banks will quickly discount overstated or unrealistic financial forecasts and decline loan applications.

Base 5: Compatability

Purchasing a franchise business has the benefit of working in business 'for yourself but not by yourself'. The relationship between the franchisee and franchisor is an important ingredient to having a successful franchise business. Meeting with the franchisor is an additional step when purchasing a franchise business. Remember you are interviewing the franchisor as much as they are interviewing you when you are considering buying the system. Franchising has been likened to a marriage relationship - proceed with caution before you commit. Two are better than one when both partners adopt a win/win approach. Checking with other franchisees in the franchise system is a worthwhile exercise to gain the pulse on this relationship. Some franchisors have different management styles – some are hands on others hands off, so do your home work. Don't take short cuts!

When evaluating the possible purchase of an existing franchise business you need to visit each base and work through the process when coming to your decision:

- **Suitability** – Does the franchise business fit with you and your family needs & criteria?
- **Affordability** – What is your budget? What can you borrow and service?
- **Viability** – Does the business financially measure up?
- **Bankability** - Can you get finance? Is the franchise system known to banks?
- **Compatibility** – Can you work with the franchisor and vice versa? Is the culture workable?

Working through these bases will help provide a process you can use when making a decision about whether to purchase an existing franchise business or not. Do your homework, be systematic and use a franchise specialist and/or experienced accountant, banker, business broker and lawyer to guide you through the process of making an informed decision. All the best.

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