

LEGAL QUESTIONS AND ANSWERS



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Lawyer, David Foster, is the Vice Chairman of the Franchise Association of New Zealand and is a frequent speaker and author on franchising matters.

David says he is regularly approached by clients who say something along the lines of: "I have been made redundant but I have my own house and some savings. Buying a franchise looks like a good idea to get me back working." They then usually ask two questions. "What do I need to know? and Which franchise should I buy?"

David says these are very familiar, and seemingly simple questions.

"Needless to say the answers are not as simple, but I will answer the second question first," David said.

1. Which franchise should I buy?

There are many franchises for sale in New Zealand. It is estimated that there are 350 different franchise systems in New Zealand alone. Many home grown. Some franchises are excellent, some are bad and some are plain ugly.

Choose a franchise that is profitable

If your new business fails, the chances are that you will, apart from losing your business, be sued by your landlord and have the bank take your house. Also your relationship has a very good chance of failing. How do you find out if a franchise is profitable? Go to answer number 2.

Consider what you enjoy

What is it that you really enjoy? Rodney Wayne, New Zealand's own iconic hairdresser, has an interesting story. Rodney trained as

a butcher and loved being a butcher and chatting away to customers as he carved up the meat for them. For one reason or another he then happened to have to work in the butcher's section of a supermarket. Rodney was still cutting the meat up but realized he wasn't doing what he really enjoyed – talking to his customers. He then went to train as a hairdresser. It is all history from there. If you are enthusiastic about your work your enthusiasm will be contagious and will attract you business. It just happens that way. Also if you enjoy your work it is a pleasure and not a chore.

Franchising is (not) a partnership

Any franchise agreement will state that the agreement does not evidence a partnership and the franchisee can not contractually bind the franchisor. However you are entering into a relationship and when you enter into a relationship you need to trust the person/people that you have that relationship with. Whilst the franchisor may sell its franchise system to someone else (that is always a possibility) for the time being at least, you need to be able to have a trusting co-operative relationship with the franchisor and the franchisor's staff. How do you work this out? Once again see answer two below, but in the meantime consider:

1. is the franchisor bound by the Franchise Association of New Zealand Code of Conduct, Code of Ethics and Rules i.e. is the franchisor a Franchise Association member?
2. do the other franchisees in the system trust the franchisor and its staff?

What do your advisors think?

Listen to them. Seek advice from lawyers and accountants who are thoroughly knowledgeable about franchising. These people will be members of the Franchise Association of New Zealand and will have industry knowledge rather than just a passing familiarity with contracts. Your advisors will be less swayed by the franchisors' (or sales managers') smooth talk (I notice that some of the best salesmen/franchisors sell the most undeveloped and dangerous franchises). Your advisors will be also be able to review the system/agreement and financials completely and impassionately – which you may not be able to especially if you see the franchise as the answer to your prayers/the light at the end of the tunnel/your future and fresh start.

And now for the big question (or answer):

2. What do I need to know?

In a nutshell, as in buying any business, you need to know just about everything you possibly can. Buying a franchise does not guarantee financial success or indeed any other success or fulfillment of any promise, representation or dream. You have to undertake your own 'due diligence' investigation. This is not as hard as it may seem but you and your advisors will need to find out everything possible about the business, the people behind the business, the product, the other franchisees, the profitability, the location of the business, the costs of setup etc etc...

To assist you, the Franchise Association of New Zealand has published a manual called 'The Franchisees Guide'. This is an excellent

publication, easily readable, full of information and reasonably priced. Order this online. (Your franchise lawyer may have a copy that can be lent to you). You should also visit the Franchise Association website – www.franchiseassociation.org.nz to ascertain where you can locate competent advisors, and which franchisors are Association members. Franchise Association members display with pride the green FANZ member logo. Think twice if the franchisor is not a Franchise Association member. And then think again.

1. A successful franchise system does not happen overnight. The invention of a product might. Creating a system that operates efficiently and profitably for both 'partners' takes time. (Just briefly – a franchise system ideally has a 'pilot' with a history of at least one year before a franchise consultant can undertake a feasibility study. The consultant will then create the system and manuals which is a procedure that can take 6 months or so).
2. What does the franchise sell? If it sells widgets, consider whether widgets will be a saleable commodity in 3, 5 or 10 years time? If it is a computer widget it is likely to be already obsolete. Then what do you sell?
3. Is it a happy franchise? Talk to all of the franchisees – not just those that the franchisor gives you contact details of. Find out how many franchises have been terminated, not renewed or transferred.
4. Has another franchisee operated from the premises or in the territory you propose to purchase? Did that franchisee succeed or fail? Find out from the franchisor and the previous franchisee what happened. If the franchisor is a Franchise Association member this information and the answers to many of the questions you should ask will already be provided in the Disclosure Document, which must be provided by Association members.
5. What is the financial situation of the franchisor? Successful/struggling/failing? What happens if your franchisor can no longer provide you with the widgets. Who will be the new owner of the system if it fails? Will you get adequate support as the system fails?
6. How amenable is the franchisor to proposed changes to the franchise agreement? This gives quite a good indication of the solidity of the system.
7. What does the franchisor want to know about you? The less you are asked the

more concerned you should be. If the franchisor just asks you about your financial situation and has a passing interest only in the remainder of the things about you then you can reasonably ascertain what the franchisor's focus is. You want to be part of successful system. Successful systems are created with the best and most suitable people – not just those with the money to pay to a franchisor.

8. What does your accountant/banker/lawyer know about the franchisor?
9. The money. Here is a question for your accountant and bank. Does the franchise represent value for money, what are all of the setup costs (vehicles, premises, stock, initial advertising, uniforms, computer and accounting systems etc?) How much working capital does the business need? If you underestimate these amounts you could be on a slippery slope. Just as in any business.
10. What ongoing fees do you pay the franchisor? Does the franchisor profit from your product purchases? How does the franchisor make his money? If the franchisor only makes money on the sale of the franchise BEWARE!
11. Was the franchise created by a reputable franchise consultant? There are a number of 'franchise consultants' who lack the experience and qualifications necessary to create a successful and enduring system.
12. If the franchise has specific requirements for premises, consider also not just the fitout costs but the refurbishment costs and when you need to refurbish – usually on a renewal and also possibly when you sell. Refurbishment can add significant costs.
13. What are the costs for you to sell the business? Most franchises charge an administration fee and obviously the new franchisee will need to be trained (therefore a training fee) – who pays? – and there are likely also to be legal costs incurred. Some franchisors also charge a percentage of the sale price. This could be a significant cost, particularly if you have also used a broker to achieve a sale.
14. Territory – do you get exclusive rights to an area? Do you need them? Consider not just competing businesses but the possible threat from other franchisees and the franchisor if you do not have exclusivity.
15. And finally what does your franchisor do for you? Whilst franchise agreements appear to be written largely 'in favour' of

the franchisor, the reason for this apparent bias is for protection. You are buying the right to sell a product/service and use a system. If another franchisee doesn't meet the required standards then the franchisor needs the ability to:

- (a) ensure it does; or
- (b) terminate the agreement if the franchisee refuses to comply; and/or
- (c) prevent the franchisee from using the franchisor's intellectual property to compete against you and your co-franchisees once the agreement has ended. That 'bias' gives all franchisees protection from a bad franchisee. If you use a lawyer inexperienced in franchising and/or licensing you will detect such inexperience by frequent comments such as 'this agreement is unreasonable', 'unfair bias', 'clearly unconscionable'. If you hear these comments, terminate your instructions and take the agreement to someone who understands franchising.

Franchise support is likely to include:

1. Training – initial and ongoing – check who pays and where the training is.
2. The secrets of the system – contained in (hopefully) a professionally prepared Operations Manual.
3. Support – sales, advertising, merchandising, purchasing business account systems.
4. Franchise meetings.
5. Franchise Advisory Council – a group of elected franchisees who represent all franchisees and meet with the franchisor to communicate issues/successes, possible improvements.
6. Problem solving. Your franchisor should, through his experience, (and pilot operation) be able to assist you in solving any problems you may encounter. (Your fellow franchisees should be able to assist). How available is the franchisor or his experienced franchise support office to help you?

Conclusion

Great franchising is a joy to all – franchisor, franchisee and customer. Make sure you buy a great franchise by using the significant amount of resources now available in this exciting franchise community. ❖

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