Six things to look out for when buying a franchise business

Investing in a franchise business can seem like a quick and easy route to success: there's already an established brand identity and goodwill, so you may think that takes a lot of the leg work and risk out of starting a business.

While this may be true to an extent, running any business is difficult, and many franchises are forced to close their doors year after year, so it's critical that your franchise agreement doesn't include clauses that could be detrimental to you and your future business dealings.

So before taking the leap and buying a franchise business, here are six key things to look out for when buying a franchise business and negotiating a franchise agreement.

1. Personal Guarantee

Today, franchisors have come to expect a personal guarantee from franchisees as a standard business practice, either as a separate document, or as clauses worked into the lengthy franchise agreement.

No matter the form it takes, it's critical to carefully examine the terms of the guarantee, as it makes you personally liable for the full extent of any losses suffered by the franchisor and if the franchisee company is found in breach of any of its obligations.

2. Post-termination Provisions

Post-termination provisions or restrictive covenants usually include non-compete, non-solicitation and non-dealing clauses designed to protect the franchisor if the franchisee closes up shop and pursues another business venture in the same industry.

However, be sure to thoroughly examine the section of the post-termination provisions relating to the protection of the franchisor's trade secrets, business methods, and expertise so that you are not left vulnerable to claims.

Ensure that reasonable periods of time and areas of operation are fixed according to the nature of the business and its specific area of operation; otherwise, this could seriously hinder your ability to conduct business in your industry later on.

3. Royalty Payments

There are a few things to consider when it comes to royalty payments. Importantly, verify that the initial franchise fee and royalty payments in the contract match up to what the franchisor has promised.

Secondly, ensure that ongoing royalty payments will be calculated as a percentage of the profit, not of the turnover. If royalties are based on the turnover, you could still be bound to pay them even if you're operating at a loss.

4. Renewal

Franchises usually run for a 5 or 10 year term, after which the franchisee is provided with a right of renewal if they are in full compliance with the franchise agreement.

Although renewal clauses should be a standard part of franchise agreements, this is not always the case, so you should have the agreement reviewed by a professional to ensure that you will have the right to renew. Otherwise you could face the risk of investing significant resources into running the business, only to lose it to the franchisor or a new operator after expiry of the initial term.

5. Due diligence

Time and time again, franchises have been marketed as being vastly profitable and a great business opportunity, and yet when a new franchisee takes on the outlet, it struggles and ultimately goes out of business. It turns out that the franchise may have inflated its financial figures and only given financial figures for some years, and not all.

You may think that it would be easy to sue the franchisor for misrepresentation, but the UK operates a 'buyer beware' approach to purchasing a business (or even property), which means that you must ensure that you have carried out all necessary legal and financial due diligence to be satisfied of the franchise's viability.

Unfortunately, case law often favours franchisors in such matters and therefore it is imperative to ask all the right questions before signing up to the franchise agreement.

6. Selling the Franchise

Should you wish to sell the franchise business in the future, it is essential to check whether the agreement stipulates that the franchisee must pay the franchisor a percentage of the final sale price.

Even though the franchisor will likely have the first right to purchase the business, it's imperative that the agreement permits you to sell the business at market value at any time before the expiration of the franchise agreement; this way you can reap the most benefit from the sale. Also be sure to check that any transfer fees are not excessive.

For more information, or for expert advice on business or personal legal issues, call us on 020 3475 6751 or via email at info@carterbond.co.uk

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