

Vault

Your trusted adviser

FRANCHISING ADVICE



NO ADVICE WARNING

This e-book contains general information only.

The information in this e-book is general information only and has been prepared without taking into account your personal objectives, financial situation or needs. You should consider any advice in this e-book in light of your personal objectives, financial situation or needs before acting on it. You may wish to consult a licensed financial adviser to do this.

The information in this e-book is no substitute for financial advice.

If you are considering acquiring a financial product you should obtain a Product Disclosure Statement (PDS) and consider its contents before making any decisions.

Vault Accountants (Aust) Pty Ltd and Vault Financial Group Pty Ltd (“Vault”) can take no responsibility for any actions you take independently, and without seeking professional advice from a licensed financial adviser. The information in this ebook is not to be taken as taxation, investment or personal advice and is only an indication of the views of the writer and cannot be relied upon by the reader. Should the information be acted upon the reader is doing so at their own risk. If the reader requires this advice to be used and acted upon they will require this to be presented on the letterhead of the writer. Vault have made every reasonable effort to ensure the information provided is correct, but Vault makes no representation or any warranty as to whether the information is accurate, complete or up to date. To the extent permitted by law, Vault accepts no responsibility for any errors or misstatements, negligent or otherwise. The information provided may be based on assumptions or market conditions and may change without notice.

TABLE OF CONTENTS

Introduction	1
What is franchising?	2
The pros of franchising	3
Things to do before purchasing a franchise	5
Other potential risks associated with franchising	8
Understand your legal obligations	11
Important information about employing staff	12
Franchising and tax	13
Updates made to the franchising code	16
Summary	17
Who we are?	18
Contact us	18



Dear Reader,

We are delighted to provide you with a free copy of this e-book.

We hope that some part of what you read in this e-book is beneficial and of service to you.

As accountants and financial advisers with years of experience, we help people make educated financial decisions throughout various stages of life.

Ring us today on **1300 1 VAULT** to make an appointment or book a meeting directly via our website at www.vaultgroup.com.au.

Introductory meetings are free and carry no obligation.

Kind regards,

A handwritten signature in black ink that reads "Brad A. Gunn". The signature is written in a cursive, flowing style.

Brad A. Gunn

Executive Director

Vault Financial Group Pty Ltd

ABOUT THIS EBOOK

If you are currently thinking about buying a franchise there are a number of pros and cons that should be taken into consideration before making your purchase.

As a country Australia has embraced the concept of franchising with open arms. Australia's franchise industry is worth an excess of \$180 billion in annual revenue and it also employs just over 98,000 people.

This e-book will give you access to essential information making it easier for you to understand the various risks and potential rewards associated with franchising. This e-book also covers the many legal and tax obligations that come along with signing a franchise agreement.

WHAT IS FRANCHISING?

For anyone unfamiliar with the concept, a franchise is an agreement where a firm (a franchisor) enters into a contract with an individual or business (franchisees). This permits the franchisees the authorisation to distribute goods and services under the franchisor's trade name and guidance, in exchange for a fee.

Franchises are everywhere you look. The majority of the most popular businesses in the industries of fast food, retail and fashion are franchises. Australia's love of fast food is arguably one of the reasons for the popularity of franchises in Australia.

During the late 1960's and early 1970's, Australia experienced a huge influx of successful American fast food restaurants, which the Aussie public immediately embraced.

KFC opened its first Australian store to much fanfare in 1968, while both McDonalds and Hungry Jack's (or Burger King, as it is known outside of Australia) opened their first restaurants in 1971.

In 2021, Subway is currently the largest franchise in Australia as it has over 1300 stores across the country. This is followed by McDonald's with just over 1000 stores and Dominos with 700 stores.

THE PROS OF FRANCHISING

There are many advantages associated with purchasing a franchise. The basics of economics illustrate that if there is a type of business that's finding success, then people will want a share of that success.

To put it simply somebody creates a supply for a demand that hasn't been satisfied, then they make large amounts of cash; then others decide that they want a portion of that cash and start trying to satisfy what is left of that demand.

Buying into an established business

One of the major benefits of buying a franchise business is that it enables you to take advantage of a brand and business that has already established itself. That means the franchise will come with a tested and tried set of operating procedures and policies, as well as an existing audience or customer base. One of the reasons why many new businesses fail within the first few years of opening is because they often struggle to raise awareness about their existence. Buying a franchise allows you to skip over some of the more challenging aspects of launching a new business enabling you to hit the ground running straight away.

Simpler Financing

Establishing a new business is a risky and often an expensive process. Another significant advantage of buying a franchise is that it makes acquiring financing much easier. Lenders are much more likely to provide financing for an entrepreneur who is looking to invest in a business that has already proven itself to be a huge success. The franchise itself will come with an established network, branding, and a strong support structure to help new franchisees succeed. In some cases, franchisors themselves might even be willing to finance the purchase of one of their franchises.

Support and Security

To grow a business to the point where franchising is a feasible option, franchisors need to invest in support and security systems. These systems will supplement the training franchisees receive for managing the business' accounts, tracking sales, setting targets, and marketing locally. All of these are usually included in the cost of the franchise and ensure the franchisee has access to everything they need to lead a successful franchise.

Access to an in-built network

It's hard to exaggerate the value of a network of dependable business contacts. Building a network is essential for any entrepreneur who aspires to excel in their chosen field or industry, but it takes a lot of time and hard work. Buying a franchise makes you a part of the franchisor's network while also enabling you to take advantage of every contact they have acquired. Your franchisor should have lined up suppliers, distributors, marketers, and other essential personnel so new franchisees can get up and running as soon as possible. As they introduce you to more people within their network, you will have the opportunity to foster your own relationships.

Better chances of success

Regardless of how savvy an entrepreneur is, the odds are stacked against those who decide to launch their own business. Most businesses fail within the first few years, although the precise figures are often distorted. While some businesses launch with the eventual intention of franchising, many others make the decision once their business has proven itself viable and successful enough to make the franchise model work for them. The point is that franchises are generally safer investments than conventional businesses and are less likely to fail. You are much more likely to see the money you spend buying a franchise again than if you had spent it building a business from scratch.

An excellent management opportunity

Working your way up through any business to the point where you can apply for a managerial position takes a lot of time and dedication. Landing your first manager job is especially difficult because you can be sure that there will be other applicants competing for the same position. If they have already held managerial positions in the past, they will be much more attractive to prospective employers. However, the unique nature of franchises means they are ideally suited for anyone looking to gain experience managing a business or branch. Because franchises come with all the essential components already in place and franchisors provide support to franchisees, franchisees can learn how to manage a business even if they don't have any previous experience. After gaining some experience running a franchise, a whole new world of opportunities will open.

THINGS TO DO BEFORE PURCHASING A FRANCHISE

Before you decide to go ahead and purchase a franchise, you must consider the same issues as you would if you were buying or starting any other business. Do online research on the franchise system, know the market you are going to be operating in and understand how the business works.

It is also super important to consider the issues specific to franchises, such as what happens if the franchise or franchisor fails. The franchisor will act in their commercial interest. It is your responsibility to protect and act in your own commercial interests.

Be Aware of Potential Risks

There are plenty of risks associated with running a franchise. If you buy a franchise business and it goes badly, you could lose all your money and any assets, such as your house that you have borrowed against.

Franchising is very different to other types of business. You won't have the same level of control compared to a business you run independently. Franchisors can usually control the products or services you offer, where they must be sourced from even if it you can get them cheaper somewhere else. As the franchise adjusts to meet changes in the market, the franchisor might make changes to the franchise system. A franchisor may be able to make these changes, even if you don't agree with them.

Make sure you understand the costs of:

- the upfront fees
- establishing and maintaining the franchised business
- any significant expenditure you might have to pay
- franchisor insolvency

Don't Rush Putting Pen To Paper

When you are buying a franchise, you're often dealing with a sales person. Avoid rushing into making a quick decision. When you are given new information or documents take the time to understand them, verify the information and get advice. If the franchisor tries to rush you, remember you can walk away. There will always be other opportunities.

Talk to Other Franchisees

To gain valuable knowledge about franchising as a career, it would be a great idea to talk to other people who have already done what you are planning to do. Talking to other franchisees will make it easier for you to determine if franchising is the right career move for you to make.

It is encouraged that you take the time to talk to at least 10 franchisees and tap into their knowledge. Ask them about all the pros, cons, and if there are any hidden costs.

It is important to keep in mind that ego is a big thing in the business world. Therefore, some franchisees might not feel comfortable with admitting to you that they have struggled.

Questions to Ask Other Franchisees

- What information did they learn about franchising that they didn't gather from their research before they became franchisees?
- How long did it take them to become profitable?
- How much did they budget for their enterprise, and how much did they end up spending?
- What was the toughest part of building the business?
- How supportive is headquarters?
- How challenging is it to hire good staff?
- Based on their experiences given what they know now, they would do it again or recommend the franchise to a close family member or friend?

Consider getting professional help and advice

To help your business get off to a good start it would be advised that you hire an accountant and a legal expert to help you navigate your journey as a franchisee. An accountant and lawyer will help you review your financial health and how it will be affected by the franchise arrangement before you sign a franchise contract. The reality is if you're buying a business that costs between \$150,000 and \$1 million, you need an attorney to look at the documents and tell you what they mean.

Count Your Money

Take a look past the minimum requirement for buying a franchise, usually listed as the franchise fee and the cost of equipment. Getting a franchise up and running also in most cases requires a huge fee for marketing costs and the need to survive on break-even books, or a period of net losses, before your business catches on. Even if you're franchising a well-known brand like McDonald's, customers still need time to discover your new location. Before taking on a franchise it is important that you have access to money that will cover both business expenses for six months and your personal living expenses for at least a year.

Do a Cost Benefit Analysis

Write up a big list of the many pros and cons of becoming a franchisee. Draw a line down the centre of a piece of paper and on one side, write down the benefits you're getting, such as the established brand, proven market, training, recipes if it's a food franchise, staffing guidelines, store design.

On the other side list the costs and liabilities, including franchise fee, money you're required to pay for marketing, mark-ups on merchandise and ingredients the chain requires you to buy, the share of sales you must pay in royalties. Consider whether you could hire a consultant to help you open up your own donut or sandwich shop, and instead of paying royalties, mark-ups and marketing fees, keep that money for yourself.

Consider working in a store

This is arguably the most reliable way to see how a franchised business works from the inside, and whether your personality fits the company culture. A business such as Domino's strongly favours franchise applicants who have worked their way up from delivering pizzas. Some businesses, have a policy of granting franchises only to people who have worked for the chain for at least three years. To ensure that taking on a franchise is right for you it is highly advisable that you consider spending six months as a worker before you become a franchisee.

OTHER POTENTIAL RISKS ASSOCIATED WITH FRANCHISING

Just like any business, your franchised business or the franchisor's business may fail. In most cases franchise agreements often include termination rights in favour of the franchisor. The Franchising Code sets out processes the franchisor must follow if they desire to terminate franchise agreements, it doesn't stop you from being lawfully terminated. It is important to be aware that you could potentially lose your whole investment if the franchisor terminates your franchise agreement.

Furthermore, you can't always resell or renew the franchise. This is important to be aware of if it isn't possible for you to make enough money to recover your costs before your franchise term finishes.

The franchisor can also act in their own commercial interest. Even if this reduces the income of franchisees, it may not be against the law.

The Most Important Things To Do Before Signing A Franchise Agreement

It is important to do some thorough research and investigate the franchise system you're considering buying into. This will allow you to make a more informed decision.

Make sure you;

- Review all the documents provided to you, such as the information statement, disclosure document the franchise agreement and the Franchising Code
- Seek legal, accounting and business advice
- Verify the earnings information
- Check the franchisor's financial position
- Complete a background check on the business/company on the ASIC Connect website
- Research the market for the product/service
- Watch out for scammers
- If the franchise requires a site or lease carefully review any lease documents and seek professional advice

Ask Questions

Some of the best information can be retrieved from those working in the business. Speak to current and former franchisees, and ask them questions such as:

- Are they making a profit?
- How many previous owners has the site had and for how long? –A high turnover of one site (commonly referred to as churning) or across a system (known as burning) could be a warning sign about a franchise system.
- Are there any hidden and unexpected costs?
- What training and support did the franchisor provide for you?
- What are labour costs, and what wage/salary did the franchisee receive?
- What made you decide to leave the franchise system?
- Were the promises made by the franchisor kept?
- Especially any profit or earning promises?
- What happened at the end of their franchise agreement?
- Could they renew the franchise agreement if they wanted?
- Were they told about major changes within the business before they happened?

If it's too hard to contact former franchisees, or they don't want to talk, consider this a big warning sign about the franchise system.

Make Sure You Understand the Franchising Agreement

Purchasing a franchise means you're buying the rights to run a business under a brand name. Often these rights are subject to conditions that are set out in a franchise agreement.

The franchise agreement is a legally binding document that details the rights and responsibilities of both the franchisor and franchisee. Once you enter into a franchise agreement, you are legally committing to run the business according to the requirements set out in the franchise agreement and the franchise operating manuals. Often franchise agreements are written so they favour the franchisor, you will often have significantly more obligations than the franchisor. Sometimes this reflects franchising as a business model, and sometimes it is a bad business deal. It's important to get advice to understand which one you might be signing.

Before You Sign A Franchise Agreement

Before signing a franchise agreement, obtain as much information about the franchise as possible and make sure you understand the risks. As soon as you show a genuine interest in a franchise, franchisors must give you a short information statement outlining the risks and benefits of franchising.

At least 14 days before you sign a franchise agreement or make a non-refundable payment, franchisors must give you:

- a copy of the Franchising Code
- a disclosure document
- the franchise agreement in its final form

You are able to take more than 14 days to think about the offer, and you should not rush into making a decision.

Before signing an agreement it's important to understand what issues may arise at the end of an agreement. Some questions you might like to discuss with the franchisor, your legal adviser and talk to other franchisees about include:

- Will the franchisor purchase unsold stock, marketing material, equipment and other assets?
- Is the franchisee entitled to any compensation for goodwill in the business?
- Will you be subject to any restraint of trade (or similar) clause?
- Are you aware of the types of events that may lead to non-renewal or termination of an agreement? How would this impact you?

The Cooling Off Period

You can terminate a new franchise agreement (not a renewal, extension or transfer of a franchise agreement) within 7 days of entering or making a payment.

End of Agreement

A franchise agreement generally operates for a set period. Renewal of your agreement is likely to be subject to signing a new agreement or other conditions.

A franchise agreement may end due to expiry (non-renewal), termination or the franchise system ceasing to operate for any reason.

UNDERSTAND YOUR LEGAL OBLIGATIONS

Like any business decision, you should consider franchising carefully and follow the right processes. There are laws you must follow when franchising in Australia, including:

- Franchising Code of Conduct
- Australian Consumer Law (ACL)
- Fair Work Act
- Contract Law

Your franchise agreement is a contract, so you may have rights and obligations under contract law. Contract law is not written down in one place it is made up of past court cases. Your legal advisor will help you understand your rights and obligations under contract law. If you occupy a premise it is likely you will be required to comply with a lease or license. It is important to understand your obligations and what rights and obligations you may have under applicable retail legislation and council requirements.

As a franchisee, the Franchising Code details:

- your minimum rights and obligations
- the information franchisors must tell you before you sign
- some of the things a franchise agreement must contain
- the process for resolving disputes

If something goes wrong after you sign the agreement, you may need to take your own legal action to enforce your rights. The Australian Competition and Consumer Commission (ACCC) enforces the Australian Consumer Law and the Franchising Code of Conduct. The ACCC takes action for breaches of these laws where it serves the public interest. The ACCC does not take action on your behalf if something goes wrong for your franchise.

These laws can't guarantee your success – a franchise can fail, just like any other business.

IMPORTANT INFORMATION ABOUT EMPLOYING STAFF

Franchisees that employ staff have the same workplace responsibilities as other employers. It's important to keep in mind that if you're operating a franchise in Australia, you must follow Australian workplace laws, regardless of where the franchise originated. You should consider:

- minimum wages and awards
- employee benefits such as long service leave
- record keeping obligations
- offences and financial penalties for breaches of workplace laws, including those who underpay employees, fail to keep correct time and wage records, fail to issue compliant pay slips or who force employees to repay wages

Understand The Leasing Requirements

Your franchise may need to lease a commercial premise to operate. It's important you understand your rights and obligations when signing a lease, you need to:

- seek professional advice
- know what is involved in the lease transaction
- know who the lease is with (franchisor as the landlord or an independent landlord)

It's important to ask questions about the lease before you sign the franchising agreement:

- Does the franchising agreement include the leasing of business premises?
- Who holds the lease over the premises, franchisee or the franchisor?
- Can the lease be terminated while you continue to hold the rights to the franchise?
- What are your rights and obligations under the lease agreement?
- Who owns the fit-out and other inclusions in the leased premise?

The lease contract and the franchise agreement are two separate documents.

Understand Your Tax Obligations

Franchisee businesses can operate under different business structures. Like any business, your structure, earnings and assets will determine your taxation obligations.

Ongoing franchise fees are often deductible in the year you pay them. You might be able to deduct other payments including training fees and loan interest from your taxable income. Check what you can deduct with your accountant.

When you buy, sell, transfer or terminate a franchise, taxes may apply.

FRANCHISING AND TAX

Starting and running a franchise business is much like starting and running any other small business. However, there are some additional things to consider.

You need to understand the different tax treatments for franchise-specific payments and transactions and how these transactions work between franchisors and franchisees, including:

- Franchise Fees
- Training Fees
- Royalties or Interest Payments
- GST
- Transferring or Terminating a Franchise

The franchisor and each franchisee need to have separate Australian Business Number (ABN).

A franchisor grants the right to use a business brand name or trademark and the right to produce or distribute their product or service.

A franchisee, receives the right to use a business brand name or trademark and the right to produce or distribute the franchisors product or service.

Franchise fees

The initial franchise fee or transfer fee you pay to the franchisor forms part of the cost base for your franchise business as your capital asset. As these fees are capitally invested in your business, you do not deduct them as business expenses from your annual income tax.

Depending on the circumstances your franchise renewal fees may also form part of your cost base. Any franchise renewal fees not included in your cost base may be deductible as a business expense and subject to the prepayment rules.

Training fees

Generally, you can deduct the fees you pay to the franchisor for ongoing training as a business expense.

Royalties or interest payments

An agreement to purchase a franchise often includes ongoing payments of royalties, interest payments or levies to the franchisor. These payments typically cover head office expenses, such as administration, advertising and technical support.

Unlike the initial up-front fee, when you work out your annual income tax liability you can deduct payments of royalties, interest payments and levies in the year you incur them, as they are a continuing expense in carrying on your business.

Royalty and interest payments to non-residents

As a franchisee, you may make royalty or interest payments to non-resident franchisors. Generally, you are required to withhold a flat rate of 30% from the gross amount of a royalty payment and 10% from the gross amount of an interest payment. However, a double tax agreement with the non-resident's country of residence may reduce this rate.

You pay to us the amounts you withhold from royalty and interest payments, and report the amount in your activity statement for the relevant reporting period. You later report the total annual amount of royalty and interest payments and amounts withheld using the form – PAYG withholding from interest, dividend and royalty payments paid to non-residents – annual report.

You can only deduct the royalty payment to a non-resident as a business expense if you have withheld tax from the royalty payment and the amount is paid to us.

GST

The payments you make to the franchisor will generally also include a goods and services tax (GST) component if the franchisor is GST registered. If you are GST registered you will generally be able to claim a GST credit from us for the GST amount included in:

- initial franchise fee
- franchise renewal fees
- franchise service fees or royalties
- advertising fees
- transfer fees
- training fees

Transferring or terminating a franchise

If you either transfer a franchise to another party or terminate a franchise, you need to consider both capital gains tax (CGT) and GST consequences.

When you transfer or terminate your franchise, the initial franchise fee or transfer fee that is included in your cost base may be relevant in working out your net capital gain (if any) to include in your annual tax return.

UPDATES MADE TO THE FRANCHISING CODE

The Franchising Code of Conduct is a mandatory industry code across Australia that regulates the conduct of franchising participants towards each other.

On 1 June 2021, it was announced that the Franchising Code has been amended. Many of these changes will apply from 1 July 2021.

The Franchising Code includes:

- disclosure requirements
- a good faith obligation
- a dispute resolution mechanism
- a cooling-off period
- procedures for ending a franchise agreement.

The ACCC regulates the Code and can investigate alleged breaches if they meet our priorities. Decisions about which matters to pursue are made in line with the ACCC's Compliance and Enforcement Policy. Certain breaches of the Code can result in the ACCC issuing an infringement notice or asking a court to impose a financial penalty.

Individuals also have the right to take their own legal action over an alleged breach of the Code.

The purpose of the Competition and Consumer (Industry Codes—Franchising) Amendment (Fairness in Franchising) Regulations 2021 (the Regulations) is to improve the fairness and transparency of the franchising sector. It furthers the overarching goal of the Competition and Consumer Act 2010 (the Act) to enhance the welfare of Australians by promoting competition and fair trading in the franchising sector and providing for the protection of parties who wish to enter into franchise agreements.

SUMMARY

Buying a franchise can be a wise move, especially if you haven't owned a business and have no experience being self-employed. Generally speaking, franchising secures an established brand for a product or service. It provides a proven business model and marketing system, which reduce typical start-up risks. Most franchisors also offer ongoing support and training.

On the downside, buying a franchise can limit the way you operate as a business. Franchisors may place restrictions on what you sell, where you operate and how you do business. Franchisors could potentially demand a higher percentage of the profits generated by the franchise. They may also make business decisions that have a negative effect on the value of your franchise. You need to be careful about the type of franchise you buy and look to match your own strengths and weaknesses against the different franchises on offer.

WHO WE ARE?

Vault was established in 2009 by Brad A. Gunn to provide affordable, transparent financial advice with the client's personal and financial objective being the primary objective at all times.

Our Services

Vault can assist you with all your financial and lifestyle goals. Our services include:

- SMSF & Superannuation
- Tax / Accounting & Bookkeeping for Individuals / Company's / Trust / Partnerships / SMSF
- Investment Advice
- Lending & Finance
- Financial Advisers
- Insurance (Life / TPD / Income Protection / Critical Illness)
- Wealth Building
- Property Investment
- Legal Services (Estate Planning)

CONTACT US

Please take this opportunity to call and book in with one of our experienced financial advisers or accountants.

You can make an appointment or ask any question directly via our website.

Vault Accountants & Financial Advisers

M1/88 Creek Street, Brisbane, QLD 4000

T 1300 1 VAULT - 1300 182 858

E info@vaultgroup.com.au

W www.vaultgroup.com.au

Associated Companies

Vault Accountants (Aust) Pty Ltd (ABN 86 605 066 528)

Vault Financial Group Pty Ltd (ABN 64 149 220 299) is a Corporate Authorised Representative of Shartru Wealth Management Pty Ltd (AFSL 422409)

Disclaimer

This article has been prepared for clients of Vault Accountants (Aust) Pty Ltd ABN 86 605 066 528 (Vault) and Vault Financial Group Pty Ltd ABN 61 149 220 299 (VFG) and others on request. The article is based upon generally available information and is not intended to be, or to replace specialist advice in the areas covered but rather, the article is intended to be informative and educational only. Vault & VFG, its associates, representatives and authorised representatives shall to the maximum extent permitted by law disclaim liability, directly or indirectly, for any loss or damage caused to you in respect of the information provided in this article.

This article may contain 'general advice' which is defined in the Corporations Act to mean that we have not considered any of your personal circumstances, needs or objectives. It is therefore imperative that you determine, before you proceed with any investment or enter into any transactions, whether the investment or transaction is suitable for you in consideration of your objectives, financial situation or needs and you must therefore, before acting on any information included in this article, consider the appropriateness of the information having regard to your personal situation. Vault & VFG recommends that you obtain financial and tax or accounting advice based on your personal situation before making an investment decision.

© Copyright of this document vests exclusively with Vault Accountants (Aust) Pty Ltd and Vault Financial Group Pty Ltd. This information should not be reproduced or redistributed or passed on directly or indirectly in any form to any other person or published, copied, in whole or in part, for any purpose, without prior written permission from Vault and/or VFG.



Your trusted adviser