

## 5 Common Pitfalls of Franchising

While franchising is an increasingly popular model for conducting business, there are some common pitfalls that prospective buyers of a franchise should consider and obtain professional legal advice from a lawyer experienced in franchising.



# What is a franchise?

A franchise is a model for conducting business where the owner and user of a business name, brand and system are different. It is also subject to particular regulations and franchise code that impose various rights and obligations on all parties to a franchise.

**The following are 5 common pitfalls that you should be aware of when considering buying a franchise.**

### 1. Verify oral representations

Prior to buying a franchise, it is common to have extensive verbal discussions with the franchisor (or their representative) in relation to the franchise system. You may have had discussions in relation to the success of the franchise, the areas of operation, the operational aspects of the franchise and the current strategies for marketing. You may also have had some discussions with selected existing franchisees.

It is important to obtain professional legal advice to ensure that your understanding of the franchise system is accurately reflected in the franchise agreement and associated disclosure. It is a common occurrence that a prospective buyer relies on certain representations made in the lead up to buying a franchise that are not reflected in the franchise agreement executed by you.

### 2. Advertising

It is important to understand that as part of a franchising system, the franchisor may already have systems of advertising in place and may restrict your ability to advertise

on social media platforms for your particular franchise. There may also be advertising fees payable by you towards the franchisor's advertising costs. It is important to review the advertising costs in proportion to your geographical area as you may find that you may be paying a large amount to the franchisor and not receiving much benefit by way of advertising in your particular franchise area.

It is also important to understand what your abilities are in relation to social media advertising as you may be in breach of the franchise agreement should you create your own social media page without the prior written consent of the franchisor.

### **3. Locked in suppliers**

It is natural to source the various supplies required for your franchise at the best available rate, however, a franchise agreement may lock you in to sourcing certain supplies from designated suppliers. For example, you may be running a pizza franchise and may be required to source your pepperoni and other pizza ingredients from a particular supplier even though you can obtain the same ingredients at a better rate elsewhere. It is therefore important from a budgeting perspective to understand the financial commitments relating to these locked in suppliers.

### **4. Costs**

There are many other costs that a person buying a franchise will often be required to pay in addition to the franchise fee. These additional costs may include a retention fee, an ongoing turnover fee, a central telephone system fee. Whilst the franchise fee is normally the primary fee, these other costs can be just as significant and can also create obligations throughout the term of the franchise agreement that effect the franchise's cash flow.

### **5. Not buying a business**

It is critical to understand that when entering a franchise agreement you are not buying a business. Rather, you are buying the right to use a business name, brand and system. This right will expire at the end of the franchise term. Under the terms of the franchise agreement, you will be required to comply with the prescribed franchise system and other operational protocol. It is important therefore not to expect that you will be able to run the business and that any deviation from the prescribed system without the prior written consent of the franchisor may place you in breach of the franchise agreement.

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