

# FINANCIAL POST

Monday, October 19, 2009

## Beware costly surprises in your contract

Renovations

Derek Sankey, Financial Post



J.P. Moczulski/National Post

An increase in first-time franchisees, many of which are laid-off workers who've received a golden handshake in the past year, is causing some experts to warn potential franchisees about exactly what they are getting into.

Franchisees aren't buying anything. They're renting the rights to a brand and that contract will expire at some date and, even if the contract is renewed, franchisees could be in for some significant costs to update or renovate their locations.

"This is an open-ended obligation to do a renovation at the end of your contract," says Vancouver-based franchising lawyer Tony Wilson, with Boughton Law Corp. "You are renting [and] you've got to appreciate there's going to be some costs."

He suggests carefully reading the franchising agreement with a lawyer to determine if there is a way to cap renewal obligations to a manageable amount to avoid being landed with a \$300,000 obligation to renovate and update the brand according to the franchisor's demands.

"I think there's a feeling within a lot of these budding entrepreneurial franchisees that they're buying something and they're not really buying anything," says Brent Barr, a franchising instructor at Ryerson University. "No one ever buys a franchise: They gain the rights to a franchise."

Franchise brands such as Starbucks, McDonalds and Burger King continually update their image and those costs can be absorbed by the franchisees.

A trend in the past decade to lower-cost, service-based franchise systems has also muddied the waters because entry costs are lower with seemingly more autonomy, yet franchisees have to remember their obligations, Mr. Barr says.

"There has been a shift to services [and] franchising within services is where its strength fits," he adds.

Companies such as mobile pet-grooming services, gutter-cleaning services and personal home-care services have become much more common and can often be less expensive to get into than some better-known, established

Presented by



brands.

"Buying a van that can wash a dog does not cost nearly as much as building out a Boston Pizza or White Spot or McDonalds," Mr. Wilson says. "I'm seeing a lot more home-based franchise businesses spring up."

Whatever kind of franchise system an entrepreneur invests in, he or she must conduct the same due diligence that a bank would when evaluating a business plan.

That includes the background of the company, financial documents, operations, branding and positioning, the product or service and customer base, Mr. Barr says.

"Not only do you ask the franchisor those questions, but once they have given you the disclosure documents ... you should pick a random group [of franchisees] and do the same thing -- ask them very similar questions," he says.

Most would-be franchisees are so excited about the opportunity that they tend to hear and remember what they want to, instead of the full picture-- such as hidden renewal obligations.

If a franchisee isn't prepared for those costs, it can cause an immediate cash crunch to renew as they struggle to find the resources to meet renovation or updating costs, which can vary substantially.

Many franchisors have agreements in place with banks for the initial cost of being awarded a franchise, however franchisees are likely on their own when it comes time to overhaul the look and feel of their business. If the banks turn you down, there are other, less conventional sources of financing available to franchisees.

Liquid Capital Corp. offers financing to franchisees through a concept called factoring. As well as being a franchised company itself, Liquid Capital supports many franchise operators who find themselves in a cash squeeze.

The company makes money available to franchisees by purchasing his or her accounts receivable. By purchasing those receivables, they provide immediate cash to small businesses for day-to-day operations or one-time costs such as renewal obligations.

"By having cash coming in every week and having a business owner focused on sales rather than on always collecting, they can go out and grow their business," says Judy Perdomo, a Calgary franchisee with Liquid Capital.

The company sets a limit on the amount any client can borrow, but it must be no more than 75% to 80% of accounts receivables.

Mr. Barr says the key message when approaching any franchise is to remove emotion and gain an in-depth understanding of all your obligations before proceeding. And remember, it's not really your own business.

"There is certainly a mind-set that you're buying something, but you're not," he says.

---

© 2009 The National Post Company. All rights reserved. Unauthorized distribution, transmission or republication strictly prohibited.