

## When to Buy a Franchise?

*Due to the growth in franchising over recent years, many people have been attracted to this particular form of business ownership.*

*The following is a conversation between two brothers who are planning to buy into a retail franchise system. But their problem is that they cannot decide 'when' to buy a franchise.*

*Note: The 'when' in the conversation refers to the franchise system's life cycle.*

### **Their Franchise Discussion**

- Bill:** I now see Burger's Galore stores everywhere. I read somewhere that they now have 1,000 stores in the country – that's more than McDonald's.
- Ben:** I'm not that keen on them. I just don't think that they have that much potential to grow. If we took one of their franchises, where would we locate the store, as all the good locations are gone?
- Bill:** Sure, all the shopping malls and major suburbs have a Burger's Galore store, but what about a small suburb, the rent will be a lot cheaper?
- Ben:** The rents are cheaper because there are less customers walking by. Just do some simple maths – even with a \$50,000 rental, plus staff, plus food cost, plus 10% of turnover in franchise fees, we would need a sales turnover of at \$300,000 just to break-even, let alone make a profit.
- Do you really think that a location in a small suburb could actually turn-over that much?
- Bill:** Well which franchise do you want to buy into?
- Ben:** I was having a look at a new Mexican food franchise. It's very successful in America and they have only just started here. I think they only have three stores so far. We could jump in now and get a key location at a big shopping mall.
- Bill:** But that would mean our rental costs alone would be about \$100,000pa. That's a big ask for an unknown franchise.
- Ben:** Yeah, but if we got involved with Burger's Galore when they started 15 years ago and grabbed a major franchise back then, we'd own a gold mine now.
- Bill:** That's fine for a franchise system that is going to grow and add more outlets. But what if this Mexican franchise doesn't take off? You know that Mexican food is not as popular in this country as it is in America.
- Then we could be stuck with a huge rent commitment and limited sales turnover. And you don't need to do the maths to know that means a big loss.
- Ben:** So, the question is: Do we buy into a franchise system early on the basis that one day it could possibly be very successful (or the opposite) OR do we buy into a franchise system late (because we know it's a proven system) although the return is likely to be quite low? Basically, it's your classic risk/return decision.

### **Student Discussion Questions**

1. What factors make the Burgers Galore franchise attractive?
2. What factors make the Mexican food franchise attractive?
3. If only choosing between these two franchises, which one would you select? Why?
4. Would you suggest that the brothers would be better off opening their own store (rather than a franchise)?