

FranchiseCanada

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ASK A LEGAL EXPERT

Q What do I need to consider when contemplating the purchase of a franchise?

A: Prospective franchisees looking to purchase a franchise should conduct extensive due diligence before purchasing a franchise given the significance of the investment that many if not most prospective franchisees make when buying a franchise. Prospective franchisees are strongly encouraged to adopt the following due diligence strategies before making an investment:

1. Contact Franchisees. The most critical source of information for prospective franchisees is the existing franchisees and those who have left the system. The disclosure document provided by franchisors in those provinces which currently mandate disclosure (the Provinces of Ontario, Alberta and PEI) should identify such existing franchisees and those who have left the system within the last fiscal year immediately preceding the date of the disclosure document and their last known addresses and telephone numbers.

2. Disclosure Document. Another very critical source of information is a franchisor's disclosure document. Some disclosure documents are very useful in conveying important information to prospective franchisees, including the following. Is there a high termination rate? Have there been a disproportionate number of transfers or franchisees that otherwise left the system? Is the number of civil actions which involve the franchisor disproportionate to the size of its system? Are there important inconsistencies as among the disclosure document and the franchise agreement and other documentation?

3. Financial Statements. An integral piece of the disclosure document is the financial disclosure which is mandated by franchise disclosure legislation in Canada. Financial statements reviewed with the assistance of professional accountants may reveal certain strengths and weaknesses of a franchisor and its system. Some franchisors may on occasion also

provide disclosure of earnings claims or projections in which case, prospective franchisees should carefully assess these claims and projections and test them by confirming their accuracy with as many exiting franchisees as possible.

4. Professional Advice. One cannot underestimate the importance of retaining professionals with franchising experience. Prospective franchisees should consult with a franchise lawyer who could guide prospective franchisees through their disclosure documents and the purchase of their franchises. Equally important are accountants capable of reviewing the financial statements disclosed by the franchisor and any business plans prepared by the prospective franchisees. Franchising certainly does have its nuances and the professionals retained by prospective franchisees should have experience in this method of conducting business.

5. Securities Commissions. If a franchisor's shares are publicly traded, prospective franchisees should review any public documentation filed with the applicable provincial securities commission as this may be a source of pertinent information regarding a franchise system.

6. Industry Organizations. It may be useful to examine industry and franchise association websites to better understand the business considered and any competitors of the franchisor.

7. U.S. Documents. If the franchisor conducts business in the U.S., it will have issued U.S. franchise disclosure documents. Prospective franchisees should review these documents to compare the disclosures made in the U.S. with those made in the Canadian disclosure documents. Any additional information or inconsistencies may raise issues worthy of further investigation and analysis.

8. FAC Leaders. Prospective franchisees should speak with the target franchise system's franchisee association or franchisee advisory council leaders as

they may be an invaluable source of information regarding the franchisor and its franchise system.

9. Operations Manuals. Prospective franchisees are encouraged to conduct a review of their franchisors' operations manuals if at all possible. Though a franchisor is not inclined to permit their prospective franchisees to conduct such a review before selling a franchise to the prospect (due to the proprietary information contained in the manuals), some franchisors will provide a very limited opportunity to their prospects to review the materials before they purchase the franchise. A cursory review may be useful to prospective franchisees as it may verify the level of expertise of the franchisor and the nature of their commitment to excellent franchising practices.

10. Other Due Diligence. If a franchisee is purchasing an existing franchised unit, it should engage a lawyer to conduct the necessary due diligence searches and to obtain the financial statements regarding the target unit. Searches customary on the purchase of a business are also typically recommended.

The above due diligence strategies represent some of the steps that a prospective franchisee should take when considering the purchase of a franchise. Conducting such research and analysis are vital prerequisites to achieving success when contemplating the purchase of a franchise.



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