

## Buying a franchise from an existing franchisee

By: Michael H. Seid and Kay Marie Ainsley Managing Directors,  
Michael H. Seid & Associates, LLC

Question: I have the opportunity to buy an existing franchise from the current owner who is a franchisee. How does buying an existing franchise differ from starting a new franchise?

There are some significant differences and potentially some advantages to buying an existing franchise instead of starting from scratch.

- It exists: Instead of starting out by looking for a location, building out the site, purchasing all of the necessary furniture, equipment and signage, finding vendors and buying inventory, looking for employees to hire and train, etc. etc. etc. – the business already exists.
- There's history: Since the business already exists, it has a reputation in the community and existing customers. You can see how much volume the business has done historically, how much income it has earned, better determine your working capital requirements, understand the location's seasonality and its operating trends.
- You know its cost: When buying an existing operation, the buyer purchases the business based upon a negotiated price that may be based upon its asset base, its cash flow or some other agreed upon terms or conditions. The information provided by the franchisor in their UFOC can only provide you, at best, an estimate of your costs to develop your new business.
- Return on Investment: With a new location, even with an experienced franchisor providing you with guidance and even with all of the research available – its still speculative. With a new location there is no history to rely upon.
- Easier to Finance: Banks like the fact that they can base their lending decisions not only on the reputation of the franchise system and your background but also on the performance of an operating location.

You still have to do your homework when purchasing an existing franchise. Even if the historic information looks solid, you need to dig for some more information.

- Find out why the franchisee is leaving the business.
- Find out if the staff and existing management will be staying. If you're counting on having a staff ready and trained, you need to be sure the staff will stay with you.
- Find out if the trends for the business are still as strong as the past history. Is the market drying up? Has the neighborhood started changing? Are their new competitors coming into the market that could affect future performance?
- Check out the location and the center your business is in. Is there new road construction that will impact your location? Will there be any changes in the anchor tenants in your retail center? Is the center's management changing? If it is, what is the reputation of your new landlord?

Make sure you look at the location as if you were starting fresh. After all, if the business has been on a decline for the past several months or years, there's no guarantee you'll be able to turn it around. Don't make the mistake of assuming that just because you think you'll work harder or smarter than the prior owner that you'll have better performance.

As a new franchisee you might expect to receive from the franchisor a copy of the disclosure document they give to other new franchisees. This may not be the case when you purchase an existing franchise and you are assuming an existing agreement without any modification. Since the agreement you will be signing is simply a transfer of the seller's agreement, the franchisor may not be required to provide you with a pre-sale disclosure.

However, if the franchise agreement the franchisor is offering you is different than the franchise agreement of the existing franchisee, you should expect to receive a copy of the franchisor's disclosure document. Read the new agreement and disclosure information carefully because it may contain fees and terms very different from the agreement signed by the seller of the business and these changes could have a major impact on your how much the business is really worth.

It is critical, as with all franchise transactions, that you make certain your attorney is familiar with the franchise rules. You should expect them to be able to provide you with guidance, and your Uncle Alex who did your house closing may not have the required working knowledge of the franchise rules. He may be less expensive but without sufficient knowledge, the reduced legal fee may prove to be very expensive to you later on.

Buying an existing franchise can be a great opportunity but remember you still have to do your homework before you make your purchase.