

Buying a Franchise – Due Diligence Checklist



So you have a signed Sale & Purchase Agreement and you now need to conduct a complete Due Diligence investigation of the business. This is when you find out as much as you can about the business before you make the final decision to purchase. We have set out below a check list of items which we recommend you consider during your due diligence period.

1. The Franchise

- a) Is the Franchisor the owner of the Intellectual Property relative to the System? if not then does the Franchisor have a licence to use the Intellectual Property? Does the Franchisor's licence last longer than the term of your Franchise Agreement? What happens if the Franchisor loses their licence?
- b) What experience do the directors of the Franchisor have in running a Franchise?
- c) Is this Franchisor a member of the Franchise Association of New Zealand Inc? If not do they have any intentions of becoming a member?
- d) Are there currently any legal issues involving the Franchisor or any of the Franchisees? Have there been in cases in the past involving the Franchisor or any Franchisees?
- e) Have you seen the Manual? Are you clear about what your obligations are under the Manual? Is the Manual comprehensive?
- f) Does the Franchisor require any refurbishment to the Premises or replacement of equipment? If not when are refurbishments are required? If so who is expected to pay for the refurbishments? And how much? If not then when are refurbishments expected to be required?
- g) Has the Franchisor provided you with a list of other Franchisees? Have you spoken with any other Franchisees to gauge their experience of the Franchise System as well as their experience of the Franchisor and the support they have received?
- h) Are you receiving funding for your purchase? If so, does the Bank require security over your assets? If so, is the Franchisor OK with this?
- i) Do you think you have, or can establish, a good relationship with the Franchisor? Remember that your success is their success, so developing a good working relationship with the Franchisor is beneficial for both of you?
- j) What training requirements are there? Where will the training be held? What does the training program consist of? You will usually be responsible for all travelling, accommodation and training costs?
- k) Does the length of the Franchise Agreement suit you? Do not rely on renewals of the Franchise Agreement as the basis for a profit in your investment as, for various reasons, you may not receive a renewal. Does the term match the terms of the lease?
- l) On what grounds can the Franchisor terminate the Franchise Agreement?

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- m) Does the Franchisor require you to use certain suppliers? Do you need to create accounts with those suppliers?
- n) Does the Franchisor supply product to you? If so have you seen the price list? Can the Franchisor increase the prices at their discretion?
- o) Does the Franchise Agreement contain restraints on your future trade once the Franchise Agreement is terminated, assigned or expired? Are those restraints reasonable and can you work within them?
- p) What insurance are required to take out under the Franchise Agreement?
- q) Do you have enough funds to purchase the business as well as fund operating costs?
- r) What happens if you do not proceed? What costs are you likely to incur – e.g refund of legal's.
- s) What are the on-going fees? What are the future renewal fees? What are the assignment fees if you were to sell the business (or can you not sell the business)? Are there any advertising fees?
- t) What happens if you are unable to continue trading from your Premises through no fault of your own?

2. Lease

- a) What is the current rent and outgoings? When are these next scheduled to be reviewed and/or increased? On what basis can the rent be reviewed? Are there any outstanding rent reviews?
- b) Are the premises described correctly?
- c) If the landlord owns other shops in the area, is there any restriction on the landlord leasing premises to competitors?
- d) Is the Franchise Business a permitted use under the lease? Will you require licences to operate?
- e) Have you visited the premises during trading hours? Are there any issues in the area outside business hours that could affect your business?
- f) Is there a local business group operating in the area?
- g) Have you obtained a LIM report for the premises? A LIM obtained by another party may provide you with the information; however you will have no legal recourse against the Council who provided it unless it is produced for you.
- h) Have you contacted the NZ Transport Agency about any plans for changes to the roads in the area?
- i) Will you require any variations to the lease, such as additional rights of renewal?
- j) Does any fit out of the Premises have council consent?
- k) What insurance do you require under the lease? What excess is payable by you in respect of insurance taken out by the landlord?
- l) Are there any advertising fees payable under the lease?
- m) Is there any current or future refurbishment requirements? What are these likely to cost?
- n) Who owns the fit out of the Premises? At the termination/expiry of the lease, who owns the fit out? Will there be a cost to you to remove the fit out?
- o) Are there provisions in the lease for a situation where the premises is undamaged but inaccessible? At what point can you terminate the lease if the Premises are damaged?
- p) What are the requirements of the lessor regarding personal guarantees or bank bonds?

3. Vendor

- a) Are there any securities in place over the vendor's assets? These should be removed (or there should be an undertaking that these are removed) prior to settlement.
- b) Is there a clear indication of which assets are included in your purchase?
- c) Has the vendor provided you with a list of customers? (when applicable)
- d) Is there a restraint of trade in the sale and purchase agreement? While there will most likely be one in the vendor's franchise agreement, you cannot rely on this as you are not a party to that agreement.
- e) Has the Vendor provided their financial accounts? Has your accountant reviewed those accounts?
- f) Have you inspected the Premises and equipment thoroughly, reporting back any issues during the due diligence period?

4. Staff

- a) Have you asked for, and received, a copy of each employee's file (including the employment contracts) currently in place?
- b) Have you interviewed the current staff?
- c) Is there a date by which you need to notify the vendor of which staff you wish to retain?
- d) Are there any requirements under the Employment Relations Act 2000 for you to retain staff?
- e) Which staff will you be employing? You will need to provide letters of offer and employment contracts after you go unconditional.
- f) If you need more staff – are you sure you will be able to hire them?

5. Financials

- a) Have you received all of the financial records of the business from the vendor?
- b) Have you engaged an accountant to assist you to understand the financials? We are happy to recommend accountants with franchise experience if you need a referral.
- c) Have you prepared a Business Plan?
- d) Does the purchase represent a good investment?

6. Assets

- a) Do you have a detailed list of all of the assets you will be purchasing?
- b) Have you conducted an inspection (or arrange third party inspections) of the assets to ensure they are in good working condition with no damage?
- c) Does the franchisor require you to purchase any additional assets?

7. Premises

- a) Are the premises in a good location? Is there lots of foot traffic?
- b) Are or will there be any competitors close by?
- c) Have you inspected the Premises? Are they structurally sound? Is any maintenance required? Eg is there any evidence of leaking or earthquake strengthening issues?
- d) Are there any Council proposals to the Premises or the adjacent Premises? We recommend you obtain a LIM Report.

- e) Make sure you inspect the Premises immediately prior to settlement.

8. You

- a) Not everyone is suited to own and operate a franchise. Are you ok with being told what to do and following rules?
- b) Will you enjoy the work? If the franchise system involves networking and seeking out clients – are you comfortable with doing this?
- c) While a good franchise system will provide you with comprehensive initial training it is still important that you have some knowledge about owning and operating a business – do you have this knowledge?
- d) Do you have a good idea of what hours you will be required to work in the business? Are you OK with this?
- e) Are there any restrictions on you operating another business now and in the future? What effect will this have on you?

This checklist is not designed to be a comprehensive list of all issues you need to consider when conducting a due diligence investigation and should not be relied upon as such. Your professional advisers will be able to provide you with further information.

We can help!

Please contact us if you need any assistance with the above. We'd love to help you.



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