

investing in YOUR FUTURE

WITH MARKET CONDITIONS IMPROVING, IS IT TIME TO COMMIT TO THE FUTURE? DANIEL CLOETE OF WESTPAC LOOKS AT HOW TO FUND ANY INVESTMENT



⇒ Over the last 18 months, with confidence low and some industries struggling with reduced sales, many people have been reluctant to commit to business ventures. Conditions meant that they (and their accountants and bankers) were looking a lot more closely at economic fundamentals and brought new realism to the markets.

However, there is increasingly good news for potential business buyers or investors. The prices of existing businesses are now a lot lower for similar earnings, rents tend to be a lot more realistic, suitable sites are more available and interest rates are at a historic low (although they will probably start to trend higher before long). Accordingly, with all the major share markets showing significant gains in the last calendar year and market sentiments showing signs of turning more positive, this may be a good time to look at investing in that business you have been contemplating.

FUNDING OPPORTUNITIES

Once you've identified the particular opportunities that you are interested in and done proper due diligence with the help of specialists (see *the Directory on page 93*), you need to consider how best to fund the investment. Despite all the scare stories and the very real credit crunch, good, profitable franchise businesses can still find funding. The Australasian banks have been in a relatively strong position throughout the downturn and are well able to support lending that makes business sense.

In fact, Westpac actually increased its business lending last year.

To work out whether to offer funding or not, a bank will look at the same issues that you should consider with your accountant. The primary ones are: debt servicing ability, equity and security, along with other factors such as brand equity, site, rent, etc. These are detailed in the *Westpac Guide to Franchising* (call 0800 177 007 for a free copy) but let's look here at those first three factors in more detail.

DEBT SERVICING ABILITY

This is the most important aspect to understand because it is the primary factor the bank will look at. The debt servicing ability measures the amount that the business can afford to repay on a regular basis without undue stress. For most franchisees, this measure would also need to take into account the ability to service any personal debt, as well as the fact that the owner will want a decent salary and return on their investment on top. With interest rates relatively low at the moment, higher debt may be affordable but you will want a safety margin in the event of rate rises in the future.

Another factor to consider is that the typical business loan runs over a relatively short term of three to five years. This means that capital repayments are pretty aggressive when compared to a loan secured against property, where repayments are over 25 years or more and interest rates tend to be lower. For example, on a loan of \$100,000, repayments of

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capital and interest could vary from as little as \$900 per month up to \$3250 depending on the term and security involved. How you structure your funding can therefore make a massive difference to cash flow and affordability.

If the business cash flow can't support the debt repayments, the result will inevitably be increasing debt and ultimately failure. You'd be surprised how many people get into this position, so don't let it happen to you – take advice from a specialist franchise banker when setting up the business.

EQUITY AND SECURITY

Typically, a franchisee will fund their business through a combination of cash and lending. While part of the lending may be secured against the assets and cash flow of the business, they can also borrow up to 100% of the requirement by using their equity in property or other assets as security. Banks are not equity partners and do not share in the owner's risk (or returns), so they need a reasonable indication of how the debt will be repaid.

As a franchise specialist, a question that I get all the time is, 'How much will you lend against the business itself?' This is the wrong approach, as the real question should be, 'What can the business afford?' This depends on the factors outlined above, and when these aspects are factored in, the potential profitability of the business will answer the question. Remember to consider any tax implications in making the calculations: your bank would not want you to be unsuccessful at running the business because of being over-g geared.

The bank will look at how much money you are prepared to put in yourself, the security offered, your financial record of accomplishment and business acumen, and any other relevant factors. They will also look closely at any figures and cash flow projections. In certain exceptional cases with well-known, proven systems, they may also do some debenture lending or cashflow lending where the equipment or stock lends itself to that approach. This can reduce the total security required. Because of the many variables involved, this will be judged on a case-by-case basis.

With proven systems and well-known applicants, the perceived risks are lower and the loan requirements would be more relaxed. This is another reason for you to deal with a franchise banker who should have specialist knowledge about the franchise systems in which you are interested. Involve your banker in the decision-making process on the amount required and the mix of lending, and you should achieve the best financial solution for your needs. The good news is that funding is definitely available for profitable businesses or new franchises with robust and proven business models. ■

- Your bank values your business and wants to make it as easy as possible to obtain finance, especially in the current environment.
- Familiarise yourself with the process and information required to obtain finance. This will help you to ask the right questions when buying a franchise and save a lot of time and effort.
- The information that is required to process a finance application is the same information that you will use yourself to assess the viability of the business opportunity and your involvement in it.
- In obtaining finance you are entering into a long-term financial relationship with your franchise banker built on trust. This makes it important to the bank to look after your interests.
- You should also look at the services, transactional packages and added value that your bank offers over the longer term. You are in this together for the long haul and informed relationship banking can make a huge difference to the success of your business.

ABOUT THE AUTHOR

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