

Starting Your Own Franchise Business



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Table of Contents

Introduction	3
Business Success Cycle	5
What is a franchise?	7
What kind of person should consider owning a franchise?	7
What are some advantages of franchise ownership ?.....	8
What are some disadvantages of buying franchise?.....	9
What is the cost of buying a franchise?.....	9
What are the steps to finding the right franchise?	11
How is a franchise financed?	12
A Few Statistics.....	15
A Consumer Guide to Buying a Franchise	18
The Benefits and Responsibilities of Franchise Ownership.....	18
The Cost.....	20
Controls.....	20
Terminations and Renewal.....	21
Before Selecting a Franchise System	21
Shopping at a Franchise Exposition	25
Investigating Franchise Offerings.....	27
Additional Sources of Information.....	34
About The Author	37

Introduction

Franchising is rapidly becoming the primary method of delivering goods and services in the United States. It has been called the “wave of the future”, and is expected by analysts to be the leading way of doing business in the next century. By the year 2000 it was estimated that:

- there were in excess of 534,000 individual franchise units in the U.S.
- franchise businesses accounted for over \$1 trillion in sales
- 3.2% of all businesses and 1/3 of all retail businesses in the U.S. were franchises
- more than 8 million people were employed in franchising
- franchising accounted for over 40% of all U.S. retail sales
- franchise systems controlled over 35% of combined retail and service revenue in the U.S.

Franchise owners are not entrepreneurs in the traditional sense because they do not "invent" or create a business. A franchise owner buys a tested and proven business system and has the support of a franchisor who, like the franchisee, has a vested interest in the success of the franchise. For this reason, the probability of business failure is much lower for a franchise than for an independent small business. It has been said that a franchise owner is in business "for himself, but not by himself "

Franchise owners are self-employed and bear the responsibility for the success or failure of their business. They must deal with the many problems and responsibilities inherent with business ownership, including the risk of financial failure. For this reason, most franchise owners work extremely long hours, especially in the early years of their business. In one survey, over 80% of franchise owners said they worked more hours in their business than they expected. It is not uncommon for franchise owners to report working between 60 and 80 hours per week. In spite of the long hours and challenges associated with business ownership, more than two-thirds of franchise owners express a higher level of overall satisfaction as an owner of a franchise than with previous jobs held or previous businesses owned. Only slightly more than half of surveyed franchise owners expressed satisfaction with the level of profits they had attained.

For individuals with the right combination of motivation, confidence and management ability, owning a franchise can be a rewarding and profitable career. These benefits must be balanced against the financial risk, long working hours associated with business ownership, stress put on families, and the inherent challenges created for engaging in meaningful levels of Church and community service.

What is a franchise?

Franchising is a method of delivering retail products or services by which the owner of a product, service, or business method (the franchisor) distributes through affiliates (franchisees). The franchisees normally pay to the franchisor a one-time franchise fee, plus periodic royalties based on a percentage of sales. There may be additional expenses or fees. In many cases, the franchisor concurrently operates additional business units, which are owned by the company.

The franchisee has the right, by legal contract, to the marketing, logo and business system of the franchisor, and is obligated to deliver the product in a manner proscribed by the franchisor. The objective is for the product to be uniformly delivered by all franchisees. For example, anywhere in the United States, a McDonald's hamburger, in theory, tastes the same, is priced about the same, and is delivered by people that are dressed the same and work in a restaurant that looks the same as any other McDonald's in the country. In almost all franchise systems, the franchisee owns the assets of his/her business, but has chosen to invest in someone else's brand and operating system and ongoing support.

Other franchisees and company-operated units, where they exist, are not a franchise's competition; in fact, the opposite is true. Sister franchises share the task of establishing the brand as the dominant brand in all markets entered and reinforcing the customers' familiarity with and trust in the brand. So in this respect, franchises are "teamMates" with others in the system. All franchisees share the responsibility for quality, consistency, convenience, and other factors that define the franchise and insure repeat business for everyone. Increasing the value of the brand name is a shared responsibility of the franchisor and franchisees.

What kind of person should consider owning a franchise?

Often thought of as the business opportunity for persons with an "entrepreneurial" bent, a true entrepreneur would be a poor candidate for owning a franchise. Listed below are a few of the characteristics that are generally agreed upon as attributes of a good candidate for franchising:

1. Able to work within a business system and accept direction from others, a "team player".
2. Possesses management skills. Can manage other people, and has some business savvy.
3. Willing to work hard. Must be self-motivated. Owning a franchise is not the same as "buying a job".

4. Willing to work long hours, especially in the beginning.
5. Able to make quick decisions, usually without consulting with anyone.
6. Willing to take financial risk.
7. Has a supportive family (especially spouse).
8. Well organized.
9. Confident, motivated and enthusiastic.

Anyone considering investing in a franchise should undertake a process of self-examination in order to make an informed business decision about whether franchising meets their needs. Basic questions must be asked, such as: What do I want from my career at this time? What are my wants, needs, and desires? What are my goals, objectives, and dreams? Have I decided to leave what I am now doing—not just the job, but the profession? Am I comfortable becoming part of another organization? Can I work within someone else’s business system? Do I have a personality that can accept running a business according to someone else’s plan without feeling that it compromises my individuality? Do I have an interest in doing this kind of work for the length of a contractual agreement? Have I ever worked for one company for five or ten years? Do I have related skills, knowledge, abilities, and work-related experiences similar to the ones required for running the franchise? Do I have the financial resources to open and operate the business successfully? Can the business support my lifestyle needs?

What are some advantages of franchise ownership vs. starting a business?

1. Reduced risk. A Department of Commerce study showed that 92% of franchised businesses are still operating after five years as compared to 23% of independent small businesses. Although experts disagree about the statistical probability and definition of success in small businesses, there is a strong consensus of opinion that there is much lower risk of failure in buying a franchise vs. starting an independent business.
2. Proven business format. In theory, the franchisor has already succeeded in developing a highly successful business that is merely duplicated by the franchisee. The Small Business Administration says most businesses fail from lack of management skills. With a franchise, many avoidable business mistakes have been worked out of the system through experience of the franchisor and other franchise owners.
3. Uniform system of operation. Because franchises all look the same and are run the same way, each franchise enjoys the benefits of mass purchasing power (keeping costs lower), brand identification and customer loyalty.
4. Advertising. Each franchise benefits from the franchiser’s national advertising campaign, although this may come at a cost.

5. **Training.** All franchisors provide training to new franchisees. Training helps the franchisee understand the proven business format and method and helps them get started. It is also essential in establishing the uniform system of operation. This training is one of the things that enable inexperienced people to buy and successfully operate a franchise.
6. **Franchise network.** Other franchisees in the franchise family are usually helpful and are interested in the success of their “sister” franchises. Everyone in the system benefits from the success and quality of other franchises.
7. **Brand awareness.** It can take years for a business to successfully build a well recognized brand that helps drive sales and provides a competitive advantage over smaller competitors. Brand awareness can make or break a business. Consumers buy things that they are familiar with and work with companies they know and trust. Mobile American consumers have come to depend on and appreciate the consistent quality of franchised products and services. Today, no matter where they go, people expect and want the same quality, which is why consumers so often stop at franchised establishments. The ability to easily recognize a franchised store, restaurant or hotel from the outside improves the likelihood that there will be no surprises or disappointments on the inside.

What are some disadvantages of buying franchise?

1. **Risk.** Although the likelihood of a business failure is lower for a franchise than for an independent small business, there is substantial financial risk.
2. **Long hours.** It is common for franchise owners to work 60-80 hours per week, especially in the early years of the franchise. This schedule would likely put great stress on marriages, families, and would limit a person’s ability to serve in the Church and be involved in the community.
3. **The buck stops with you.** Although the franchisor will provide support in certain areas, you are in business for yourself, and must be willing and able to make quick decisions.
4. **Loss of independence.** A person who likes to make business decisions alone may struggle in the framework of a franchise. A franchise owner must comply with the controls and procedures established by the franchisor. Of course, those who are not by nature “independent” as both necessary and helpful may view these controls and procedures.

What is the cost of buying a franchise?

The cost of buying a franchise varies widely with the type of franchise. It can be as little as a few thousand or as much as several million dollars.

In exchange for obtaining the right to use the franchisor's name and its assistance, the investor may pay some or all of the following fees.

1. Initial franchise fee and other expenses. The initial franchise fee, which may be nonrefundable, may cost several thousand to several hundred thousand dollars. There may also be significant costs to rent, build, and equip an outlet and to purchase initial inventory. Other costs include operating licenses and insurance. Some franchisors also require payment of a "grand opening" fee to the franchisor to promote a new outlet.
2. Continuing royalty payments. Most franchisors pay the franchisor royalties based on a percentage of weekly or monthly gross income. These royalties may be required even if the outlet has not earned significant income during that time. In addition, royalties usually are paid for the right to use the franchisor's name. Even if the franchisor fails to provide promised support services, the franchisee may have to pay royalties for the duration of the franchise agreement.
3. Advertising fees. Some franchisees have to pay into an advertising fund. Some portion of the advertising fees may go for national advertising or to attract new franchise owners, but not to target a particular outlet.

What are the steps to finding the right franchise?

Prior to investigating specific franchise opportunities, basic questions must be answered. For example, do I want a home-based business? Am I willing to work weekends and evenings? Is there a specific industry that I want to work in? Would I prefer a product or service business? Must I have a franchise with low start-up costs? The answers to these and other basic questions lead to a more in-depth analysis of a few specific franchise opportunities.

The detailed search should be a careful and deliberate process. Making the right decision regarding which franchise to own---finding the right fit---is the most important step in franchise ownership. Critical steps include:

- 1. Enlist the help of professional advisors. Your advisors should include a CPA and a franchise attorney. This step should not be overlooked in an effort hold down costs.**
- 2. Study the Uniform Franchise Offering Circular (UFOC). The UFOC is a document that must be provided, by law, to potential franchisees before a contract can be signed. The UFOC provides much information including fees, litigation history, bankruptcy history, estimated initial investment cost, territorial rights, etc.**
- 3. Interview franchisees already within the system. Talk too as many as possible. They will be the best source of information about the franchise because they will have real life experience with the franchisor and the system. . Ask them if they would do it again. How long did it take them to recoup their investment? How much money are they making? Does the operating system work? Are they provided with good marketing programs? Do the franchisees get along well with each other and with the franchisor? What are the major problems with the business? Do they use all of the operating system? Is the franchisor's ongoing support adequate and helpful?**
- 4. Interview franchisors. If possible, meet the CEO, the CFO, and the people that support franchisees. Try to meet people in the organization that are not in sales or marketing.**
- 5. Evaluate the legal documents from a business perspective. Determine whether the franchisor has territory policies that might make franchisees less competitive in a highly competitive environment.**
- 6. Look for a franchisor that can communicate a strategy for increasing market share. If a franchisor cannot talk about these issues, it is entirely possible the franchisor is using franchising as a way to generate franchise fees and royalty revenue rather than to establish a competitive position in the marketplace.**
- 7. Evaluate the marketing/advertising fee.**

8. **Determine if the franchisor sponsors Franchise Advisory Council, and try to determine its effectiveness.**
9. **Be sure you can answer the question “How will I make money in this business?” There should be a very simple answer to this question. It will not violate earnings claims restrictions for the franchisor to answer it because you are not asking “How much money will I make?” You simply want to know how money is made in the business**
10. **Evaluate the Franchisor’s Business Plan. The franchisor should have a business plan for the system that covers at least the length of the agreement you are being asked to commit to. Ask for the plan for the market where you are going to locate the operation. Ask for their analysis of the competition. Ask how many units are being planned for your area and why that many. Why not more, why not less? Ask how much is going to be spent on marketing in your area.**
11. **Ask to receive a full explanation of the initial and subsequent training programs. Ask how people are trained. Is it classroom or hands-on practice? Are there case studies and discussions or is it straight lecture?**
12. **Ask for a full explanation of the pre-opening assistance offered by the franchisor. Understand any help franchisors give for site selection and lease negotiation. Be clear about what ongoing support the franchisor provides to the franchisees.**

How is a franchise financed?

The cost of getting started with a franchise can range from a few thousand dollars for some simple home-based businesses to several million dollars.

Sources of capital include:

1. Personal savings
2. Loans from family and friends
3. Bank loans, including SBA loans
4. Equity investors
5. Franchisor financing

The amount of capital required will dictate the type of financing, the source and the information required in a loan proposal.

Before obtaining financing, it will be necessary to develop a detailed business plan. A CPA can assist with this step. A Business Plan is essentially a financial plan and analysis, focusing on why money is needed, how it will be used and how it can be repaid. This is a fitness start-ups since it common knowledge, especially

among lenders and investors, that many new businesses fail because they “run out of money.” The Business Plan is usually a highly stylized presentation with numerous spreadsheets and exhibits. Additionally, it includes the franchisor’s vision, philosophy, operating procedures, experiences and knowledge of factors in the local marketplace.

The franchise type will have a very significant impact on a Business Plan. For example, a single unit 1200 square foot retail outlet franchise plan will be considerably easier to prepare than a franchise hotel development. In some cases franchisors provide their franchisees with business plan formats on disks with blanks to fill in for a specific franchisee situation.

In those rare cases where a franchise startup is completely self-funded without the need for outside financing, a Business Plan should still be written for the benefit of yourself, spouse and family, advisors (CPA and attorney), suppliers, regulators and the franchisor. Reasons for writing the Business Plan, other than for fund raising, include:

- Decision confirmation
- Self direction and controls
- Timetable
- Basis for reality checks
- Confidence builder
- Basis for timely assistance solicitation
- As a reference when obtaining input in areas of non expertise
- Basis for results measurements and evaluation
- Control business development
- Cash flow projections
- Ball out signals

Bank financing falls into three main categories: short term loans, operating lines of credit and intermediate term loans. Many lenders provide federally guaranteed loan programs for small businesses through the Small Business Administration (SBA).

- 1 . Short-Term Loans - Ordinarily, franchisees use short-term loans for a specified purpose, and lenders expect that the loan will be repaid at the end of the project. For example, a seasonal business may borrow capital to build inventory in preparation for the peak season; when the season comes to a close, the lender expects to be repaid immediately. Similarly, a short-term loan could cover a period when the company’s customers or clients are in arrears; when the accounts receivable are collected, the bank must be repaid. Short-term loans are usually made in the form of a

promissory note payable on demand. The promissory note may be secured by the inventory or accounts receivable, which the loan is designed to cover, or it may be unsecured, under which status no collateral is required. Short-term loans are an excellent means of establishing a relationship with a bank and demonstrating creditworthiness.

2. **Operating Lines of Credit**-A line of credit consists of a specific amount of capital, which is made available to the borrower on an “as needed” basis over a specified period of time. A line of credit may be short-term (60 to 120 days) or intermediate term (one to three years), renewable or nonrenewable, and at a fixed or fluctuating rate of interest. Prospective franchisees should be especially careful to negotiate ceilings on interest rates; to avoid excessive commitment, processing, application, and related “up-front” fees; and to ensure that repayment schedules will not cause undue strain on the operation of the franchise. Franchisees should also ensure that obligations to make payments against the line of credit are consistent with anticipated cash-flow projections.
3. **Intermediate-Term Loans**- An intermediate-term loan is usually provided over a three to five year period for the purposes of acquiring equipment, fixtures, furniture, and supplies or for expanding existing facilities, for acquiring another business, or for working capital. It is likely that virtually all start-up franchisees will need to secure this type of financing for the construction and opening of the franchised business. If real estate is to be purchased for the site of the franchised business, however, long-term financing may also be necessary.

The intermediate-term loan is almost always secured not only by the assets being purchased with the loan proceeds but also by other assets of the franchisee, such as inventory, accounts receivable, equipment, and real estate that may be available to serve as security. The intermediate-term loan will usually call for a loan agreement, which typically includes restrictive covenants that govern the operation and management of the franchise during the term of the loan. These restrictive covenants are designed to protect the interests of the lender and ensure that all payments are made on a timely basis, before any dividends, employee bonuses or non-critical expenses are paid.

Non-Bank financing options include: **Trade Credit**-The use of credit with key suppliers is often a means of survival for franchisees, especially in retail businesses. When a company establishes a good credit rating with its suppliers but as a result of rapid growth tends to require resources faster than it is able to pay for them, trade credit becomes the only way that growth can be sustained. A key supplier has a real economic incentive for helping a loyal customer grow and prosper and, therefore, may be more willing to negotiate credit terms that are acceptable to both parties.

Equipment Leasing-Many start-up franchisees are desperately in need of the use but not necessarily the ownership of certain key resources to fuel and maintain growth. Therefore, equipment leasing offers an alternative to ownership of the asset. Monthly lease payments are made in lieu of debt-service payments. Many forms of equipment leasing, such as operating leases, are generally shorter in term and include re-pair and maintenance services; capital leases, generally longer in term, do not include ancillary services and virtually transfer ownership to the lessee, due in part to the attractive terms of the option to purchase the asset at the end of the lease term.

Miscellaneous Sources of Nonbank Debt Financing-Debt securities, such as bonds, notes, and debentures may be offered by start-up franchisees to venture capitalists, private investors, friends, family, employees, insurance companies, and appropriate financial institutions. Many franchisees turn to traditional sources of consumer credit, such as home equity loans, credit cards, and commercial finance companies to finance the growth of their business

A Few Statistics

In 1997 Gallup surveyed 1001 randomly selected franchise owners from across the United States, and reported the following:

- 92% of franchise owners said they were either very or somewhat successful.
- 83% said they were either more satisfied or had the same level of satisfaction compared to involvement in other jobs or businesses.
- 65% said they would purchase the same franchise again.
- Average annual gross income was reported as \$91,630*
- 28% reported annual gross income between \$50,000 and \$100,000*

***There are dozens of variables that impact income and profitability of a franchise, e.g., amount invested, number of years in business, type of franchise, location, etc. Statistics reporting average income and income ranges should not be relied upon to project profitability for a prospective franchise owner.**

Trends

Growth in franchising is expected in such industries as health care and elderly care, personal well-being, education and training, home and business-to-business services, specialty retailing, technology industries and anything related to the baby-boomer generation.

Resources

Dozens of books on franchising are available. Most are written from the perspective of the franchisee, and attempt to give a step-by-step guide to individuals who are seriously considering franchising as a career. Some of the best include:

Achieving Wealth Through Franchising by Robert T. Justis and William Vincent Adams Media, 2001

Tips and Traps When Buying a Franchise by Mary E. Tomzack McGraw Hill, 1999

Opportunities in Franchising Careers by Kent Banning VGM Career Horizons, 1996

The International Franchising Association, a trade association of franchisors, publishes a semi-annual guide called Franchise Opportunities Guide.

Countless articles have been written on the topic, and there are many websites devoted to promoting and providing information about franchising. A few of the best are:

<http://www.franchising.org/com/>

<http://www.startupjournal.com/>

<http://www.franchiseexperts.com/update.com/>

<http://www.franchise-update.com/>

<http://www.franchiseinfomall.com/franchiseadvantage.com/>

<http://www.franchiseadvantage.com/>

Additionally, every company in the franchise business sponsors its own website.

Terminology

Franchisor - The parent company that grants, for a fee and other considerations, the right to use its name and system of business operations.

Franchise - Agreement-A written contract detailing the mutual responsibilities of franchisors and franchisees. It is usually for a several-year term, and when the term is up, the contract expires and must be renewed. Some state laws require the contract to be renewable at the franchisee's option. Usually

a franchise agreement may not be sold, transferred, or otherwise assigned without the franchisor's permission.

Franchise Fee - An up-front entry fee, usually payable upon the signing of the contract (franchise agreement) for the right to use the franchisor's name, logo, and business system. Often, the franchise fee is also the consideration paid for initial training, site selection, operations manuals, and other help given by the franchisor before the opening of the business. Franchise fees can be amortized over the life of the franchise agreement.

Royalty - A continuing payment to the franchisor that is payable on a periodic basis (usually weekly, biweekly, or monthly) throughout the term of the franchise agreement. In theory this royalty payment is for:

Compensation for the continuing services given by the franchisor (for training, field services, etc.)

Payback financing of the true market value of the franchise. Royalty payments can be either fixed amounts, based on percentage of gross sales, or based on a sliding scale, with graduated breakpoints.

Advertising Fun - Another continuing periodic payment to the franchisor that, like the royalty payment, can be a fixed amount or a percentage of gross sales.

Estimated Initial Investment - A detailed listing of all fees and expenses you can expect to incur in starting your franchised business. This listing represents the total dollar amount that you would need to pay or get financing for, including fees paid to the franchisor; estimates for furniture, fixtures and equipment; opening inventory; real-estate costs; insurance inventory; etc. This estimate should include a provision for working capital through the start-up phase.

Uniform Franchise Offering Circular (UFOC)-Federal -Trade Commission enacted a Rule in 1979 requiring the franchisor to give a written prospectus to prospective franchisees (see 10-day and 5-day Rules). The prospectus prescribed by the FTC is called the Uniform Franchise Offering Circular or UFOC. The UFOC contains explicit items of information related to the franchise, including the franchisor's background; important provisions of the franchise agreement; amount and terms of the franchise fee (Item 5) and royalty and advertising-fund fee (Item 6); estimated start-up costs (Item 7); details on existing franchisees; the franchisor/franchisee relationship; audited financial statements for the last three fiscal years; and copies of all contracts that will be used.

10-day and 5-day Rules - If you meet with a franchisor (or a representative of the franchisor) at a sales or other meeting held to discuss the sale or possible sale

of the franchise, the franchisor or the franchisor's representative must give you a complete copy of their UFOC. If you do not have a face-to-face meeting with the franchisor (everything is done by mail, for example) they are still required to give you a complete copy of their UFOC at least 10 business days before any contract is signed or any money changes hands (the 10-day Rule). And you must be given a separate contract, with all blanks or negotiated parts completed (except signatures) at least five business days before any contract is signed or any money changes hands (the 5-day Rule).

The Federal Trade Commission

A Consumer Guide to Buying a Franchise

Introduction

Many people dream of being an entrepreneur. By purchasing a franchise, you often can sell goods and services that have instant name recognition and can obtain training and ongoing support to help you succeed. But be cautious. Like any investment, purchasing a franchise is not a guarantee of success.

The Benefits and Responsibilities of Franchise Ownership

To help you evaluate whether owning a franchise is right for you, the Federal Trade Commission has prepared this booklet. It will help you understand your obligations as a franchise owner, how to shop for franchise opportunities, and how to ask the right questions before you invest. A franchise typically enables you, the investor or "franchisee," to operate a business. By paying a franchise fee, which may cost several thousand dollars, you are given a format or system developed by the company ("franchisor"), the right to use the franchisor's name for a limited time, and assistance. For example, the franchisor may help you find a location for your outlet; provide initial training and an operating manual; and advise you on management, marketing, or personnel. Some franchisors offer ongoing support such as monthly newsletters, a toll free 800-telephone number for technical assistance, and periodic workshops or seminars. While buying a franchise may reduce your investment risk by enabling you to associate with an established company, it can be costly. You also may be required to relinquish significant control over your business, while taking on contractual obligations with the

franchisor. Below is an outline of several components of a typical franchise system. Consider each carefully.

The Cost

In exchange for obtaining the right to use the franchisor's name and its assistance, you may pay some or all of the following fees.

- *initial franchise fee and other expenses.* Your initial franchise fee, which may be non-refundable, may cost several thousand to several hundred thousand dollars. You may also incur significant costs to rent, build, and equip an outlet and to purchase initial inventory. Other costs include operating licenses and insurance. You also may be required to pay a "grand opening" fee to the franchisor to promote your new outlet.
- *continuing royalty payments.* You may have to pay the franchisor royalties based on a percentage of your weekly or monthly gross income. You often must pay royalties even if your outlet has not earned significant income during that time. In addition, royalties usually are paid for the right to use the franchisor's name. So even if the franchisor fails to provide promised support services, you still may have to pay royalties for the duration of your franchise agreement.
- *advertising fees.* You may have to pay into an advertising fund. Some portion of the advertising fees may go for national advertising or to attract new franchise owners, but not to target your particular outlet.

Controls

To ensure uniformity, franchisors typically control how franchisees conduct business. These controls may significantly restrict your ability to exercise your own business judgment. The following are typical examples of such controls.

- *site approval.* Many franchisors pre-approve sites for outlets. This may increase the likelihood that your outlet will attract customers. The franchisor, however, may not approve the site you want.
- *design or appearance standards.* Franchisors may impose design or appearance standards to ensure customers receive the same quality of goods and services in each outlet. Some franchisors require periodic renovations or seasonal design changes. Complying with these standards may increase your costs.
- *restrictions on goods and services offered for sale.* Franchisors may restrict the goods and services offered for sale. For example, as a restaurant franchise owner, you may not be able to add to your menu popular items or delete

items that are unpopular. Similarly, as an automobile transmission repair franchise owner, you might not be able to perform other types of automotive work, such as brake or electrical system repairs.

- *restrictions on method of operation.* Franchisors may require you to operate in a particular manner. The franchisor might require you to operate during certain hours, use only pre-approved signs, employee uniforms, and advertisements, or abide by certain accounting or bookkeeping procedures. These restrictions may impede you from operating your outlet as you deem best. The franchisor also may require you to purchase supplies only from an approved supplier, even if you can buy similar goods elsewhere at a lower cost.
- *restrictions of sales area.* Franchisors may limit your business to a specific territory. While these territorial restrictions may ensure that other franchisees will not compete with you for the same customers, they could impede your ability to open additional outlets or move to a more profitable location.

Terminations and Renewal

You can lose the right to your franchise if you breach the franchise contract. In addition, the franchise contract is for a limited time; there is no guarantee that you will be able to renew it.

- *franchise terminations.* A franchisor can end your franchise agreement if, for example, you fail to pay royalties or abide by performance standards and sales restrictions. If your franchise is terminated, you may lose your investment.
- *renewals.* Franchise agreements typically run for 15 to 20 years. After that time, the franchisor may decline to renew your contract. Also be aware that renewals need not provide the original terms and conditions. The franchisor may raise the royalty payments, or impose new design standards and sales restrictions. Your previous territory may be reduced, possibly resulting in more competition from company-owned outlets or other franchisees.

Before Selecting a Franchise System

Before investing in a particular franchise system, carefully consider how much money you have to invest, your abilities, and your goals. The following checklist may help you make your decision. **Your Investment**

- How much money do you have to invest?
- How much money can you afford to lose?
- Will you purchase the franchise by yourself or with partners?
- Will you need financing and, if so, where can you obtain it?
- Do you have a favorable credit rating?
- Do you have savings or additional income to live on while starting your franchise?

Your Abilities

- Does the franchise require technical experience or relevant education, such as auto repair, home and office decorating, or tax preparation?
- What skills do you have? Do you have computer, bookkeeping, or other technical skills?
- What specialized knowledge or talents can you bring to a business?
- Have you ever owned or managed a business?

Your Goals

- What are your goals?
- Do you require a specific level of annual income?
- Are you interested in pursuing a particular field?
- Are you interested in retail sales or performing a service?
- How many hours are you willing to work?
- Do you want to operate the business yourself or hire a manager?
- Will franchise ownership be your primary source of income or will it supplement your current income?
- Would you be happy operating the business for the next 20 years?
- Would you like to own several outlets or only one?

Selecting a Franchise

Like any other investment, purchasing a franchise is a risk. When selecting a franchise, carefully consider a number of factors, such as the demand for the products or services, likely competition, the franchisor's background, and the level of support you will receive.

Demand

Is there a demand for the franchisor's products or services in your community? Is the demand seasonal? For example, lawn and garden care or swimming pool maintenance may be profitable only in the spring or summer. Is there likely to be a continuing demand for the products or services in the future? Is the demand likely to be temporary, such as selling a fad food item? Does the product or

service generate repeat business?

Competition

What is the level of competition, nationally and in your community? How many franchised and company-owned outlets does the franchisor have in your area? How many competing companies sell the same or similar products or services? Are these competing companies well established, with wide name recognition in your community? Do they offer the same goods and services at the same or lower price?

Your Ability to Operate the Business

Sometimes, franchise systems fall. Will you be able to operate your outlet even if the franchisor goes out of business? Will you need the franchisor's ongoing training, advertising, or other assistance to succeed? Will you have access to the same or other suppliers? Could you conduct the business alone if you must lay off personnel to cut costs?

Name Recognition

A primary reason for purchasing a franchise is the right to associate with the company's name. The more widely recognized the name, the more likely it will draw customers who know its products or services. Therefore, before purchasing a franchise, consider:

- The company's name and how widely recognized it has a registered trademark.
- How long the franchisor has been in operation.
- If the company has a reputation for quality products or services.
- If consumers have filed complaints against the franchise with the Better Business Bureau or a local consumer protection agency.

Training and Support Services

Another reason for purchasing a franchise is to obtain support from the franchisor. What training and ongoing support does the franchisor provide? How does their training compare with the training for typical workers in the industry? Could you compete with others who have more formal training? What backgrounds do the current franchise owners have? Do they have prior technical backgrounds or special training that helps them succeed. Do you have a similar background?

Franchisor's Experience

Many franchisors operate well-established companies with years of experience both in selling goods or services and in managing a franchise system. Some franchisors started by operating their own business. There is no guarantee, however, that a successful entrepreneur can successfully manage a franchise system.

Carefully consider how long the franchisor has managed a franchise system. Do you feel comfortable with the franchisor's expertise? If franchisors have little experience in managing a chain of franchises, their promises of guidance, training, and other support may be unreliable.

Growth

A growing franchise system increases the franchisor's name recognition and may enable you to attract customers. Growth alone does not ensure successful franchisees; a company that grows too quickly may not be able to support its franchisees with all the promised support services. Make sure the franchisor has sufficient financial assets and staff to support the franchisees.

Shopping at a Franchise Exposition

Attending a franchise exposition allows you to view and compare a variety of franchise possibilities. Keep in mind that exhibitors at the exposition primarily want to sell their franchise systems. Be cautious of salespersons that are interested in selling a franchise that you are not interested in. Before you attend, research what type of franchise best suits your investment limitations, experience, and goals. When you attend, comparison shop for the opportunity that best suits your needs and ask questions.

Know How Much You Can Invest

An exhibitor may tell you how much you can afford to invest or that you can't afford to pass up this opportunity. Before beginning to explore investment options, consider the amount you feel comfortable investing and the maximum amount you can afford.

Know What Type of Business is Right for You

An exhibitor may attempt to convince you that an opportunity is perfect for you. Only you can make that determination. Consider the industry that interests you before selecting a specific franchise system. Ask yourself the following questions:

- Have you considered working in that industry before?
- Can you see yourself engaged in that line of work for the next twenty years?

Do you have the necessary background or skills?

If the industry does not appeal to you or you are not suited to work in that industry, do not allow an exhibitor to convince you otherwise. Spend your time focusing on those industries that offer a more realistic opportunity.

Comparison Shop

Visit several franchise exhibitors engaged in the type of industry that appeals to you. Listen to the exhibitors' presentations and discussions with other interested consumers. Get answers to the following questions:

- How long has the franchisor been in business?
- How many franchised outlets currently exist? Where are they located?
- How much is the initial franchise fee and any additional start-up costs? Are there any continuing royalty payments? How much?
- What management, technical, and ongoing assistance does the franchisor offer?
- What controls does the franchisor impose?"

Exhibitors may offer you prizes, free samples, or free dinners if you attend a promotional meeting later that day or over the next week to discuss the franchise in greater detail. Do not feel compelled to attend. Rather, consider these meetings as one way to acquire more information and to ask additional questions. Be prepared to walk away from any promotion if the franchise does not suit your needs.

Get Substantiation for Any Earnings Representations

Some franchisors may tell you how much you can earn if you invest in their franchise system or how current franchisees in their system are performing. Be careful, The FTC requires that franchisors that make such claims provide you with written substantiation. This is explained in more detail in the section "Investigating Franchise Offers." Make sure you ask for and obtain written substantiation for any income projections, or income or profit claims. If the franchisor does not have the required substantiation, or refuses to provide it to you, consider its claims to be suspect.

Take Notes

It may be difficult to remember each franchise exhibit. Bring a pad and pen to take notes. Get promotional literature that you can review. Take the exhibitors' business cards so you can contact them later with any additional questions.

Avoid High Pressure Sales Tactics

You may be told that the franchisor's offering is limited, that there is only one territory left, or that this is a one-time reduced franchise sales price. Do not feel pressured to make any commitment. Legitimate franchisors expect you to comparison shop and to investigate their offering. A good deal today should be available tomorrow.

Study the Franchisor's Offering

Do not sign any contract or make any payment until you have the opportunity to investigate the franchisor's offering thoroughly. As will be explained further in the next section, the FTC's Franchise Rule requires the franchisor to provide you with a disclosure document containing important information about the franchise system. Study the disclosure document. Take time to speak with current and former franchisees about their experiences. Because investing in a franchise can entail a significant investment, you should have an attorney review the disclosure document and franchise contract and have an accountant review the company's financial disclosures.

Investigating Franchise Offerings

Before investing in any franchise system, be sure to get a copy of the franchisor's disclosure document. Sometimes this document is called a Franchise Offering Circular. Under the FTC's Franchise Rule, you must receive the document at least 10 business days before you are asked to sign any contract or pay any money to the franchisor. You should read the entire disclosure document. Make sure you understand all of the provisions. The following outline will help you to understand key provisions of typical disclosure documents. It also will help you ask questions about the disclosures. Get a clarification or answer to your concerns before you invest.

Business Background

The disclosure document identifies the executives of the franchise system and describes their prior experience. Consider not only their general business background, but their experience in managing a franchise system. Also consider how long they have been with the company. Investing with an inexperienced franchisor may be riskier than investing with an experienced one.

Litigation History

The disclosure document helps you assess the background of the franchisor and its executives by requiring the disclosure of prior litigation. The disclosure document tells you if the franchisor, or any of its executive officers, has been convicted of felonies involving, for example, fraud, any violation of franchise law or unfair or deceptive practices law, or are subject to any state or federal injunctions involving similar misconduct. It also will tell you if the franchisor, or any of its executives, has been held liable or settled a civil action involving the franchise relationship. A number of claims against the franchisor may indicate that it has not performed according to its agreements, or, at the very least, that franchisees have been dissatisfied with the franchisor's performance. Be aware that some franchisors may try to conceal an executive's litigation history by removing the individual's name from their disclosure documents.

Bankruptcy

The disclosure document tells you if the franchisor or any of its executives have recently been involved in a bankruptcy. This will help you to assess the franchisor's financial stability and general business acumen and predict if the company is financially capable of delivering promised support services.

Costs

The disclosure document tells you the costs involved to start one of the company's franchises. It will describe any initial deposit or franchise fee, which may be non-refundable, and costs for initial inventory, signs, equipment, leases, or rentals. Be aware that there may be other undisclosed costs. The following checklist will help you ask about potential costs to you as a franchisee.

- Continuing royalty payments.
- Advertising payments, both to local and national advertising funds.
- Grand opening or other initial business promotions.
- Business or operating licenses.
- Product or service supply costs.
- Real estate and leasehold improvements.
- Discretionary equipment such as a computer system or business alarm system.
- Training.
- Legal fees.
- Financial and accounting advice.
- Insurance.
- Compliance with local ordinances, such as zoning, waste removal, and fire and other safety codes.

- Health insurance.
- Employee salaries and benefits.

It may take several months or longer to get your business started. Consider in your total cost estimate operating expenses for the first year and personal living expenses for up to two years. Compare your estimates with what other franchisees have paid and with competing franchise systems. Perhaps you can get a better deal with another franchisor. An accountant can help you to evaluate this information.

Restrictions

Your franchisor may restrict how you operate your outlet. The disclosure document tells you if the franchisor limits:

- The supplier of goods from whom you may purchase.
- The goods or services you may offer for sale.
- The customers to whom you can offer goods or services.
- The territory in which you can sell goods or services.

Understand that restrictions such as these may significantly limit your ability to exercise your own business judgment in operating your outlet.

Terminations

The disclosure document tells you the conditions under which the franchisor may terminate your franchise and your obligations to the franchisor after termination. It also tells you the conditions under which you can renew, sell, or assign your franchise to other parties.

Training and Other Assistance

The disclosure document will explain the franchisor's training and assistance program. Make sure you understand the level of training offered. The following checklist will help you ask the right questions.

- How many employees are eligible for training?
- Can new employees receive training and, if so, is there any additional cost?
- How long are the training sessions?
- How much time is spent on technical training, business management training, and marketing?
- Who teaches the training courses and what are their qualifications?
- What type of ongoing training does the company offer and at what cost?
- Whom can you speak to if problems arise?

- How many support personnel are assigned to your area?
- How many franchisees will the support personnel service?
- Will someone be available to come to your franchised outlet to provide more individual assistance?

The level of training you need depends on your own business experience and knowledge of the franchisor's goods and services. Keep in mind that a primary reason for investing in the franchise, as opposed to starting your own business, is training and assistance. If you have doubts that the training might be insufficient to handle day-to-day business operations, consider another franchise opportunity more suited to your background.

Advertising

You often must contribute a percentage of your income to an advertising fund even if you disagree with how these funds are used. The disclosure document provides information on advertising costs. The following checklist will help you assess whether the franchisor's advertising will benefit you.

- How much of the advertising fund is spent on administrative costs?
- Are there other expenses paid from the advertising fund?
- Do franchisees have any control over how the advertising dollars are spent?
- What advertising promotions has the company already engaged in?
- What advertising developments are expected in the near future?
- How much of the fund is spent on national advertising?
- How much of the fund is spent on advertising in your area?
- How much of the fund is spent on selling more franchises?
- Do all franchisees contribute equally to the advertising fund?
- Do you need the franchisor's consent to conduct your own advertising?
- Are there rebates or advertising contribution discounts if you conduct your own advertising?
- Does the franchisor receive any commissions or rebates when it places advertisements? Do franchisees benefit from such commissions or rebates, or does the franchisor profit from them?

Current and Former Franchisees

The disclosure document provides important information about current and former franchisees. Determine how many franchises are currently operating. A large number of franchisees in your area may mean increased competition. Pay attention to the number of terminated franchisees. A large number of terminated,

cancelled, or non-renewed franchises may indicate problems. Be aware that some companies may try to conceal the number of failed franchisees by repurchasing failed outlets and then listing them as company-owned outlets.

If you buy an existing outlet, ask the franchisor how many owners operated that outlet and over what period of time. A number of different owners over a short period of time may indicate that the location is not a profitable one, or that the franchisor has not supported that outlet with promised services.

The disclosure document gives you the names and addresses of current franchisees and franchisees who have left the system within the last year. Speaking with current and former franchisees is probably the most reliable way to verify the franchisor's claims. Visit or phone as many of the current and former franchisees as possible. Ask them about their experiences. See for yourself the volume and type of business being done.

The following checklist will help you ask current and former franchisees such questions as:

- How long has the franchisee operated the franchise?
- Where is the franchise located?
- What was their total investment?
- Were there any hidden or unexpected costs?
- How long did it take them to cover operating costs and earn a reasonable income?
- Are they satisfied with the cost, delivery, and quality of the goods or services sold?
- What were their backgrounds prior to becoming a franchisee?
- Was the franchisor's training adequate?
- What ongoing assistance does the franchisor provide?
- Are they satisfied with the franchisor's advertising program?
- Does the franchisor fulfill its contractual obligations?
- Would the franchisee invest in another outlet?
- Would the franchisee recommend the investment to someone with your goals, income requirements, and background?

Be aware that some franchisors may give you a separate reference list of selected franchisees to contact. Be careful. Those on the list may be individuals who are paid by the franchisor to give a good opinion of the company.

Earnings Potential

You may want to know how much money you can make if you invest in a particular franchise system. Be careful. Earnings projections can be misleading.

Insist upon written substantiation for any earnings projections or suggestions about your potential income or sales.

Franchisors are not required to make earnings claims, but if they do, the FTC's Franchise Rule requires franchisors to have a reasonable basis for these claims and to provide you with a document that substantiates them. This substantiation includes the bases and assumptions upon which these claims are made. Make sure you get and review the earnings claims document. Consider the following in reviewing any earnings claims.

Sample Size. A franchisor may claim that franchisees in its system earned, for example, \$50,000 last year. This claim may be deceptive, however, if only a few franchisees earned that income and it does not represent the typical earnings of franchisees. Ask how many franchisees were included in the number.

Average Incomes. A franchisor may claim that the franchisees in its system earn an average income of, for example, \$75,000 a year. Average figures like this tell you very little about how each individual franchisee performs. Remember, a few, very successful franchisees can inflate the average. An average figure may make the overall franchise system look more successful than it actually is.

Gross Sales. Some franchisors provide figures for the gross sales revenues of their franchisees. These figures, however, do not tell you anything about the franchisees' actual costs or profits. An outlet with a high gross sales revenue on paper actually may be losing money because of high overhead, rent, and other expenses.

Net Profits. Franchisors often do not have data on net profits of their franchisees. If you do receive net profit statements, ask whether they provide information about company-owned outlets. Company-owned outlets might have lower costs because they can buy equipment, inventory, and other items in larger quantities, or may own, rather than lease their property.

Geographic Relevance. Earnings may vary in different parts of the country. An ice cream store franchise in a southern state, such as Florida, may expect to earn more income than a similar franchise in a northern state, such as Minnesota. If you hear that a franchisee earned a particular income, ask where that franchisee is located.

Franchisee's Background. Keep in mind that franchisees have varying levels of skills and educational backgrounds. Franchisees with advanced technical or business backgrounds can succeed in instances where more typical franchisees cannot. The success of some franchisees is no guarantee that you will be equally successful.

Financial History

The disclosure document provides you with important information about the company's financial status, including audited financial statements. Be aware that investing in a financially unstable franchisor is a significant risk; the company may go out of business or into bankruptcy after you have invested your money.

Hire a lawyer or an accountant to review the franchisor's financial statements. Do not attempt to extract this important information from the disclosure document unless you have considerable background in these matters. Your lawyer or accountant can help you understand the following.

- Does the franchisor have steady growth?
- Does the franchisor have a growth plan?
- Does the franchisor make most of its income from the sale of franchises or from continuing royalties?
- Does the franchisor devote sufficient funds to support its franchise system?

Additional Sources of Information

Before you invest in a franchise system, investigate the franchisor thoroughly. In addition to reading the company's disclosure document and speaking with current and former franchisees, you should speak with the following:

Lawyer and Accountant

Investing in a franchise is costly. An accountant can help you understand the company's financial statements, develop a business plan, and assess any earnings projections and the assumptions upon which they are based. An accountant can help you pick a franchise system that is best suited to your investment resources and your goals.

Franchise contracts are usually long and complex. A contract problem that arises after you have signed the contract may be impossible or very expensive to fix. A lawyer will help you to understand your obligations under the contract, so you will not be surprised later. Choose a lawyer who is experienced in franchise matters. It is best to rely upon your own lawyer or accountant, rather than those of the franchisor.

Banks and Other Financial Institutions

These organizations may provide an unbiased view of the franchise opportunity you are considering. Your banker should be able to get a Dun and Bradstreet report or similar reports on the franchisor.

Better Business Bureau

Check with the local Better Business Bureau (BBB) in the cities where the franchisor has its headquarters. Ask if any consumers have complained about the company's products, services, or personnel.

Government Departments

Several states regulate the sale of franchises. Check with your state Division of Securities or Office of Attorney General for more information about your rights as a franchise owner in your state.

Federal Trade Commission (FTC)

The FTC publishes other information that may be of interest to you, including business guides like Getting Business Credit and Buying by Phone.

About The Author

Harold Carey Jr. first entered the computer field in 1977. He has over 20 years experience in computer and business consulting, multimedia, technical writing, teaching, editing, typesetting, and publishing books.

In 1990 Harold worked as a contract consultant to develop a multimedia software program for the [Orange County Department of Education](#) on the [State of California](#) "Anti-Drug Gang Violence" campaign. He also has conducted computer-training class for hundreds of [Coca-Cola](#) and McDonnell Douglas, (now [Boeing](#)) employees.

In 1996 Harold left **BYU** to start his own [Internet Company](#). Within two years he created and was managing and maintaining over 65 web sites. Some of his first [web sites](#) were for the [Daily Herald newspaper](#), (one of the first online newspapers), [American Home Business Association](#), [Moxtek](#), [1-800-Contacts](#), and [Learn2.com](#) (Yahoo most informative site of 1997).

In 1998 he contracted with [Utah Valley State College](#) to do its first [online Internet courses](#). He designed and created the **Electronic Campus** and the courses Introduction to Algebra, Foundations in Algebra, and Biology.

He served as a web site consultant for [Utah Governor Michael O. Leavitt's](#) successful re-election campaign (*michaelleavitt2000.com*) and his [Muhammad Ali Sports web site](#) was featured in a [Microsoft commercial](#) "Heroes on the Internet."

He has been interviewed in [newspapers](#), on the radio and on [television](#). Harold is the author of hundreds of articles and numerous books, including "[Utah Job Guide](#)," "Starting Your Own Business," "How to earn income on the Internet," and "Earning a Living with Online Auctions."

Harold is currently an **Internet Marketing and Business Consultant** helping small and home-based businesses to effectively market their good or services. He has helped numerous Internet-only and brick-and-mortar businesses succeed in their offices and online, as well as helping larger businesses to effectively use the web to reduce costs and save both time and money.

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