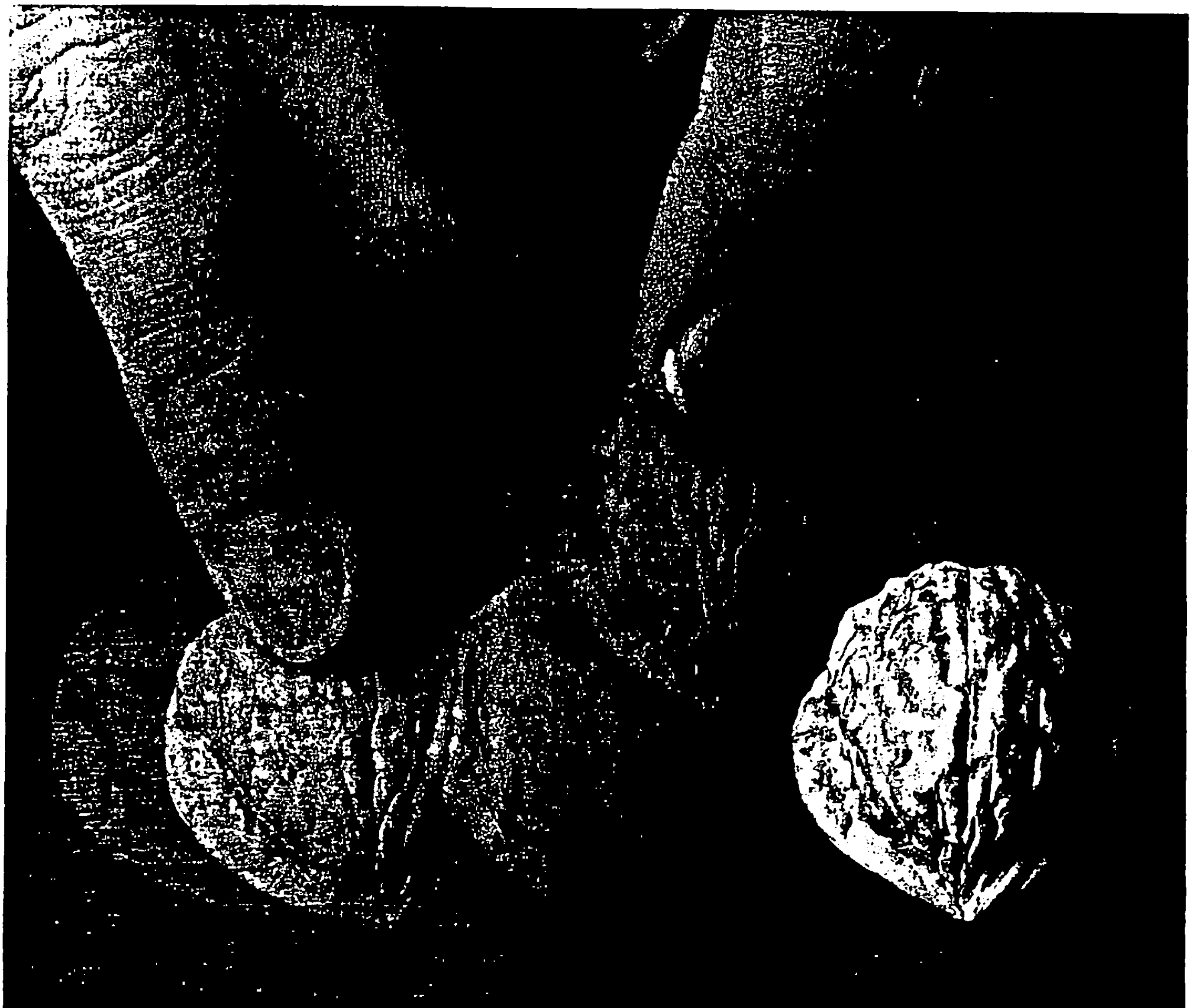
Scammed!

By Andrew A. Caffey



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You may think you've uncovered a golden opportunity, but keep your eye on the company selling you this dream business . . . or you could come up empty.

"It didn't work out quite the way we planned," says Michael Messuri.

That's an understatement. In fact, Messuri calls his franchise experience a "horrifying nightmare" that cost him more than $90,000. As a result, he has filed suit in federal court against his franchisor.

James and Wendi Ferguson puchased a business opportunity featuring countertop video poker machines and learned some lessons the hard way. The couple, who invested about $15,000 in the venture, are now joining other plaintiffs in a suit against the seller to recover what money they can.

For all the success stories you read, for all the statistics quoted by various authorities, and for all the enticing advertising you see about exciting business opportunity and franchise ventures, there is, and always has been, another side of the story. On that other side are embittered, disillusioned investors who purchased programs from scam artists and unworthy organizations. They tell of their former naivete and of their slow realization that they'd been hoodwinked in their investments and cleverly separated from their money.

Even in the most heavily regulated and litigious country on earth, investors must exercise prudence in all forms of business investment. Too many would-be entrepreneurs get an unpleasant surprise *after* they invest their money, when their problems could have been avoided with a little care, diligence and common sense in the beginning.

On the following pages, disappointed investors recount the lessons they learned from their experiences, and reveal what they would have done to protect themselves if they knew then what they know now.

The Franchise From Hell

"Like most people looking to buy a business, I wanted to share in the American dream," says Michael Messuri of Manassas, Virginia. "My wife, Mary, and I spent a lot of time researching the types of businesses that would fit our needs. We knew from my experience in the convenience store industry that we did not want to own a 24-hour-a-day operation. We liked the looks of a retail ice cream business because it features a pre-made product that takes minimal attention on the retailer's part—just scoop it up and sell it. Of course, I now wish we had put as much energy into selecting the franchisor as we did into selecting the type of business we wanted.

"We ran into what I now realize were classic high-pressure sales tactics. The franchisor told us there were other investors lining up to buy franchise rights in the part of the city we were interested in, and I believed them. Due to that pressure to buy, we really shortchanged ourselves in the investigation phase of our purchase.

"The franchisor also pulled other tricks. For example, they showed us a sales projection chart and told us we could expect $500,000 in annual sales at the location we were considering. They suggested we talk to some handpicked franchise owners, so we called them, and they painted an incredibly rosy picture of their experiences. I now suspect they were paid by the franchisor to say what they did.

"Looking back on the experience, I realize how gullible I was. I asked the franchisor what I thought were the right questions. I asked to see the company's disclosure document and was told by the president that the business was not required by law to have a disclosure document because it was a 'private company.' I believed him, because he was so believable. This guy was a piece of work, and very slick. I asked him for the company's financial statements and received some sort of mock-up of a financial balance—totally fabricated.

"After I signed the franchise agreement and paid the $30,000 fee, things changed almost immediately. The franchisor gave me a tremendous amount of attention right up to the point I signed the agreement—

but once they had my money, the franchisor was nowhere to be found. My wife and I opened the store that was licensed to us, and enjoyed the business for a few months, but we were so unsophisticated in business, we didn't realize we were losing money from the start.

"We would have a $20,000 sales month and feel pretty good. It was so exhilarating to touch that much money—we had never made that kind of cash before. It didn't sink in for a while that it was all going out in expenses before it even got warm in our hands. It turns out our rent was way out of line, and the cost of the ice cream product we were required to buy was about twice what it should have been. There were also some serious problems with the product packaging that shortchanged the franchisee.

"We finally changed the name of our [store] and sued the franchisor for our losses, but we are still struggling under the lease for the store. I don't know whether we are going to survive in this location."

What would he do to protect himself were he to do it all over again? Messuri is succinct and to the point: "First, spend the time and money to thoroughly check out the franchisor. I'm sorry we didn't put more time into researching the company before buying a franchise. Hire an attorney to really 'debug' the offering papers and see what's there. Don't just call other franchise owners on the telephone; get in the car and go see their operations for yourself. It's like buying a house—you shouldn't buy the first one you see. And remember, the salesperson on the other side of the table is out to sell to you; he's not necessarily looking out for your interests."

Another entrepreneur who bought an ice cream franchise from the same company had similar experiences, and he adds additional thoughts to Messuri's advice:

"Look at the numbers involved in your prospective business extremely carefully, and read every word of the disclosure document," says Martin Miller, a former franchisee in Richmond, Virginia. "I also suggest asking tough questions when talking about the investment with your attorney. Too many attorneys will tell you only that the contract has the standard provisions in it. You have got to push beyond that.

"When talking to other franchise owners, you should ask detailed questions about debt levels, how they are financed, and what level of cash flow their business generates," Miller says. "Ask how hard they work at the business, how many hours a week they put in, and what the bottom line is. Ask what frustrates them, what they like about the business, and how the franchisor performs when they need help. My mistake was being too polite to ask the hard questions that would have been really helpful in evaluating the investment."

The Business Opportunity That Wasn't

Wendi and James Ferguson of Champaign, Illinois, were successful entrepreneurs and real estate investors when they started thinking about diversifying. They scanned the business advertisements looking for a part-time business that would offer them a reasonable return on the cash they were prepared to invest. "We called in response to several of the business opportunity advertisements in our local papers and were most impressed by a company selling video poker vending machines for placement in local lounges," says Wendi, 28. "We were very skeptical in the beginning, but the company seemed to have the answers to all our questions."

"We were told that these machines were terrific moneymakers and that our investment would be returned within 15 to 18 months," says James, 31. "Our initial investment purchased five machines for $15,500, which included a fee to a vending machine placement company. We were promised—in writing, no less—that the machines would be placed in five establishments in our town—'top locations.' We were also told that the machines were insurable. We flew across the country to see the company and close the transaction. That was on a Friday. We were told we had three days to change our minds, including the weekend days that were gone by the time we returned home."

"Before the sale was made, they had every answer to our questions," says Wendi. "After they had our money, no one would return our calls. The placement company couldn't even find locations for the machines in our town; our area was a 'terrible location,' they told us, because some other vending machine company had already sewn up all the better locations. After the first few weeks, we knew we'd been scammed."

Things went downhill from there. "Four of the five machines were located in a town 30 miles away and they generated about one-tenth of the projections we'd been given," says Wendi. "Insurance, it turns out, is prohibitively expensive, and bar owners do not want the machines included under their umbrella policies—our investment was very vulnerable to damage done at their locations. One machine was never placed and to this day graces our dining room. Two of the machines are now broken, and we don't want to throw good money after bad to fix them."

What advice can the Fergusons give other investors? "The one step we wish we had taken was to call the Better Business Bureau," says Wendi. "If we had seen its report on this company, we probably would not have gone ahead with the investment because several complaints had been lodged.

"The company should have offered us a disclosure document, but we didn't ask for one—we didn't know that was our right. We also should have pressed the company for the names of route owners. They gave us three names and no more, claiming some vague reasons they couldn't give us any more information. We received a glowing report from the three people we called—they must have been paid to give those reports, or they just lucked into a profitable situation. We're glad we visited the headquarters; that was the right move, but we were taken in anyway. My advice is to move cautiously."

"If I'd Only Known . . . "

The advice these disappointed investors offer applies to virtually any business investment, and can be reduced to the following key points:

1

Don't part with your money easily. Investigate the deal thoroughly and be fully informed.

2

Ask for a disclosure document. Read it carefully and ask questions. If you don't get a disclosure document, ask why. Not all business opportunity sellers are required to provide disclosures, but all franchisors are (there are a few narrow exceptions, check with your lawyer).

3

Talk to other investors. Meet at least three investors of your own choosing. A classic scam technique is to present shills as investors. Ask for a list and pick your own business owners to interview. Ask them how much money they are making at the business and whether they would make the same investment knowing what they know now.

4

Do your homework. Remember the three rules of self-protection in your investment and business life: investigate, investigate, investigate. Don't rely solely on promotional pieces or sales talk from company representatives. Look hard for objective information sources. Check the Better Business Bureau and industry groups where this company may be a member. State enforcement agencies, especially in states with franchise and business opportunity statutes, are good sources of information.

5

Be realistic. Counter the natural tendency to dream about the unlimited success that may come with an exciting entrepreneurial venture. This is no way to make a significant business decision that involves a big cash investment. Decide with your head, not just your heart.

Don't focus solely on the product and its potential, but determine your role in selling the idea. Will you enjoy this business? Will you be good at it? Do you have enough time? Can you afford to buy this business opportunity and not succeed? How long can you hold on financially if this business is slow getting off the ground?

If you don't think you can handle the rejection that comes with making cold calls, don't buy a business that requires it. If you are not comfortable selling to your friends, don't buy into a program that depends on personal contacts to make sales. Narrow down the industries you're interested in before you start connecting with sales representatives at trade shows or calling for information.

6

Resist high-pressure tactics. Never allow yourself to be rushed into a decision. Despite what you may be told by sales representatives, the price is not really about to go up, the territory is not about to be sold out, and it doesn't matter if the salesperson is leaving town on Monday afternoon. There is no real reason to feel pressured to buy right away. Recognize these statements as old and well-worn high-pressure sales tactics, designed to play on a buyer's excitement and enthusiasm and create a feeling of anxiety. Don't be taken in; take your sweet time. Remember, the seller is far more motivated to sell you this investment than you are to make it.

7

Negotiate! Ask for a lower price, or suggest structuring your payments to fit your needs. It never hurts to ask. Do not be impressed by "rules," "policies," printed price lists and other arbitrary hurdles. Remember the negotiator's strength: Always be prepared to walk away from the deal.

8

Get professional advice. The larger the investment, the more important it is to seek the advice of legal and accounting professionals.

9

Take any complaints to your seller first. Most sellers want satisfied customers. If you have trouble, take the problem to the seller—in writing—before you approach the Better Business Bureau or other organizations.

10

Arm yourself with information. For a detailed discussion of business opportunities and franchising, including a digest of the state business opportunity and franchise laws that protect investors, send $13.95 to National Business Opportunity Services, P.O. Box 6271, Washington, DC 20015-0271, and request a copy of *The Business Opportunity/Franchise Buyer's Guide.* ■

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