Just the FAQs

Got questions about researching and buying a franchise or a business opportunity? We've got answers.

Andrew A. Caffey | June 1, 2003

URL: http://www.entrepreneur.com/article/62234

Q: I'm not sure what my next career move should be, but I have always dreamed of owning my own business. Can a franchise or business opportunity help me get there?

A: You're not alone looking for help with entrepreneurial solutions in your career plans. Tens of thousands of people every year take a good look at purchasing a franchised business or the smaller, do-it-yourself packages known as business opportunities. The two concepts are similar only to the extent that they both help the buyer get into business.

A franchised business grants you the right to operate under an established trademark, using a proven system of business, and to have an ongoing relationship with your franchisor. Yes, you pay fees for the use of the trademark and the services--usually an upfront initial franchise fee and then ongoing monthly or weekly royalties measured as a small percentage of your gross sales. Franchisors, at least the good ones, provide you with full training before you open and continuing support as you meet the challenges of the business.

Franchising is the well-established legal structure behind the worldwide explosion of American fast food, with famous brands like McDonald's, Subway and Holiday Inn leading the parade. It's not limited to fast food, of course; franchising as a distribution method has popped up in many different industry categories.

Need a road map before you start your search for the perfect franchise or business opportunity? You can find them in our **how-to center**.

A business opportunity, on the other hand, is a one-time shot: a package of materials needed to start a business, usually with no trademark or supportive continuing relationship with the seller, but also with no royalty fees to pay. Most business opportunities, if we can generalize about this varied concept, are packaged sales programs, inviting the buyer to sell goods bought presumably at wholesale. They include everything from a string of vending machines (you name the product) to selling advertising on the Internet to retailing a specialty product from a shopping mall kiosk.

Start your search for the right franchise or business opportunity by getting introspective: Decide what you really like to do with your time and energy. Assess your resources so you know what you can afford, and then begin your quest.

Q: What steps can I take to avoid--or at least reduce--the financial risk of buying a franchise or business opportunity?

A: There will always be financial risk in business; some say that's what makes it so exciting. Franchising often presents a business package that has been tested and found successful in the marketplace, a trademark that is well-known, training for the business neophyte and ongoing assistance. Does a franchise reduce the financial risk of going into business simply because it is a franchise? Probably not--at least you should never assume that's the case.

A business opportunity may be less risky, because it tends to involve a smaller initial purchase price than a franchise. Even at the lower purchase levels, however, you must be prepared to lose your entire purchase price when buying a business opportunity.

There is really only one way to reduce financial risk with a franchise or business opportunity investment, and that is research. Your goal by the time you commit to the purchase should be to know as much as possible about the business and the people in that business. You should take a number of steps in this research phase, including carefully reviewing the information given to you by the seller, contacting regulatory agencies in your state, meeting with the existing owners, and consulting with your own professional advisors.

Business Opportunities vs. Franchises

Q: I've heard franchising is heavily regulated, but that it's a different case for business opportunities. Is that so, and how are they different?

A: Yes, the government has inserted itself into the franchise and business opportunity arena. As with your car, the safety features mandated by the government help but don't completely protect you in the event of an accident. You have to buckle up to protect yourself.

In 1979, the FTC adopted a set of rules all American companies must follow when selling a franchise or business opportunity. Before the sale, they must deliver a document to a prospective franchisee or business opportunity buyer, including a prescribed list of information that tells the investor who the seller is and what the buyer will receive for the investment. Go to the FTC's Web sitefor basic information about the disclosures you can expect to receive.

This requirement is far more developed and more widely applicable for franchise sales than for business opportunity sales. If you purchase a franchise in the United States, you will, with very few exceptions, receive a completed disclosure document. This document follows a demanding disclosure format developed by state regulators, called the Uniform Franchise Offering Circular (UFOC). If you buy a business opportunity, you may or may not receive a disclosure statement, depending on your state's laws.

Too Much Information?

Disclosure is just the beginning of the long list of regulations franchisors must follow. In some states, they must register their franchise offerings before they can run an ad in the state or attempt to offer their programs. The states requiring franchise registration are: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington and Wisconsin.

There are nearly twice as many states regulating sales of business opportunities. The 26 states that regulate these sales are: Alabama, Alaska, California, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Michigan, Minnesota, Nebraska, New Hampshire, North Carolina, Ohio, Oklahoma, South Carolina, South Dakota, Texas, Utah, Virginia and Washington. Even though so many states are involved, the regulation of business opportunity sales is spotty. The statutes are all different in the scope of their application and the requirements imposed on the sellers.

Q: Is researching a business opportunity investment the same as researching a franchise?

A: Not really. With a franchise, you can be sure of receiving a disclosure document, and that makes a huge difference in the task of researching. For example, most business opportunity sellers do not maintain a continuing relationship with their buyers, so they may not be able to give you a full list of buyers you can contact. If you receive a franchise UFOC, however, you will find such a list in Item 20, showing at least 100 franchisees in the system (or all franchisees, if there are less than 100).

However, the due-diligence process, whether it's for a franchise or a business opportunity, is the same. Check with state agencies and the Better Business Bureaufor complaints or problems. Read all materials carefully so you know what's being offered, ask the sales representative questions (and then ask more questions), visit the company's headquarters, and meet as many company executives as possible.

Q: I want to narrow down my choices of a franchise to buy and was planning on attending a franchise/business opportunity trade show. Is the effort to go in person really worth it, or, with today's technology, can I just get most of the same information online?

A: The Internet is a fabulous source of information, but the ratio of breathless hype to factual information is way too high. By all means, visit the sites of companies that interest you (start with www.franchise.organd Entrepreneur.com), but don't skip that franchise and business opportunity trade show. There is nothing to compare with face-to-face conversations.

UFOCs and Getting Outside Opinions

Q: I just received a UFOC from the franchise I'm interested in buying, and I'm a little overwhelmed by all the information. Which items are most important to me? What specific information should I keep an eye out for?

A: There are 23 separate chapters plus exhibits in the UFOC format, and you should take the time to read the entire document. According to state and federal regulations, it must be written in plain English, so it's not quite as bad as reading a dense insurance policy. Here are some important sections and the red flags to watch for:

- **Item 3 (Litigation):** Don't expect a clean slate here; even the best franchisors carry the scars of our overly litigious society and must disclose certain cases against them for a period of 10 years. If the number of cases disclosed seems excessive, ask the company and the franchisees about the company's dispute resolution style.
- **Item 7 (Initial Investment):** This chart shows what you can expect to pay to get started in the franchised business you have chosen.

- **Item 8 (Restrictions on Sources of Products and Services):** This section is important because it may have a dramatic financial impact on your ongoing business operations. Make sure you understand these restrictions.
- **Item 12 (Territory):** Are your territory rights truly "exclusive"? Can the franchisor sell competing products to customers in your territory over the Internet? How near to you can the company establish another unit? Read this item carefully.
- **Item 19 (Earnings Claims):** Franchisors are allowed to reveal performance information about their franchised units, as long as it is disclosed in Item 19. If the information is limited in any way, you'll find the limitations described in a footnote. Don't read this section with stars in your eyes; check out real-world earnings by discussing it with existing store owners.
- **Item 20 (List of Outlets):** This item contains snapshots of the national franchise system, listing names, addresses and phone numbers not only of current franchisees, but also of those franchisees who have left the system for any reason in the past year. Call and visit as many as you can.
- **Item 21 (Financial Statements) and Item 22 (Contracts):** You will find up to three years of the franchisor's audited financial statements in Item 21. Review these with the help of an experienced accountant. Also, plan to go over the sample franchise agreement and other contracts in Item 22 with your attorney.

Q: I would love to talk to some people who have purchased one of these businesses and have already been through this experience. How do I approach them, and what would they feel comfortable discussing?

A: You'll find that most people love to talk about their business, especially with someone facing the same business decision they once made. Talking to franchisees is probably your best source of unvarnished information about the program. Find a quiet time to discuss the owner's experience, and ask about the training they received, the support provided by the franchisor, what they like and don't like about the business, and what the business grossed in the past year. Finally, ask them if, knowing what they know today, they would make the same investment decision again.

Q: I have never used the services of a lawyer, and frankly, the whole idea intimidates me. All I know about lawyers is that they are expensive. When do I need to hire a lawyer? Whom do I hire and how? What about an accountant?

A: Every small business, with rare exception, needs the assistance of an accountant and an attorney. The franchise and business opportunity purchase is a complicated transaction, and it's easy to get caught up in the excitement of a new business venture and lose sight of your own best interests. A good professional accountant and an attorney can help you early in the decision-making process. As soon as you close in on a program you want to pursue, it's time to locate and engage your professional team. Ask current franchisees or your friends in business whom they use. Sure, professional fees may seem expensive, but it may be the best insurance money you've ever spent. It can help you avoid even more expensive mistakes.

Andrew A. Caffey is an attorney in the Washington, DC, area and is the author of Franchises & Business Opportunities: How to Find, Buy and Operate a Successful Business *(Entrepreneur Press).*