

WORLD *Of* OPPORTUNITY

Understanding the ins and outs of franchises
and business opportunities

BY ANDREW A. CAFFEY

FRANCHISING HAS REACHED most corners of the commercial world. Its extraordinary international expansion in the past decade has flourished on the strength of its basic business genius: a joint business venture where an owner/operator receives the trade identity and support of a resourceful franchisor, as well as the use of its proven business operating system. When franchising is working well, both parties benefit. The franchisor expands through the capital investments of others and receives a steady stream of royalty income; the franchisee operates a profitable business venture at a lower risk level than he or she would face alone. Franchising has created more millionaires than any other business expansion concept in history.

Although franchising is the most well-known type of business package investment, others are making slow but steady headway in the international marketplace as investors look for smaller, more affordable homebased businesses. What do these other programs have to offer individual investors, and how are they different from franchising? Most of all, what do you need to know to make the right investment decision?

FRANCHISE PERSPECTIVE

Although the laws of a number of countries now regulate the sale of "franchises," the concept does not enjoy a universally understood definition. Even in the birthplace of franchising, the United States, the various jurisdictions that regulate franchise sales have each adopted their own legal definitions of the concept.

However, there are three fundamental business and legal concepts that comprise a franchise which are virtually universal. A franchise exists when a franchisor: 1) licenses to a franchisee a trademark that identifies the franchisee's business or the products distributed by the franchisee, 2) prescribes a marketing plan or provides

assistance or control in the franchisee's business operation, and 3) requires the franchisee to pay a fee for the right to participate in the program. All three elements must be present to constitute a franchise; if one is missing, the investment is not a true franchise.

The business concepts underlying the franchise relationship are even less sharply defined. A business format franchise is a continuing commercial relationship in which the franchisor conveys know-how and a proven business concept (the "business format") to the franchisee. In return, franchisees invest their own capital to build and operate the business using the franchisor's trademarks.

Investors who purchase franchise programs need protection from franchisors, at least in the opinion of a number of government agencies around the world—notably the United States, Brazil, Australia and France, and most recently the Russian Federation and Spain. More accurately, prospective franchisees need protection from making uninformed business investments.

Most governments regulating franchise sales require franchisors to deliver key information about the investment, the business system being licensed, and the company's background. The pre-sale disclosure document is designed to ensure all the necessary information is available and to equip the purchaser, at least in theory, with the information necessary to make an informed business decision.

VARIATIONS ON A THEME

Retail franchises are typically a fairly expensive way to go. If you can't afford one, however, there is good news: Other, more affordable business package programs are gaining ground in the international marketplace. These include business opportunities, multilevel marketing programs and straight product distributorships. Each of these programs allows you to begin a small business, usually from your home and

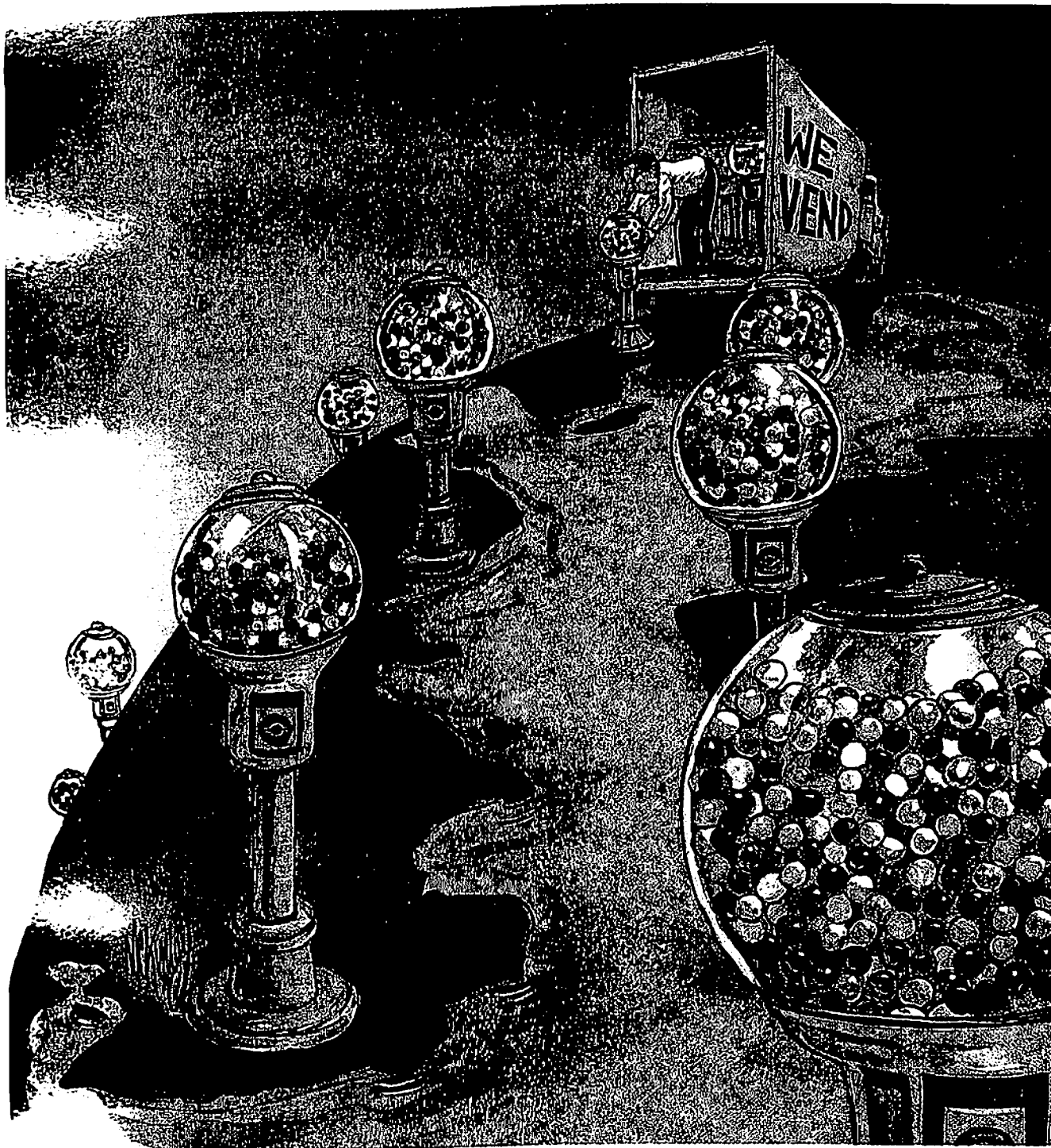


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usually for a relatively modest initial investment.

1. Business opportunities: Business opportunities (also known in some areas of the United States as "seller-assisted marketing plans") include a wide variety of packaged business concepts that allow the buyer to begin a business. Some examples of popular business opportunities:

- ❖ a string of several vending machines (dispensing anything from maps to cigarette lighters to candy to video poker games), where the seller offers assistance in placing the machines in profitable locations

- ❖ a self-contained vending cart selling specialty food items, where the seller assures the buyer that he or she will profit from the purchase

- ❖ a software program designed to run a computerized message service from the purchaser's home computer, where the seller offers a sales plan and promises to buy back the package if the buyer is dissatisfied in any way

- ❖ a line of jewelry to be sold via display racks in convenience store outlets where the seller provides an initial inventory, 10 display racks, an instructional sales

video, and a supply of marketing materials and advertising brochures, and promises gross sales of at least \$250,000

Under U.S. law, the sellers' promises of location assistance, profitability, a sales plan and inventory buyback are part of what makes these programs regulated business opportunities. However, because they don't

provide the buyer with a trademark license, these programs fail the franchise test.

Business opportunity packages range in price from \$400 to \$10,000, but most cost less than \$1,000. The buyer pays a single fee with no continuing royalties. Unlike franchising relationships, where the franchisor provides constant support and ad-

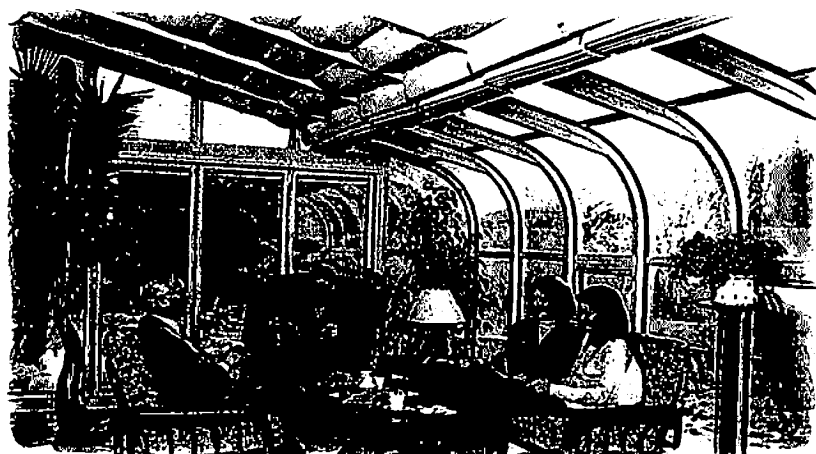
vice, a business opportunity is a one-time purchase. The buyer is on his or her own when it comes to running the business.

In the United States, the business opportunity concept is heavily regulated. Twenty-five states and the federal government regulate the sale of business opportunities, generally requiring that the sellers be registered and deliver pre-sale disclosure documents to the buyer.

Other countries govern these programs under general laws of misrepresentation and fraud if problems arise. "The term 'business opportunity' has no legal significance, as such, in the United Kingdom," says franchise expert David Bigmore. "Business opportunities are not regulated under our Trading Schemes law unless they fall within the definitions of the Fair Trading Act of 1973. They may be regulated under other statutes, such as The Financial Services Act, depending on how the programs are structured and sold. That may change under new Trading Schemes legislation recently passed by the House of Lords. But for now, if a business opportunity seller misleads a buyer, the buyer would be forced to bring an action for misrepresentation and/or fraud. Fraud can be rather difficult to prove under English law."

Are business opportunity programs growing in popularity? The answer depends on the country and the role played by entrepreneurs in its culture. In the United States, Canada, and, to a lesser degree, Australia, business opportunities are growing in number and in popularity. On any given weekend, you'll find a large business opportunity trade exposition in any major American city. "It is different in the U.K. and other countries in Europe," says Bigmore. "The level of entrepreneurial impulse in European cultures is not as high as in North America and Australasia."

2. Multilevel marketing: Multilevel marketing businesses are nothing new in the international marketplace. Direct sales distribution programs such as Amway and Avon have built an extraordinary international presence. In these low-



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investment businesses, the sales representative purchases an initial inventory of products, typically for \$100 to \$500, and sells the merchandise directly to friends, family and personal contacts. The rep places the orders, collects payment and delivers the product.

The recruitment of other sellers for the rep's "downline" is the hallmark of these programs and creates the multiple level network that gives the programs their name. In many networks, reps receive compensation for recruiting others and for the sales made by his or her recruits (and their recruits) in the downline.

"Direct sales programs are legal in the U.K.," says distribution specialist Mark Abell, "but they often come close to constituting illegal pyramid plans or trading schemes under our law. They must be carefully structured to limit the amount of money earned for signing up other representatives, to allow cooling-off periods for purchasers, and to meet restrictions on the wording of promotional materials and contracts. If incorrectly structured, they may be prohibited under the Fair Trading Act."

Many people become involved in direct sales programs on a strictly part-time or seasonal basis, and because the investment required is low, there is a high rate of turnover among sales reps. This type of investment program may fit your needs if you are looking for an inexpensive and flexible business, and don't mind selling products or services to your friends and family.

3. Distributorships: Perhaps you are interested in a more straightforward product distributorship, where you buy a supply of product at wholesale and resell it to retailers. In a distributorship, you purchase merchandise from a manufacturer who produces and ships product but has no interest in teaching distributors how to operate their businesses.

This is a difficult business for entrepreneurs without any experience in the market for the product. If you don't know the market well, it's easy to assume that retailers will be happy to carry your product or that you

will find other buyers. Make a mistake on this point, and your home will fill up with product you have purchased but cannot sell.

If you are confident about the market and self-sufficient in operating your own business, a product distributorship may fit the bill. Many manufacturers will appoint you as the exclusive sales rep for your immediate market (although this promise is often linked to your achieving a minimum level of sales in that market).

INVESTMENT TIPS

Regardless of the style of business package you choose, exercise caution when investing your hard-earned money in any opportunity. Be realistic in your assessment of the potential return on that investment. Not every glowing promise you hear will come true. Keep these points in mind:

❖ *Ask the seller a lot of questions before you buy.* What exactly will you receive for your money? Take a look at the materials, and decide for yourself whether the program has potential for you.

❖ *Take the time to talk to as many other buyers as you can.* Are they happy with the program? How much time do they put into the business? Has it made money with it? Have they enjoyed the work? Would they buy into the package again knowing what they know now?

❖ *Investigate the seller's background.* Has the company been in legal trouble with government agencies in your country? Have they been the target of lawsuits from unhappy buyers? What is the company's financial standing and credit history? Know who the company is before buying.

Sellers of business packages may promise sky-high financial returns. But the reality of business—any business—teaches us such returns rarely happen. There are quality, low-investment business packages on the international market, but you must investigate them carefully. For investors who move cautiously and invest wisely, they may offer a realistic first step toward business—and financial—independence. □

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