

# Information Please

Buying a franchise? The questions to ask, the people to see, the resources to use

Andrew A. Caffey | December 2, 2008

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## *Be Your Own Boss*, Fall 1999

You meet a world-renowned automobile expert at a party and casually pose this question: "I'm in the market for a new car. So tell me, what's really the best car on the market?" If the expert has the patience and enthusiasm for this exercise, he or she will respond with a series of questions about you. "What do you like in a car? How will you use it--for off-road excitement or suburban hustle? How long is your daily commute to work? How many passengers will you have? Will you be driving up and down mountains, or do you live on the plains?" And, finally, "What's your budget?" Any expert will tell you the precise answer to the "best car" question can only be determined by understanding the needs and wants of the buyer.

For most of us, it usually doesn't help if the answer is something like "Take my advice--you really can't go wrong with a \$200,000 Lamborghini. It's received the highest performance rating this year." Like a lot of expert advice, this recommendation is accurate, technically correct, rational . . . and completely useless.

Given the same "What's really the best on the market?" question asked about franchises, a good franchise expert will reverse the inquiry every time and ask for further details about you. Listen up: There really is no inside scoop on franchises. From an objective viewpoint, some are better than others, for sure, but the only true measure of a franchise is how well it meets the ambitions, talents, skills and pocketbooks of its franchisees.

Making that determination isn't always easy, however. Researching a franchise opportunity puts most people on unfamiliar ground. After all, by its nature, franchising attracts investors who are new to business

ownership and who come from all walks of life. Finding the right franchise requires you to weigh a significant amount of information, and many of us don't have the temperament for that. In fact, we may be more comfortable kicking tires in a car lot and dreaming of buying a Lamborghini than sifting through the detailed franchise selection process. But if you think you're up to the challenge, here's how to proceed . . .

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## Know Thyself

Take a few minutes to do a personal inventory of your goals and resources. Think about what it is that really lights your fire. Passion is a driving force in our lives, and that's never as true as in business ownership. If you have a passion for your work, it'll carry you far.

If you need help assembling this personal evaluation information, sit down with a trusted friend, an advisor, your spouse or someone you now with business experience, and outline your resources, strengths and weaknesses, as well as your financial resources. Talk concept and listen carefully. You need a reality check here. Don't necessarily accept what you hear, but take it into account. What type of business activities play to your strengths? Can your advisor see you pursuing a certain type of business? Would you be better-suited for a business-to-business sales situation or a retail setup? Are you good with people, a good public speaker? Are you detail-oriented? Can you afford to run a business? Can you afford to fail? What's your level of risk tolerance?

This information will be very helpful when you start to narrow your franchise search. By maintaining a clear focus on your fundamental interests, you won't be pulled off-track by the distractions you encounter during your quest.

## Take To The Streets

Now for the fun part: Apply your personal goals to the franchise market. For a quick start, attend a franchise trade show--they're a terrific way to

gather a lot of preliminary information and survey the field in a short period of time, and you can find them in most good-sized cities.

When attending a franchise trade show, keep a few thoughts in mind. First, remember the companies exhibiting at the show by no means make up the entire universe of franchise opportunities. In fact, these events showcase only a small selection of the available franchise programs. Second, you should take full advantage of the information available. Stop by the booths of all the companies that fit the business profile you outlined in your goal-planning sessions. Leave your name and address with those companies that interest you. Ask questions, and listen carefully to the answers. Gather handouts and take notes. You'll get a good feel for franchise discourse, the questions to ask and the key sales points in any program.

## Do The Paperwork

Buying a franchise involves a unique set of paperwork that the franchisor is required by law to deliver to each prospective franchisee at least several weeks before the purchase closes. Known as the Uniform Franchise Offering Circular (UFOC), this document contains information that's invaluable to your research.

Franchisors' UFOCs aren't difficult documents to consume, but they're not an easy read either. The key is to understand what you're looking for and why. A UFOC is a sandwich document with three layers of information. The top layer is an extensive narrative about the franchise program that's organized into 20 sections, or "items." The second layer contains three years of audited financial statements from the franchisor. The final layer contains copies of the agreements that franchisees are expected to sign. Let's take them one layer at a time:

- **The narrative.** The 20 items of narrative are the mother lode. They deliver a detailed description of the franchisor and its franchise offering. Among the section's treasures: a discussion of the franchisor's history and the experience of its key executives (see Items 1 and 2); the company's litigation and bankruptcy history, if any (Items 3 and 4); the fees you'll pay and the company's estimate of your total financial investment (Items 5, 6 and 7); information about any product restrictions, trademarks and services (Items 8

through 18); the earnings potential of an individual franchise (Item 19); and statistics about the franchise system (Item 20).

The scope of the information you'll find in the UFOC is one of the more satisfying aspects of the research process. This document gathers, in one place, information that would take weeks to assemble on your own--if you could find it at all. The entire document is important reading for you if you're at all serious about a franchise program.

- **Franchisor financials.** The second layer of financial statements (Item 21) reports the financial standing of the franchisor. The fact that three years of the company's financial life are audited by an independent CPA generally ensures reliability. If you're uncomfortable reading and interpreting financial statements, hire a good accountant to help you determine the franchisor's financial standing. After all, if you're signing a franchise agreement with a 10-year term and a 10-year renewal term, you want to make sure the company will be alive and kicking for that length of time. Does the company have the capital to make it in the long run? It's important to find out before you sign on.
- **Franchise agreements.** Item 22 contains copies of sample contracts proposed for signature. Take a close look at the franchise agreement, typically a complex contract. It's designed to govern a continuing commercial relationship that can last five, 10 or 20 years--or even longer. It licenses the franchisor's intellectual property (trademarks, trade secrets, copyrights and patents) for you use. Among legal contracts, franchise agreements are right up there on the complexity scale with commercial leases; they should be reviewed with the same careful eye.

Before signing a franchise agreement, ask a competent lawyer to look it over for you. He or she can explain how the relationship will work and whether any provisions go against your best interests. Contrary to the impression conveyed by the heft of the "standard" documentation, franchise agreements are negotiable. If there's a provision that you and your attorney don't like, explore alternatives with the franchisor. Franchising isn't a one-size-fits-all situation.

## What's *Not* There

As useful as it is, the UFOC is only one aspect of your research effort. It

simply gives you an introduction to the fundamentals of the program. When you're done reading the UFOC, meet with a few current franchise owners. This is your chance to ask questions about the business, the franchisor and those topics not addressed in the UFOC.

For instance, the UFOC won't tell you about any industry trends that could affect the franchise program in the future. Are there any hot new competitors coming into the market? Is the market for the franchise's products or services in general ascent or decline? Seasonal franchisees are well aware of these industry currents.

The UFOC also won't tell you anything about competition among franchise owners or how the franchisor handles the placement of franchised units in proximity to one another. Many franchisees will tell you they dread the placement of another franchise anywhere near their location because of the negative impact it may have on their location's numbers. Find out whether the system you're considering faces this issue.

If a franchisor wants to tell you about typical store sales last year, or about sales profits achieved by franchisees in the system, that information will appear in Item 19 of the UFOC. It's not required, however, and most franchisors opt not to tell you how their franchisees are performing. If it isn't covered, make sure to ask current franchisees how their businesses are doing. Have they met the expectations they had going in? Are sales revenues seasonal? What were their gross sales in the last calendar year? It may be that the franchisor won't deliver earnings information because it doesn't paint a very attractive picture of the franchise program.

Find out how system governance issues are resolved in the franchise system. The UFOC doesn't tell you whether the franchisor provides a structured process for accepting franchisee input on potential new products or marketing strategies--or anything at all. Ask.

## In With The Old

It may not sound as exciting as dashing around to interview franchisees, but plan to spend some time at the library. Explore marketing trends and business development statistics in your market. Find a book or two about franchising. Read up on preparing a good business plan. Even though

you're considering buying a franchise, you can't assume any company will handle basic business planning for you.

Don't overlook the Internet. You'll no doubt find a Web site hosted by the franchisor and maybe some basic online information about the program it offers. Check out how the franchise system appears on the Net. Do individual franchisees have their own Web sites set up, or is the franchisor's trademark coordinated at one single site?

While you're on your computer, stop in at the Federal Trade Commission's Web site ([www.ftc.gov](http://www.ftc.gov)). This site offers some interesting reading about enforcement actions against franchisors and general advice about franchise investing.

## Research This

Although you may occasionally find yourself on unfamiliar ground, finding a franchise that best matches your talents and interests is a manageable challenge. The good news is, most franchisors are eager to tell you about their offerings and to sell their programs to you. And maybe there is one inside scoop on franchising, after all: Meeting the challenge is a tale of two disciplines--diligent research and careful preparation.

## Q&A

So you think you've found the right franchise for you? Ask these 24 questions. If the answers aren't satisfactory, chances are there's not much opportunity there.

### **The Franchise Organization**

- Does the franchisor have a good track record?
- Do the principals of the franchise have industry expertise?
- How strong is the franchisor's financial condition?
- How thoroughly does the franchisor screen franchisees?
- How profitable is the franchisor and its franchisees?

### **The Product Or Service**

- Is there demand for the product or service?
- Are industry sales strong?

- How does it compare to competing products or services?
- Is the product or service competitively priced?
- What is the potential for industry growth?

### **The Market Area**

- Are exclusive territories offered?
- Does the territory you're considering have sales potential?
- Is the competition strong in this area?
- How successful are franchises near this area?

### **The Contract**

- Are the fees and royalties reasonable?
- How attractive are the renewal, termination and transfer conditions?
- If the franchisor requires you to purchase proprietary inventory, how useful is it?
- If the franchisor requires you to meet annual sales quotas, are they reasonable?

### **Franchisor Support**

- Does the franchisor help with site selection, lease negotiations and store layout?
- Does the franchisor provide ongoing training?
- Does the franchisor provide financing?
- Does the franchisor sponsor an advertising fund to which franchisees contribute?
- How strong are the franchisor's promotional programs?
- Does the franchisor have favorable national contracts for goods and services?

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## **In The Know**

*Research compiled by Liza Potter, Bowen Park and Meredith Russell*

A good place to start looking for information on both franchises and business opportunities is the government office that regulates them.

Although not every state law is the same, as a place to start, we have compiled contact information for offices that maintain some kind of information. Be sure to contact the office in the state where you wish to do business. You won't be able to make your buying decision based on the information provided, but you can get the basics.

B= Has laws regulating business opportunities

F= Has laws regulating franchises

## **B ALABAMA**

Attorney General's Office

Consumer Affairs

(334) 242-7320

## **B F CALIFORNIA**

Department of Corporation

(415) 557-3787

## **B CONNECTICUT**

Banking Securities & Business Department

Investment Division

(860) 240-8230

## **B FLORIDA**

Consumer Services Division

(850) 922-2770

## **B GEORGIA**

Consumer Affairs Office



(404) 656-3790

**F HAWAII**

Commerce & Consumer Affairs Department

(808) 586-2722

**B F ILLINOIS**

Secretary of State

Corporate Information

(217) 782-7880

**B F INDIANA**

Attorney General's Office

Consumer Protection Division

(317) 232-6330

**B IOWA**

Securities Bureau

Regulated Industries Unit

(515) 281-4441

**B KENTUCKY**

Attorney General's Office

Consumer Protection Division

(502) 696-5389

**B LOUISIANA**

Secretary of State

Commercial Division

(225) 922-0425

**B MAINE**

Business Regulations Department

Corporations, Elections & Commissions Bureau

(207) 287-3676

**B F MARYLAND**

Securities Division

Franchise & Business Opportunities Unit

(410) 576-6360

**B F MICHIGAN**

Consumer Protection Division

Antitrust & Franchise Section

(517) 373-7117

**B F MINNESOTA**

Commerce Department

Registration Division

(651) 296-6328

**B NEBRASKA**

Banking & Finance Department

(402) 471-3445

**B NEW HAMPSHIRE**

Attorney General's Office

Consumer Protection Bureau

(212) 416-8235

**F NEW YORK**

Investor Protection & Securities Bureau

(212) 416-8235

**B NORTH CAROLINA**

Secretary of State

Securities Division

(919) 733-3924

**F NORTH DAKOTA**

Security Commissioner's Office

Franchise Examiner

(701) 328-4712

**B OHIO**

Secretary of State

(614) 466-3910

**B OKLAHOMA**

Securities Department

(405) 280-7700

**F RHODE ISLAND**

Business Regulation Department

Securities Division

(401) 222-3048

**B SOUTH CAROLINA**

Secretary of State

(803) 734-1728 or (803) 734-1951

**B F SOUTH DAKOTA**

Commerce & Regulation Department

Consumer Protection Division (for opportunities less than \$250)

(605) 773-4400

Securities Division (for opportunities more than \$250)

(605) 773-4013

**B TEXAS**

Secretary of State

(512) 463-5555

**B UTAH**

Commerce Department

Consumer Protection Division

(801) 530-6601

**B F VIRGINIA**

Clerk of the State

Corporation Commission

(804) 371-9733

## **B F WASHINGTON**

Financial Institutions Department

Securities Division

(360) 902-8760

## **F WISCONSIN**

Financial Institutions Department

Securities Division

(608) 261-9555

## **On With The Show**

If you're attending a trade show for the first time, it helps to go in with a set of questions that cover the information you need to gather. Here's a sampling:

- What's a typical day of business like for your franchise owners?
- Is there an independent franchise owners' association? Can I have the name and address of the current head of such an association?
- Tell me about your network of franchisees. How many are there in the United States, and how many were added to the system last year?
- How thoroughly have you developed the market in my town? Are franchises available in my town? How many franchises have been sold in this state? What are your development plans in this area for the coming year?
- What's the total overall cost of building a franchise?
- What are the initial franchise fees and the monthly royalty rate?