

Getting Answers

Don't let a franchisor's decision not to disclose earnings figures discourage you. There are ways to find out what you need to know.

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There is one aspect of buying a franchise that will puzzle you. In fact, you won't believe it the first time you confront it. It defies business logic and runs counter to common sense. It drives franchisors crazy and frustrates state regulators so much, they want to fundamentally alter their franchise laws.

It's information about the financial performance of the franchise, otherwise known as "earnings claims."

No other issue in the world of franchising has drawn more debate, sparked more legal action or caused more head scratching. The awkwardness of earnings information regulation has led most franchise companies to perform a distinctly Victorian dance when prospective franchisees ask: "How much money can I make with this franchise?"

These words are an immediate signal to the franchisor that it's time to strike up a minuet on the ol' harpsichord. "We can't tell you," says the franchise rep through clenched teeth. "You'll have to ask our current franchisees that question (pause for understated courtesy to your partner), and work up your own financial projections (bow deeply at the waist, flourish left arm)."

Wait a minute! In your mind, this is the most important question of all. It's the question on which will swing one of the most important financial decisions of your life. "Why should I buy this franchise if I don't know whether it will make money for me?" To be told the franchisor can't help you answer this question can be a shock. Isn't this where the real franchise selling begins?

"OK," you say, "I understand you can't make a performance projection

because, after all, no one really knows how I will do and there are too many variables to count. How about if you just share some neutral, factual information with me? Tell me the gross sales for each of your units last year, based on the royalties the company received. You should have that information at your fingertips, right?"

A well-schooled franchisor will continue the dance until the music stops. "I'm sorry," the rep pleads, "you'll have to get the answer to that question from our franchisees themselves. You'll find a list of their names, addresses and phone numbers in Item 20 of our Uniform Franchise Offering Circular."

What's going on here? Franchise law allows the franchisor to deliver earnings information if the company also provides it in its disclosure document. In a Uniform Franchise Offering Circular, this information is presented in Item 19. However, studies have shown that only about 25 percent of all franchisors choose to include any information about earnings.

Why so few? Some companies simply don't want you to have the earnings information for their system because it paints an unflattering picture and discourages future franchise sales. Others may be concerned about the litigation implications of delivering performance information, or they may not have enough reliable performance data.

Whatever the reason, the absence of earnings information puts you at a disadvantage. The only answer is shoe leather. This is your part of the dance. Get in the car, and visit as many owners as you can; get on the phone and call others. Even if the franchise you're evaluating provides earnings information, still reach out to franchisees. There's no better source of reliable, firsthand data about a franchise system. Ask them about the financial performance of their units. The larger the sampling of franchise owners you talk to, the more reliable the information you glean will be.

Take the performance data you gather to a competent accountant, and work up a solid set of projections, showing break-even figures and projected profits and losses. You can make a truly informed franchise purchase decision after you complete the earnings claims dance.

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Claim Check

Though getting earnings claims out of most franchisors is like pulling teeth, some may choose to reveal this information, either officially or off-the-record. When you receive earnings information, how do you handle it?

- Carefully review the company's statements in Item 19 of the Uniform Franchise Offering Circular (UFOC). Here, the franchisor is required to describe the facts and assumptions underlying the earnings claim. It typically states whether the claim is based on actual experience as well as the percentage of franchisees operating during the specified period who actually attained or surpassed the claims.

At the end of all Item 19 earnings statements is a required disclosure that reads something like this: "Substantiation of the data used in preparing this earnings claim will be made available to the prospective franchisee on reasonable request." If you don't understand the earnings statement or if it doesn't strike you as realistic, request to see the substantiation. Make your request in writing, and don't expect an immediate answer. Under franchise law, you have a right to review the substantiation.

- Compare the earnings claim against information you've gathered from franchisees, or show it to them and ask if it's accurate in their experience. If it's exaggerated or doesn't represent the real results in the system, take that into account when evaluating the purchase.
- Are the statements made by the company's sales reps in accord with the Item 19 disclosure? If not, move cautiously, and confirm the information for yourself.
- If you come across a problem with the earnings claim, or you discover the franchisor has been disciplined in the past for its sales practices, you may want to review the earnings statement with a closer eye. Make a point of obtaining independent verification, like visiting with franchisees. What percentage of franchisees in the system have

done as well as the stated claim? Is it a majority?

There is a movement among the franchise registration states to make the delivery of earnings performance information mandatory. The Federal Trade Commission has resisted this effort on policy grounds, setting up one of the more interesting policy debates franchising has seen in years. Observers don't expect this thorny issue to be resolved in the near future.