

# How to Research a Franchise Opportunity

Your assignment: Buy a franchise. Step 1: Take our crash course in finding the right franchise for you.

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URL: <http://www.entrepreneur.com/article/73858>

Settle down, class. Today we're going to explore how to locate and evaluate a good franchised business. Not all of you will want to hold down a job for your whole working life. Let's have a show of hands: Who's dreamed of owning your own business? OK, that's most of you. Buying a franchise is one way to get there; some even say it's the easiest way. So take notes, ask questions, and for goodness' sake, please stay awake!

## **Lesson No. 1: Is It in You?**

Not everyone who raised his or her hand will be happy as a franchisee. Owning a business is tough work, and most franchises have to be run according to a very detailed, strict set of guidelines. If you're a high-spirited entrepreneur who wants to do it your way without following somebody else's rules, you may want to look for an independent business to start or purchase; owning and running a franchise may frustrate you. So the first thing to do is to know what you want out of a business and whether it will bring you fulfillment. If you like the idea of running a business where you deal with customers at your own counter or provide services to businesses, or if you love sales or have writing skills, then keep these skills and preferences in mind when you start looking through franchise ideas. They'll help you zero in on the right business for you.

Whether the business you get into is a franchise or not, it takes money to make it happen. Make a list of your resources, relatives you can approach to be investors, your savings and your investments. Then go talk to a few bankers. You'll find that some banks will lend you money for a business as part of a federal program where the government promises to pay back most of the money to the bank if your business goes toes up and you

default. Banks love this; it lowers their risk when they lend money to new business owners. Ask the bankers about SBA loans-read about the [SBA's loan programs](#), and take a look at a [registry program](#) where franchisors and the SBA have teamed up to streamline the application process.

## **Lesson No. 2: Get Your Feet Wet**

One of the best ways to find out about the types of franchises available to you is to attend one of the franchise and business opportunity shows that appear regularly in most U.S. cities. The big ones can have up to 400 exhibitors. Attending one of these shows is well worth your time. You can kick tires, ask questions, gather brochures and try on ideas.

The Internet is also a tremendous source of information. As students, you're experts at using the web, so you know that the hype-to-fact ratio will run on the high side. What's that? Well, you're right, that's also true of franchise trade shows, but at least you can talk to real people at a show.

## **Lesson 3: Information, Please**

A big part of the challenge of looking into a franchise is getting your hands on information. I've got some good news: The franchisor is required to package the key investment information and hand it to you in a document called a Uniform Franchise Offering Circular (UFOC). It spoon-feeds you some basic information about the franchise investment.

The first thing to understand about the UFOC is that it's actually three documents sandwiched together: 1) a 23-item narrative about the franchise offer, 2) up to three years of audited financial statements of the franchisor, and 3) the form of franchise agreement you'll be asked to sign. If you're serious about a particular program, you should carefully read this document. It's amazing how many franchise investors don't bother. It's required by law to be written in plain English, so don't be intimidated. I can tell you that every student who's completed this class has read the UFOC and understands its limitations and strengths.

First, look at the UFOC's attachments. You may have no experience reading a commercial contract or a set of financials, but these will be indispensable to your professional advisors. Take the contract to a good

business attorney; let your counselor look through it and explain it to you. If you and your attorney conclude there are points you can't live with, explore negotiating with the franchisor.

Take the financial statements to an accountant trained to evaluate all those numbers. Your basic questions: Does the franchisor have the financial wherewithal to meet its commitments under the franchise agreement? And will it be around for a while? Your accountant can also use Item 7 information to advise you on your own financial planning for the investment.

## Lesson 4: Breaking Down the UFOC

Now turn to the meat of the coconut, the narrative description of the offering. This front portion of the UFOC is designed to elicit all the important information you need to make an investment decision, and it's organized into 23 separate items. It provides information about the franchisor, the investment itself, the franchise system, and the rights and obligations of the franchisor and the franchisee in the program. Let's break it down:

- **Items 1 to 4 address the franchisor and its background.** You'll find a description of the franchise in Item 1, the business experience of the key franchisor managers, as well as the litigation (Item 3) and bankruptcy (Item 4) backgrounds of the franchisor and key affiliates. Go over this information with your attorney so you can keep any litigation disclosures in perspective. They can tell you a lot about the company's dispute-resolution style.
- **Items 5 to 7 are the money sections.** They lay out the fees you pay the franchisor for the right to participate in the program as a franchise owner (initial franchise fee, continuing royalty payments, advertising contributions and any other fees). Item 7 details the franchisor's estimates of your total investment. Item 7 is presented in chart form and usually contains dollar ranges for categories of expenses. You may find more than one chart in Item 7 if the company offers different types or sizes of franchised businesses.
- **Item 8 describes restrictions regarding the products and services you can buy and sell through your business.** Though you may not think so when you first read this item, it's of the utmost

importance to your business. It gives you an idea of how much of your operation must meet the franchisor's specifications and informs you of arrangements with approved suppliers and whether you're required to purchase inventory from the franchisor.

- **Item 10 tells you if the franchisor provides any financing.** Be aware that very few franchisors do so.
- **Item 11 details the obligations of the franchisor under the franchise agreement before and after you open.** Zero in on the description of the training program. The mark of all good franchisors is a well-thought-out, thorough training program. Training is the biggest service you're buying with your initial franchise fee; get your money's worth.
- **Items 12 to 14 list the intangible rights you'll receive with your franchise package:** territory rights, trademarks, patents, copyrights and confidential information. Make sure you understand the territory rights. Is your territory exclusive? Can the franchisor or other franchisees compete with you in your territory? You'll find the answers in Item 12. Check Item 13 to see if the main trademark licensed by the franchisor is federally registered. If not, ask your lawyer if that poses any risks to you.
- **Items 15 and 16 tell you if you must participate personally in the franchised business,** as opposed to hiring a manager, and what restrictions are imposed on the customers you can serve or the products and services you can offer.
- **Item 17 is a lengthy chart summarizing the key provisions** of the franchise agreement that relate to renewal, termination, transfer and dispute resolution.
- **Item 19 is an important disclosure item.** A franchisor isn't required to provide earnings information to a prospective franchisee, but if it does, it must reproduce the statement in Item 19. This would answer the first question you might ask a franchisor: "How much money does one of these franchises make?" or "What were the average gross sales in your stores last year?" These are loaded questions. You may be surprised to learn the law restricts how they can be answered. Most franchisors aren't in a position to answer these questions since they don't have earnings information in Item 19 of their UFOCs. My estimate is that about one-third of franchisors provide some sort of earnings statement in the UFOC. Read it with a

careful eye, and make sure you review it with your accountant.

- **Item 20 is a statistical picture of the franchisor's system** that tells you how many franchisees joined the system in the last three fiscal years of the company and how many left. You'll also find the contact information for current franchisees and those who left in the past year. Call as many franchisees as you can; visit several as well. Ask them how they like being a part of the program, how much money they grossed last year (only a franchisor is restricted from answering this), and whether they would make the same investment decision if they had it to do all over again.

### **Someone Get the Lights**

The sharp-eyed among you will notice that I've left out a few items from my discussion. These are lesser disclosure items that will speak for themselves when you crack open the UFOC.

There's the bell. Thank you for your attention to this important topic. I wish you all success in your entrepreneurial ventures.

### **Quick Study**

- **Visit the [FTC's Web site](#).** The FTC maintains a useful Web site where you can read general guidelines about buying a franchise and catch up on FTC enforcement activity.
- **Check the [Franchise Registry](#).** This innovative program can smooth the way for borrowing money under the SBA loan guarantee program when you come to purchase franchise rights. You can find out if a particular franchisor has registered with this program by logging on to the Web site.
- **Find out if there are veterans' benefits.** Many franchisors offer special financial incentives for veterans. Read about the VetFran program [here](#).
- **Get [franchisee evaluations](#).** Prospective franchisees can get survey results from an online service that asks existing franchisees for their opinions about their franchise programs.

**Get help from franchisee associations.** There are three national trade associations of franchisees: 1) the [International Franchise Association](#) in Washington, DC, which is a trade group of franchisors and franchisees; 2)

the San Diego-based [American Association of Franchisees & Dealers](#), which publishes the Fair Franchising Standards; and 3) the [Franchisee Association](#) in Chicago.

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