

# Read All About It

Find the answers to your franchise questions in the UFOC.

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URL: <http://www.entrepreneur.com/article/15250>

When you sit down to talk seriously with a franchisor about the purchase of a franchise, you will no doubt have hundreds of questions about the investment: everything from the territorial rights you will receive and the amounts you will pay to the duration of the initial training. You can also assume there are another couple hundred questions that you will not think to ask.

Luckily for you, the franchisor is required by law to provide you with many of the answers--both to the questions you ask and those that might not occur to you--in the form of the Uniform Franchise Offering Circular (UFOC).

The UFOC document is a mother lode of investor information, designed to give prospective franchisees all the information relevant to the franchise offering. The UFOC contains the facts state and federal regulators consider important to your decision whether to buy the franchise. The UFOC is designed to protect you, the investor, and you will find it enormously helpful.

The UFOC is made up of three basic sections sandwiched together: first, 23 sections describing various aspects of the franchise program; second, a set of the franchisor's audited financial statements; and third, a copy of each form or contract you will sign if you buy the franchise.

State and federal franchise laws require that a franchisor deliver a copy of this document to you at the first personal face-to-face meeting with you or 10 business days before the contract is signed or money is paid, whichever happens first. This means you may not receive a UFOC simply by requesting it (although some franchisors will send one on request), but you should certainly receive a copy well before you are asked to pay money or sign a binding contract. Ask the franchisor for one early in your

investigation; it may save you a great deal of time.

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## Just read it!

The first fundamental mistake most franchise investors make is to put the UFOC aside and not bother reading it. Sure, it can be a bit intimidating--some UFOC documents are thick, bound minibooks--but they are not impenetrable. If you understand what you're looking for--the red flags that should alert you to investigate the business further--and focus on the key investment information, the UFOC is an extremely useful introduction to the franchise program you're considering.

## Treasure Hunt

Not all the information in the UFOC is enlightening or particularly useful, but you can dig out much that is. Look for this key information as you read:

- Item 2 describes the business background of the officers, directors and managers of the franchise company. Scan these summaries to get an idea of their experience.
- Item 3 summarizes the litigation background of the franchisor and the people listed in Item 2. If there have been actions taken by state or federal enforcement agencies, or if private lawsuits relevant to the franchise system have been filed against the franchisor in the past 10 years, they are summarized in this section. If you find a significant number of actions, especially where franchisees have sued the company, make a note to investigate further.
- Item 4 lists any bankruptcies in the backgrounds of either the franchisor or the people listed in Item 2.
- Items 5 and 6 summarize the initial franchise fees, ongoing royalty fees and other charges franchisees must pay. If the initial fees have been negotiated in the past year, that will be disclosed in Item 5.
- Item 7 presents the franchisor's estimate of the typical total investment

by the franchisee, in chart form. You will need this key information when you prepare your own business plan or seek financing for the franchise. Be sure you review this information with your accountant.

- Item 8 discloses the restrictions placed on the franchisee's purchase of supplies and product inventory for resale in the franchised business. It also presents information about rebates generated by franchisee purchases and the portion of the franchisor's revenue that comes from purchases made from the franchise company. If it looks like most of the franchisor's revenue comes from franchisee purchases, find out from other franchisees if products are fairly priced and effectively delivered. Supply arrangements are a vital aspect of running a franchise, so make sure the system works well.
- Item 10 discusses financing. Many franchisors either provide financing to franchisees or make special arrangements with banks or other lenders to assist franchisees. Even if there is no mention of special financing arrangements in this item, ask the franchisor about them.
- Item 11, the longest section in the document, highlights the franchisor's obligations to the franchisee under the franchise agreement. It also describes required computer equipment purchases and the initial training program.
- Item 12 explains territorial rights. Make sure you understand exactly what rights you have, both inside and outside any designated territory. If the franchisor reserves the right in this item to distribute competing products or services through other channels of distribution, find out what this means and how the company intends to use that right.
- Item 13 reveals details about the trademark licensed to franchisees. Is it federally registered or is registration pending? If it is not effectively registered, the franchisor--and you--may have problems with it down the road.
- Item 19 reveals earnings claims. This key section shows what kinds of sales or profits other franchise owners have made, if the franchisor chooses to supply the information. Most don't. If a franchisor does provide this information, it must also provide data to prove the claims upon your request. If no performance information appears here, find out why. It may be because the performance of franchisees does not paint a very attractive picture, or it could simply be that earnings vary widely from one region to another or one franchisee to another. Ask franchisees about their sales and profits; most are happy to share

- their experiences.
- Item 20 contains systemwide statistical information such as how many new businesses have opened over the past three years and how many franchise owners have left the system over the same period of time. This section also contains a list of the names, addresses and telephone numbers of current franchisees and those who have left the system in the past year. Call them.

## Legal Eagles

After you receive this treasure trove of information, you must take another vital step to make the most of it: Find professional advisors to help analyze the UFOC. Unless you are experienced in reading financial statements and analyzing complex commercial contracts, the money it costs for the assistance will be well worth it.

Using the information in the UFOC, a good accountant can put together a projection for your planned business and give you an educated guess about whether it will be profitable and how much money it may generate. Without a basic cash-flow needs analysis, you'll have no idea how much capital you'll need to run the business and no clue as to whether it will meet your income needs.

An attorney is invaluable in reviewing the UFOC and the franchise agreement. The franchise agreement is usually quite long and complex--after all, it will govern a complicated commercial relationship over a long period of time. An experienced eye looking it over with your interests in mind can identify any essential points of negotiation. Your lawyer can also explain exactly what all that legalese means for you as a franchisee.

## From The Horse's Mouth

You owe it to yourself to talk to as many current franchise owners as you can. Just get in the car and head out to see them. You will find names, telephone numbers and addresses right in the UFOC (Item 20).

Franchisees' view of the franchisor and the value of the franchise system will be enlightening. Make sure you interview a large sampling of franchisees. Some will have good experiences to report; others may preach doom and gloom. Remember, no one can predict how you will fare or whether you will enjoy the business, but you need to know the mood of

the existing owners before you join their club.

Use the visit to follow up on the information you read in the UFOC. As long as that document is, it still does not tell the whole story. You have to piece that together for yourself. Bring a list of questions when you visit franchise owners.

Make sure you visit franchisees at a good time of day. If you show up at a fast-food restaurant at noon, don't expect to get anyone's full attention. By all means, arrive at noon, watch the operation during the lunch hour, and arrange to see the owner later that afternoon, when things quiet down.

Use the UFOC as the foundation for your inquiries into the franchise program. If you know the valuable information it contains--and understand the limitations of that information--it will give you a critical advantage in the hunt for the right business investment for you.

## For More Information

- The Federal Trade Commission (FTC) provides a package of information about the FTC Franchise and Business Opportunity Rule, free of charge. Write to Public Reference Branch, Federal Trade Commission, Washington, DC 20580; call them at (202) 326-2222; or visit the FTC's Web site at <http://www.ftc.gov>

## Penny For Your Thoughts

When you visit a franchise owner, be sure to ask these questions:

- Tell me about supply arrangements for the business. Do you make your own arrangements, or are supplies handled through a buying group?
- Is there an active franchisee council or owners association?
- What do you think of the training you received when you were starting out?
- Is the business seasonal? How do you handle the financial demands of the off-season?
- Knowing what you know now, would you buy this franchise again?