

# Shop, Look & Listen

How to size up a franchise before you buy

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Competition in franchising has never been healthier. In virtually all categories of business, you'll find several competing franchisors eager to sell you a franchise, if you qualify. That's the good news. The bad news is, you'll have to choose among the leading contenders on your list.

Making a rational choice among several attractive franchised businesses can be agonizing. How can you possibly draw a straight comparison among such complex programs with so many variables? The process is complicated by the inconsistency of the information available. On top of that, investing in a franchise is a major life decision you want to get right, because you may be involved in that business for many years.

There are a few things you should take into account before you start comparing franchises. First, the demands on your time and energy will be great. Assume your commitment to the business will be the same no matter which franchise you choose.

Next, make sure you'll be happy operating any of the businesses you're considering. The question of finding a business in which you'll be happy comes first. If you're not convinced of your personal fit with a particular business, cross it off your list of franchises up for serious consideration.

## Information, Please

Your primary sources of information for comparison are the franchisor, current franchisees and the Uniform Franchise Offering Circular (UFOC). The UFOC is a document a franchisor must deliver to a prospective franchisee well before the sale is closed. It provides a wealth of information and is a vital tool in your comparison of franchise opportunities.

To make sure you're comparing apples to apples in evaluating franchise

opportunities, line them up on three levels: direct measurables, market impact and franchise system intangibles.

## Facts and Figures

Direct measurables include the initial franchise fee, continuing royalty rates and other fees (see Items 5 and 6 of the UFOC) and the estimated total investment (see Item 7). You should also note any territorial protection (see Item 12) and the terms of the Franchise Agreement.

Draw up a chart with this measurable information and place the numbers side by side. What do they tell you? Obviously, they'll give you a surface comparison only--measurable figures don't offer much depth or insight--but a surface comparison can be useful in making a first cut.

If the total investment of a franchise is beyond your budget, drop that company out of the running. If the initial fee of one company seems out of line with the others, find out why. It may be that the owner's training is more extensive or that an initial inventory is included in that company's initial franchise fee.

The continuing royalty rate is a key number in your selection of a franchise. How do the rates compare? Most franchises assess a rate between 3 percent and 7 percent of the franchisee's gross sales. If one company's royalty rate is higher than another, check to see if the rates cover the same services. For instance, some franchise systems fund systemwide advertising programs from a portion of all royalties collected from franchisees. Other franchises assess a separate advertising fund contribution.

## Take A Closer Look

The second level of comparison, market impact, requires a slightly deeper investigation of the franchise opportunity. The market impact evaluation looks at such qualities as recognizability of the trademark, sophistication and maturity of the franchisor, and thoroughness of the initial training program. It also considers the earnings potential of the business, the franchisor's involvement and expertise in opening new units, the professionalism of the company's advertising and promotional materials, the size and organization of the system's advertising fund, and your

evaluation of the company's multiple-unit development potential.

You'll find some of the market impact information in the UFOC, particularly in Item 1, the description of the competition the investor will face; Item 11, training and advertising; Item 13, registration of the trademark; and Item 19, earnings information.

How much money will you make with this business? This key question is one of the most difficult to answer. Franchisors aren't required to provide earnings data, but if they do, it must be disclosed and detailed in the UFOC. Fewer than one-third of franchises provide earnings claims, so you may have to draw the best conclusions you can from talking to current franchisees, then make your own projections by working with an accountant.

Gather other market impact information from existing franchise owners or your own market research. Visit as many franchisees as you can and find out their opinions. Does the franchisor provide effective marketing? Are franchisees' opinions considered in advertising development? For many franchisees, marketing and advertising programs are the most valuable aspect of being a franchisee.

## Digging Deeper

Franchise system intangibles are the third level of evaluation. This is the least objective but, in many ways, the most important measure of a franchise. Intangibles include the culture of the franchise network, the franchisor's leadership style, the role the franchisee association plays in directing the system, the mood of franchisees, the dispute resolution methods, the effectiveness of support and the "success quotient" of franchisors.

Although you won't find this information in the UFOC, you'll find a few hints there. Look at Item 3 (Litigation) for clues about the company's dispute resolution style. Are many lawsuits disclosed? Arbitration proceedings? Have your lawyer look at the dispute resolution provisions of the Franchise Agreement; they'll also tell you something about the franchisor's style.

The system growth statistics in Item 20 may give you clues regarding the company's "success quotient." These figures tell you the number of units

that existed at the end of each of the past three fiscal years and the number of franchisees who left the system for any reason.

Unfortunately, these statistics don't tell you *why* a franchisee left or a unit closed. Attached to Item 20 is a list of current franchisees and the names, addresses and phone numbers of those who left the system in the past year. Contact current owners, as well as some who left. Ask why people left and whether current owners would buy the same franchise again.

Interviewing a few franchisees will give you a sense of their mood as a group. Are they happy? Mixed reviews? Near revolt? This information is important; you don't want to join an unhappy group.

Comparing franchise opportunities takes time, money and a lot of legwork. It also takes a commitment to making a decision that's right for you. You cannot afford to skim the surface, just comparing fees. The deeper levels of comparison will tell you more about the program's business potential and the value of becoming a franchisee.

## Full Disclosure

The Uniform Franchise Offering Circular (UFOC) is a key source of information for evaluating a franchise. The law requires the franchisor to give you this document at the first personal meeting you have or 10 or more business days before a franchise sale is completed. You should request one from your franchisor as soon as you think you might be serious about its program. Here are a few highlights of the UFOC information you'll need in order to compare franchises:

- **Items 5 and 6** summarize initial franchise fees, ongoing royalty rates and other charges.
- **Item 7** is a chart showing the franchisor's estimate of the typical total investment.
- **Item 10** discloses financing. Many franchisors either provide financing to franchisees or arrange with banks or other lenders to assist franchisees.
- **Item 12** summarizes the territorial rights granted with each unit.
- **Item 19** presents earnings claims--information about system or unit performance, such as average gross sales or profits--if the

- franchisor chooses to supply it.
- **Item 20** presents, in chart form, systemwide statistical information, plus lists of current franchisees and those who have left the system in the past year.

## Resources

- The Federal Trade Commission (FTC) provides a package of information about the FTC Franchise and Business Opportunity Rule, free of charge. Write to Federal Trade Commission, Public Reference Branch, Washington, DC 20580, call (202) 326-3128 or visit <http://www.ftc.gov>
- The American Business Opportunity Institute is a national information clearinghouse and seminar company specializing in business opportunity and franchise investment and regulation. For information on the Institute's services, send a self-addressed, stamped, business-sized envelope to American Business Opportunity Institute, c/o Andrew A. Caffey, #700, 3 Bethesda Metro Ctr., Bethesda, MD 20814.

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