

Now You're Cooking

What are the ingredients for franchise success? Our secret recipe for satisfying your entrepreneurial appetite.

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Choosing from among the thousands of franchise opportunities available to investors is not unlike walking into a large grocery store. There's lots to buy, but you can spend every dime you have and still not go home with what you need to make dinner. Selecting the right franchise requires that you have a detailed shopping list and a clear idea of the end product. It's best to start with a recipe for the dish you're making and a list of the ingredients you'll need, and work from there. Try doing it the other way around--walking into the store with no idea what you need--and what happens? You forget a key ingredient. The soufflé falls flat, the lasagna goes limp, or the cake craters.

It takes hard work, thought and planning to find the right investment. And while the ingredients may change from person to person, the process for finding the right franchise investment is essentially the same for everyone.

A Picture Is Worth a Thousand Words

It starts with your dream. Where do you want to go with this venture? In five years, where do you want to be? If you were making a fancy meal featuring coq au vin, you'd start with the picture in a cookbook illustrating the succulent sautéed chicken glistening in a red wine sauce. This is where you want to end up. This is why you're going to the grocery store in the first place. This is your goal.

All successful business ventures start with a personal vision, a fundamental plan, a goal or an objective. Selecting the right franchise should start with some sort of personal plan and goal-setting exercise. Know where you want to go in your business. Know the general type of work you prefer. Know what really fires you up and gets you excited about business.

The Shopping List

Next, make a list of your assets, personal strengths, resources and limitations. What money do you have in the bank? Is your credit report in good shape? Do you think you'll qualify to borrow the investment capital you'll need? Do you have friends or family members who are in a position to invest in a promising business venture?

Expect to have these resources tested during your search for the right franchise. Prepare a current financial statement, and obtain references from your bank and your major creditors, like a landlord or a credit union.

If you go into the investment without your list, you could end up forgetting a crucial part of the preparation.

Never Shop When You're Hungry

If you shop when you're hungry, you end up buying food you don't need and probably shouldn't eat. In franchising, you must be prepared to resist making impulsive decisions. The field of franchising is populated with some of the most talented salespeople in business. They offer lots of sizzle, and they're careful students of the psyche of the hungry prospective entrepreneur. Before you know it, they've got you excited about the unlimited potential of their opportunity, they're urging you to get in on the ground floor, and they're telling you the territory is going fast and you must decide now. Your job in this process is to separate the sizzle from the steak and stick to your list.

Read the Labels

You have an advantage over most other investors. As a prospective franchisee, you'll receive a detailed, extensive report about the franchisor, the franchise being offered and the franchise system. This document is known as the Uniform Franchise Offering Circular, or UFOC.

The UFOC is one of the most detailed ingredient labels you'll ever come across. Like food packaging labels, the UFOC's format is established by federal law, and it's designed to deliver key information about the franchise investment. You'll find 23 items of information, all of which are important to your investment decision. If there's one piece of advice you shouldn't

ignore, this is it: Read this document carefully. Sure, it may read like an insurance policy in places, but it's a treasure trove of details for alert investors. The good news: All UFOC documents must be written in plain English. No Latin phrases. No "hereinafters" or "whereinbefores." No run-on sentences only a lawyer could love.

Pay special attention to key UFOC sections that describe the franchise program. Some sections give you information about the franchisor, its financial standing and litigation background; some outline the franchise investment itself; and others fill you in on the network of existing franchise owners. Taking all three areas into consideration is crucial when making your investment decision.

1. The franchisor. Items 1, 2, 3 and 4 tell you who the franchisor is, how long it's been in business, its key executives' experience, its litigation or arbitration history, and whether there are any bankruptcies in its background. The key information here is the litigation background. If the company is involved in numerous lawsuits with its franchisees, find out why.

You also want to know about the financial stability of the franchisor. Item 21 requires a franchisor to attach three years of audited financial statements to the UFOC. This gives you a great snapshot of the franchisor's recent financial history. You want to know if this company is going to be around for the long haul; after all, your franchise agreement can run 20 years or longer. Its value as an investment is greatly diminished if the franchisor is on shaky financial ground.

The same can be said about the principal trademark licensed to you. Confirm in Item 13 whether the mark is federally registered with the U.S. Patent and Trademark Office and whether the franchisor will stand behind you if the mark is ever challenged by a third party. If the mark isn't federally registered or if you're not entirely comfortable with the legal obligations in the event of a challenge, talk to your attorney (an important advisor in this process) and know the legal risks going into the situation.

2. The franchise investment. Items 5 and 6 lay out the fees you must pay the franchisor. Usually, franchisees pay a substantial initial fee plus ongoing royalties expressed as a percentage of the business's gross sales.

Initial fees typically range from \$10,000 to \$30,000, royalties from 3 to 6 percent. Look for other fees as well, such as a marketing or advertising fee, which adds approximately 1 to 2 percent to the monthly royalty payment. Item 6 lists other incidental fees, such as transfer fees, renewal fees, audit expenses and additional training fees.

Item 7 is very important in a successful franchise recipe. It presents, in chart form, the franchisor's best estimate of the total expenses involved in opening a franchise. Equipment costs are estimated, as are real estate and build-out cost ranges. Use this item to compare the real costs of the program to your budget. If you find a total investment range of \$150,000 to \$375,000, you'll know roughly how much you'll have to spend or raise if you want to get one of these franchise recipes off the stove and onto the table.

Other disclosure sections tell you about the restrictions placed on your product supply sources (Item 8), your obligations under the franchise agreement (Item 9), any franchisor financing programs available to franchisees (Item 10), and the franchisor's contractual obligations to provide services, training and assistance (Item 11).

If your first question is "How much money can I make with this franchise?" you'll find an answer (if the franchisor chooses to offer it) in Item 19. Most franchisors don't provide performance data. They leave it to would-be franchisees to make their own projections and assumptions about the potential of the business.

Anyone seriously considering buying a franchise should interview as many existing owners in the system as possible. You'll find a list of owners in Item 20. Ask them how their units perform and whether they're satisfied with the training program and their business's performance. Not only will this information provide an invaluable reality check, but it will also help you with your business planning and financial projections.

3. The network. Turn to the charts and lists shown in Item 20 for a systemwide snapshot of the franchise program. The charts are designed to reveal a three-year summary of the growth--or contraction--of the national franchise system and the franchisor's expansion plans during the coming 12 months.

Generally, two lists are attached to Item 20. The first is a list of existing owners, organized by state. The law requires merely that the franchisor list at least 100 franchisees in your state and adjacent states. Also attached to Item 20 is a list of the names, addresses and telephone numbers of franchisees who have left the system for any reason in the past year. Talk to these former franchise owners to find out why they left and whether it was related to shortcomings in the program.

Talk to Professional Chefs

If you're serious about being in business, you'll need a good accountant and an experienced attorney on your team. Your accountant will perform an essential function: helping you review the financial statements presented in the UFOC and using the cost projections in Item 7 to help you create your own projections and break-even analysis. Where serious dollars are concerned, you can't afford to miscalculate the capital needs and potential return on investment of your new business.

Your attorney will advise you on the franchise agreement, your lease and any ancillary contracts. These are perhaps the most complicated legal obligations you'll encounter as an entrepreneur. The franchise agreement often runs more than 50 pages in length and is not required to be presented in plain English. After all, this contract conveys trademark rights and complex know-how, appoints the right to operate a franchise unit, details the conditions of renewal, specifies fees to be charged, promises services, imposes the obligations to comply with the franchise system, addresses the right of transfer, and tackles the always-difficult topics of termination conditions and post-termination obligations. And that's before it gets to the "boilerplate" provisions of indemnification, dispute resolution and independent contractor status. Stretch these topics to apply over a five-, 10- or 20-year relationship that's bound to change during that time, and you start to get an idea of the agreement's complexity.

This is no time for a do-it-yourself, cursory review. Neither is it time to consult your niece or nephew who happens to be a first-year law student. Find a good attorney with solid experience in advising small businesses who is comfortable reviewing a franchise offering.

Follow the Recipe

The recipe analogy is apt for franchising because many franchisors insist that franchisees follow their recipe for success without deviation. Make sure you like the business of the franchise and that you're prepared to follow the franchisor's approach to management. Many systems leave no leeway for individual variations on the core elements of the franchise program, so owning a franchise is not for everyone.

This may not be the time to adhere to the old saying, "If you can't stand the heat, get out of the kitchen." It's certainly going to get hot in this kitchen, but it's all part of a great small-business investment. Get used to it. Savor it. If you're organized, relentlessly follow the recipe and choose wisely among the available franchises, you'll deliver a seven-course meal of extraordinary franchise success.

Ready, Set, Cook!

Once you've chosen a franchise, you'll be your own master chef. Then it's time to make a success of the recipe and bring your own energy, joy and hard work to the mix.

- **Watch your pennies.** Franchise specialists will tell you that most franchises, like most small-business operations, run on narrow profit margins. Success lies in your willingness to immerse yourself in the control of the expense side of the business.
- **It's people, people, people.** Location is important, but if you're running a retail franchise, your biggest challenge may be finding people to fill the working crew. Economic prosperity and low unemployment mean everyone is looking for solid employees. It's an economic season of high turnover. Offer competitive wages and strong benefits.
- **Sweat the small stuff.** The real magic of retail marketing takes place at the counter, the point of sale. Small things like eye contact, a cheerful greeting, a smile, and a subtle sales spin that promotes specials and larger orders can nudge the narrow margins into clear profitability. The best franchise programs insist on attention to detail at the front counter. The solution: ongoing training of counter or sales crew.
- **Connect with the customer.** Outreach programs are the hot topics among franchisees these days. Direct-mail promotions bring 'em into the store: coupons, punch cards, discount specials, and even

programs allowing the counter staff to learn and remember the names of regular customers are drawing new attention from franchisees in an increasingly crowded and competitive marketplace.

All The Fixings

Part of the task of finding the right franchise for your interests involves investigating resources to help with your search and evaluation. Check out the following government and private resources:

- **The Federal Trade Commission (FTC)** has regulated franchise sales since 1979. Its Franchise Rule requires franchisors to deliver a comprehensive disclosure document to all prospective franchisees at the earlier of 1) the first face-to-face meeting for the purpose of discussing a franchise sale or 2) at least 10 business days before you pay money or sign a binding contract for the purchase of the franchise. Franchisors are not required to file copies of their disclosure documents with the FTC, but you can get general advice and guidance by phone from the FTC's Consumer Response Center at (202) 326-3128, on the Internet at <http://www.ftc.gov> or by writing to the Federal Trade Commission, Washington, DC 20580.
- **Your state.** If you live in one of the 13 "registration states," you can feast on disclosure documents as part of the public record. Contact the agency in parentheses in these states: California (Department of Corporations), Hawaii (Department of Commerce and Consumer Affairs), Illinois (Office of the Attorney General), Indiana (Secretary of State, Securities Division), Maryland (Office of the Attorney General), Minnesota (Department of Commerce), New York (Department of Law), North Dakota (Office of the Securities Commissioner), Rhode Island (Division of Securities), South Dakota (Division of Securities), Virginia (Corporation Commission, Division of Securities and Retail Franchising), Washington (Department of Financial Institutions, Securities Division) and Wisconsin (Commissioner of Securities). If you don't live in one of these states, contact your state's consumer protection agency for general investment information.