

# Research A Franchise

Is that franchise right for you? Here's a step-by-step overview to help you answer that question.

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An old Chinese proverb says a journey of a thousand miles begins with a single step. But the first step from employee to entrepreneur can seem as wide as the Grand Canyon. Looking down that sheer rock cliff with no safety net, and considering how serious the risk of failure is, often intimidates most rational people. Add it all up, and that nice, safe paycheck--no matter how small or large it is--starts looking pretty darn good.

And yet the entrepreneur within just won't let go.

Purchasing a franchise offers one of the most inviting ways to get into business ownership. Franchising has complexities of its own. Of course, it can be intimidating, but it can be done. In fact, it's done every day by ambitious people with limited resources. How can you take on a new challenge in your business life and scratch that entrepreneurial itch?

There's only one way to tackle such a large task: by breaking it down into manageable steps, bite-sized pieces. Study the process so it becomes familiar, not intimidating--and tackle it methodically, one step at a time.

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## Preliminary Steps

The first part of the franchise process is to conduct a brief self-assessment of your personal strengths, weaknesses, likes, dislikes and resources.

Those psychosocial dimensions can guide you through the many decisions

you'll face in the franchise evaluation process. Without those personal signposts, it's easy to lose your way.

What types of businesses excite you? What's your entrepreneurial fantasy? Do you imagine yourself dealing with long lines of retail customers, all waving \$1,000 bills? Or do you see yourself dealing at the business-to-business level, taking calls from Microsoft and Nordstrom? Are you working outside in the fresh air, or is your idea of heaven found in the dusty inner workings of a computer? Do you see yourself working at home, near your family? Are you working part time, or do you plan on this being a full-time career position?

Check your investment resources. List them on paper. Note liquid resources, your cash on hand, savings and that rainy-day cookie jar of \$5 bills you buried in the backyard. What other personal resources can you scare up? If your Aunt Gertrude once offered to help you get started in business, now is the time to talk to her. If your bookworm sister just aced Regis Philbin out of \$1 million on national television, maybe now is the time to talk business loan (if she says no, you have the perfect response: "Is that your final answer?"). Do you have equity in your house or other assets that can be pledged for a loan? Write them down. Expect to call on virtually all your personal financial resources when you purchase a franchised business.

Knowing your resources saves you considerable time when narrowing down choices in a franchise investment.

## Information Gathering

This is the fun part. Attend a franchise trade show and begin to make contacts and gather information. No trade show coming through your town in the near future, you say? Flip through a recent issue of *Entrepreneur* or browse through the franchises listings posted here in the "Franchise Zone," then contact franchise companies directly for information. Your task is to locate businesses that meet your fundamental goals and play to your strengths.

Attending a franchise trade show can be the most efficient way to immerse yourself quickly in the franchise marketplace. Franchise trade shows can

attract hundreds of exhibitors and thousands of attendees, so brace yourself. Impose a method to the show's madness. Grab the show directory and find a place to sit down with a cup of coffee before you walk the aisles. Read the directory with pen in hand, and mark all the businesses you recognize or have even a passing interest in.

Have two or three good questions ready to go. For instance: "What are your expansion plans for my town?" "What separates your franchise from all these others?" "What are you looking for in a franchisee?" You get the idea. You need a good opener that gets the representative talking about his or her franchise.

Many retail franchises qualify applicants by their liquidity, their net worths and/or their business experience. They want to know whether you're serious about making a business investment or just dreaming. At the trade show, dress to communicate that you're serious about business. Leave your version of weekend ripped-T-shirt casual at home, take some personal business cards and prepare to take notes. This will set you apart from the crowd.

You'll come away from the trade show with a bag of company literature, your notes and some free food. All in all, not a bad afternoon. Now go over your notes, jot down your impressions and organize your thoughts. Keep the real possibilities, discard the junk and plan to contact the companies on your short list for additional discussion, maybe via one-on-one visits.

## Check 'Em Out

You've been wowed by the sales presentation; you've sampled the free popcorn at the trade show; you've asked numerous questions and narrowed your list down to a few tasty choices. Now you want to thoroughly check out the company to make sure it's legitimate--to see whether it actually does what it claims to do for its franchisees.

The first and most important step at this stage is contacting as many franchisees as possible and asking them about their business experience with the company. Where do you get a list of franchisees? From the franchisor, of course. Ask for a complete list as opposed to the jotted names of a select few. Get a list with at least 100 franchisees on it,

assuming the system has that many. If the company is able to provide a copy of its current Franchise Disclosure Document (or FDD), all the better. Item 20 of the FDD contains just the list you need.

When you contact existing franchisees, be aware that they're busy business owners on tight schedules (just as you hope to be if you pull this off). If the business is a restaurant, for instance, don't drop in at 12:30 p.m. and expect to receive much attention. Call in advance, make an appointment at a convenient time for the owner and keep the meeting brief. Ask whether the business investment has been a good one for the owner. Has the business's performance met his or her expectations? Has the franchisor lived up to its end of the bargain? Was the training useful and complete? Are franchise owners generally happy in the system or is there audible grumbling? What were last year's gross sales, and are this year's sales progressing at the same pace? Finally, given what the franchisee knows, would he or she make the same investment if he or she had to do it all over again?

You can also check out the franchisor by contacting public sources: your state's consumer protection agencies, the Better Business Bureau, Internet sources (look at [www.franchise.org](http://www.franchise.org) and the Federal Trade Commission's site, [www.ftc.gov](http://www.ftc.gov)). If you live in one of the 14 states that regulate franchise sales, you can contact the appropriate agency and ask whether the company is registered and whether there are any complaints, problems or lawsuits that the agency can tell you about.

## Evaluate The Opportunities

A prospective franchisee has a distinct advantage at this stage of the search: The law hath delivered unto you a FDD. The FDD is an extensive prospectus-like document describing the ins and outs of individual franchises; the law requires franchisors to deliver their FDDs to each prospective franchisee during an in-person meeting or at least 10 business days before you sign a contract or pay money to the franchisor.

Reading the FDD is an essential step in your evaluation. It'll open your eyes to the basic information you need to know when considering the franchise. If you treat it like an imposing insurance policy and slide it directly into your someday-I'll-get-to-it pile, you're doing yourself a big

disservice.

One piece of good news about the FDD is it's not as intimidating as it looks and is even required to be written in plain English. The FDD is a sandwich document made up of three principal parts: a narrative description, financial information and contracts. The first part is a 23-section narrative describing all aspects of the franchise being offered. You'll learn about the fees charged for the franchise, the franchisee's total investment, the legal status of the trademarks, any product restrictions, financing offered by the franchisor, the franchisor's obligations under the franchise agreement, system performance information and statistics about the network of franchisees.

The second part of the FDD is comprised of three years' worth of the franchisor's audited financial statements. This tells you in no uncertain terms about the company's financial standing. After all, if you're prepared to enter into a 10- or 20-year relationship with a franchisor, you'd better know whether it has the money to survive the long haul. If the company's net worth is minimal, at least you can gauge the risk of investing accordingly.

If you don't yet have your MBA or a CPA license, you may want to take the financials to a good accountant or other business advisor. You'll probably need the services of an accountant anyway to prepare your own business plan once you select the right franchise.

The third part of the FDD is the standard form of the franchise contract. A business-format franchise agreement tends to be a lengthy, complex legal document. It has a lot of moving parts and can be difficult to understand . . . no plain English to be found here, my friend. This single document legally manages a long-term commercial relationship; it incorporates the operating manual standards and licenses the intellectual property to be used in the franchise. It also addresses the assignment rights of the franchisee, and spells out what happens if the relationship is terminated. Lawyers for the franchisor prepare the standard franchise agreement with their client's interests firmly in mind. The typical franchise agreement is on the order of complexity of a commercial lease, and you shouldn't sign it without the aid of a competent attorney looking out for *your* interests.

Hire a good lawyer to review the FDD for you. Yes, it'll cost a few dollars, but it's insurance money well spent. You don't want surprises in your relationship with the franchisor. Your attorney can explain the obligations imposed on the franchisee, what formal promises the franchisor makes to you and whether any aspects of the contract may strongly conflict with your interests.

Can you negotiate on the terms of the franchise agreement? Any part of the agreement can be changed if the franchisor agrees to it, but companies are oftentimes reluctant to make negotiated changes in certain states. In California, for instance, a negotiated change in one franchise agreement creates significant additional bureaucratic hoops that the franchisor must jump through. The franchisor must also disclose the change to future franchisees--not an attractive prospect for a franchisor inclined to cut a series of special deals for franchisees. California's FDDs inform franchisees of all such negotiated changes and thus level the information playing field.

Tackling the largest tasks means breaking them down into more manageable pieces. Even the prospect of buying a franchise becomes far less scary if you just take it a step at a time.

## Franchise Registration States

These 14 states require a franchisor to register its FDD and maintain a registration with the state agency indicated.

If the company is authorized to sell franchises in one of these states, the company will be registered with the agencies listed here.

- California Department of Corporations (213) 576-7500
- Hawaii Department of Commerce and Consumer Affairs, Securities Compliance (808) 586-2722
- Illinois Attorney General's Office, Franchise Division (217) 782-1090
- Indiana Securities Commissioner, Securities Division (317) 232-6681
- Maryland Attorney General's Office, Securities Division (410) 576-6360
- Michigan Attorney General's Office, Consumer Protection Division Antitrust and Franchise Unit (517) 373-7117
- Minnesota Minnesota Department of Commerce (612) 296-4026

- New York Department of Law (212) 416-8200
- North Dakota Office of the Securities Commissioner (701) 328-2910
- Rhode Island Division of Securities (401) 222-3048
- South Dakota Division of Securities (605) 773-4823
- Virginia State Corporation Commission, Division Of Securities And Retail Franchising (804) 371-9051
- Washington Department of Financial Institutions, Securities Division (360) 902-8760
- Wisconsin Wisconsin Securities Commission (608) 261-9555