

The Buying Game

Don't get taken by surprise when purchasing a franchise.

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URL: <http://www.entrepreneur.com/article/13780>

Thinking about buying a franchise? If you've ever had the singular experience of buying a home, then coming to a decision as important as buying the right franchise will be easy. Well, maybe not easy, but at least having undergone the purchase of real estate--and the sheer terror of the experience--will make researching and evaluating a franchise that much easier for you.

Make no mistake: Becoming a franchise business owner demands just as much attention to detail--and possible legal traps--as becoming a homeowner. In fact, the familiar disciplines of home-buying can teach you a lot about how to go about a franchise purchase. Here, then, are the "house rules" to live by:

- *House Rule #1: Know your needs and budget.* Start by carefully evaluating your business interests and strengths, as well as your financial position. Are you looking for a full-time business or a part-time, homebased business to supplement what you're currently doing? Does a business-to-business concept interest you, or are you more interested in retail sales?

How much money do you have to invest, and what exactly (and realistically) are your financial resources? If you have family members or close friends who you think will back you in this venture, contact them and discuss your ideas in concrete terms.

Take the time to work out a rough budget for this business purchase before you start talking to franchisor representatives. It will save you a lot of time and keep you focused on programs you can afford.

- *House Rule #2: Know the market.* Remember the top three factors you look for when selecting real estate: location, location and location. This old saying hammers home a lesson that is just as important in

selecting a franchise. The marketplace determines which businesses will succeed and which will fail. So you had better know that marketplace very well before you sign on the dotted line. Drive the streets of your town, and hit the library for some old-fashioned research. What businesses are needed in your market, and where is there too much competition? Are some areas of town struggling while others are growing? Why? What trends are evident in your market, and which way are they heading in the future?

- *House Rule #3: Check out comparables.* Franchising has matured to the point that there is healthy competition in almost all industry categories. Attend a trade show or call the competitors of the franchise system you're considering. Don't know who the competitors are? Check out the Franchise 500 listing on page 206. You should talk to at least three franchisors about their programs and take them through your own comparison checklist (see "Comparing The Facts" on page 176).
- *House Rule #4: Line up your financing.* It's never too soon to line up financing sources. Don't assume that the franchisor will take care of this for you. One of the reasons the franchising concept works as well as it does is that individual investors generally bring their own capital resources to the table.

Start by getting your own information organized. Prepare a personal financial statement on forms provided by a local bank or bought at a stationery store. Talk to your personal sources to see if there's any additional financing that might be available to you. Nail down Aunt Gertrude's hint over the summer that she wants to back you in business. Find out what she really has in mind, and fold it into your financial profile.

Start meeting with bankers in your town. Find out who the best Small Business Administration (SBA) lenders are, and set up appointments to discuss your financial needs. To find out about SBA lenders in your area, call your local SBA office or check out the SBA Web site at www.sba.gov.

- *House Rule #5: Check out the neighborhood "schools."* In this case, "schools" refers to the franchisors' training programs. Training is the first indicator of a strong franchise program. Where will training take place, and how extensive is it? What is the proportion of classroom

instruction to field training, and who will be teaching you? Find out if training is available for your key employees, not only at the beginning but also if you need it later.

- *House Rule #6: Inspect the property.* Here's the good news: Crawling through the attic of a new franchise is a lot easier than it used to be. Franchisors are required by law to give you a Uniform Franchise Offering Circular, or UFOC, which describes the key aspects of their franchise offerings. This prospectus will provide you with a wealth of information about the purchase you are contemplating.

You will not automatically receive a UFOC. The law requires franchisors to deliver one at the earlier of 1) 10 business days before you pay any money or sign a binding contract, or 2) at the first serious face-to-face meeting you have to discuss the franchise opportunity. Trade show meetings generally do not trigger this disclosure obligation, so do not expect to pick up a UFOC at the show. A one-on-one meeting away from the trade show floor probably will require disclosure delivery. If you are at all serious about evaluating a particular franchise, request a copy of the company's UFOC at the earliest opportunity.

What should you look for in the UFOC? The document is organized into 23 topics of information, some more useful than others. Among the key sections:

Items 1 and 2: *The franchisor and the experience of its executives.* These sections will give you a general sense of the franchisor, the franchise offering and the business experience of the people involved in the program.

Items 3 and 4: *Litigation and bankruptcy history.* Check here for legal problems the company or its key people have experienced. If you find a listing of cases, ask your franchisor contacts: What were the cases about? Who initiated the actions? Are the system problems that led to the conflicts resolved, or are they still festering? Most American businesses have litigation scars, so don't expect a completely clean bill of health. If you find one, all the better.

Items 5, 6 and 7: *Fees and total estimated investment.* These sections break down the fees payable to the franchisor and the total investment necessary to start the business. Tip: Do not overlook the money you will

need to live on during the construction and start-up phases of your new business.

Item 10: *Financing.* If the franchisor offers any type of financing, it will be detailed here. Tip: Don't stop the inquiry if the UFOC says the franchisor provides no financing. The company may have developed relationships with bankers who understand its particular business. The company may have also gathered information that will save you time in preparing the documentation needed to apply for bank financing or give you guidance on meeting SBA loan requirements. Talk to the franchisor representative and find out how the company can help you.

Item 19: *Earnings claims.* About one-fourth of all franchisors provide information in this section about how much money you can expect to make with the franchised business. Tip: If there's no information in Item 19, ask why not. It may be that the earnings picture is not that attractive. If you find earnings information here, such as a systemwide statement of average annual revenues, the franchisor is required to provide data substantiating these claims if you request it. Also, plan to ask other franchisees how much money they are making in the business when you "meet the neighbors" (see House Rule #8).

Item 20: *System information.* Here you will get an idea of the number of franchises in the system and how many have left the system in the past three years.

Another part of Item 20 lays out the number of company locations and franchises projected for the coming year on a state-by-state basis. Attached to Item 20 is a list of the names and addresses of current franchisees in your state and in neighboring states as well as a list of the names and addresses of those who have left the system in the prior fiscal year. Use this information when you set out to meet franchisees.

Item 21: *Franchisor financial information.* This section gives you a three-year financial picture of the franchisor, prepared and audited by an independent CPA. Get help reviewing this information, particularly if you have any question about the company's financial stability. Hire an accountant to review the financial aspects of the UFOC and possibly help you prepare a detailed financial business plan.

Item 22: Franchise agreement. Yes, it's the dreaded all-American commercial contract: up to 70 single-spaced pages of turgid legalese. If the only recollection you have from reading this imposing document is the sound of your forehead hitting the kitchen table, you need . . .

- *House Rule #7: Check the fine print, and get professional help.* You simply cannot turn away from the document, telling yourself that it is all boilerplate nonsense anyway. Spend the money and find a lawyer you trust to look it over for you. He or she will tell you if there are provisions you should not accept and perhaps should try to negotiate with the franchisor.

Get used to using attorneys. In your new business, you will need to turn to a legal counselor you trust for help in organizing your company, obtaining permits, collecting money from customers and clients, and more.

- *House Rule #8: Meet the neighbors.* An essential part of your evaluation of any franchise is to meet with current franchise owners in the system. Owners will give you insiders' perspectives on a program you have only seen from the outside thus far.

Be prepared to ask some tough questions of these owners. Odds are they won't pull any punches, and they can tell you things about the business that the franchisor really can't (see "Information, Please," left).

- *House Rule #9: Buy for the long term; don't speculate.* For most of us, a purchase of this magnitude, just like the purchase of a house, is a long-term investment. You will take a financial bath if you decide to walk away from it after it's yours or if you make an error in judgment when deciding which franchise to buy.

The only answer is to move cautiously, teach yourself what you need to know to make a good decision, and get help where you need it. Make the right decision, and you will join the ranks of tens of thousands of franchise owners who would happily make the same investment again and who thoroughly enjoy the freedom that comes with business ownership.

Comparing The Facts

When researching franchise systems, make sure you're comparing apples to apples by checking out the following key points:

Training

- How much is provided
- The mix of classroom and field experience
- Comments by existing franchisees

Franchisor Financial Stability Grade*

System Culture

- Are franchisees generally happy with the franchisor's services?
- Are there regular regional and/or national meetings/conventions to keep skills fresh?
- Is there a franchise owners council with input into the franchisor's decisions?
- Is there communication among the franchisor and franchisees?

Investment Estimates and Earnings Capacity*

Legal Obligations**

Business Trends

- Is the business on the upswing in the economy?
- Will the business still be profitable in five, 10 or 20 years?
- Does the franchisor have expansion plans?
- Your measure of the competition
- Needs of your own marketplace

Franchisee Comments

Intangibles

How do you feel about the program in your gut? And, perhaps most important, will it fulfill your dreams?

Information, Please

When you visit existing franchisees, be prepared to ask these essential questions:

* Were the franchisor and the training helpful to you when you were starting up?

- Do you enjoy the business? Tell me about your typical day.
- Is the business seasonal? How do you get through the off-season?
- Do you attend systemwide meetings? Do you enjoy the meetings? Why?
- Where do you buy product supplies for the business? Do you think it needs to be improved?
- Does this franchise give you the tools you need to compete effectively?
- Do you think you are receiving good value for your royalty payments?
- What do you like least about the franchise? Most?
- Has this business met your expectations as far as the return on your investment? What did the business gross last year?
- Are you planning to develop additional franchises?
- Knowing what you know now, would you buy the franchise again?

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Straight To The Source

- The *Federal Trade Commission* provides a package of information about the FTC Franchise and Business Opportunity Rule free of charge. Write to the Public Reference Branch, Federal Trade Commission, Washington, DC 20580, or call (202) 326-3128.