

BUYING A FRANCHISE, like buying a car, is a challenge.

You know the routine when you buy a car. Choose unwisely, and you could have one costly problem on your hands. It can be a lemon or the buy of a lifetime, so you look it over with care. Finally, you step up, and after going through your best negotiating routines ("Gee, I don't know, that's an awful lot of money"), you put down your money and drive it off the lot. Mission accomplished.

Buying a franchise should involve a similar process. If you don't approach the evaluation process cautiously, you could end up with the business problems of a lifetime. Also, as with buying cars, you're one step ahead of the game if you know the frequently encountered traps before you step foot on the lot.

Trap: "You needed a hard-working pickup truck, so who talked you into that '84 Corvette?" As you read in "Wish List" on page 92, it's easy to get pulled in the wrong direction when buying a franchise. There are some real pros out there; some of the greatest salespeople in American business sell franchises. You start out seeking a part-time at-home supplement to your regular work, but you find yourself negotiating for a free-standing fast-food operation. How did you get here?

Tip: Ground yourself before you jump into the franchise selection process. Carefully evaluate yourself, your needs, dreams, working experience, financial requirements, willingness to sacrifice, time and family commitments, and willingness to undertake risks. Be realistic. Focus on what you enjoy about your working life. After all, for most people the purchase of a franchise is a radical departure from their experience as employees. Take advantage of the opportunity to find a business that's right for you. Life is short, so choose a business you will thoroughly enjoy building day in and day out.

Lifestyle was an important factor for Jim and Cheryl Klinkhamer, recent franchise buyers in Dallas. "We knew right away that we would fit in with the Great

Harvest bakery franchise. We liked their flexible philosophy, and when we visited the store, we knew we could see ourselves running a bakery, kneading bread, and having fun with our customers," says Cheryl.

"All the Great Harvest bakery owners we met were friendly, fun and hard-working people," adds Jim. "And they do a good job of empowering their employees. We like that."

Trap: "Just how do you expect to pay for that \$40,000 BMW on your salary?" It's a common and always tragic mistake to buy into a business and overpay for it. This happens frequently in franchising because of the up-front expenses that are unique to franchised businesses: initial fees to the franchisor (expect \$10,000 to \$40,000), training expenses, start-up inventory, signs and build-out specifications to achieve the uniform appearance of the franchise system. These are all paid out of pocket before the first sale is ever made. Initial expenses are often financed, of course, and the trick is to make sure that the revenue generated by the business can carry the debt and that expenses do not outstrip available capital for the start-up phase.

Tip: As with other forms of entrepreneurial ventures, there is no substitute for a detailed business plan.

Just as you should take a look at your monthly checkbook and confer with your spouse before purchasing that dream BMW, you must prepare a cash flow analysis and operations projection that are realistic.

Trap: "You just bought a what!? I got stuck with one of those #%&@!\$ rolling lemons six months ago and finally unloaded it last week. I wish you had checked with me first, ol' buddy." It's easy to feel isolated when buying a franchise. If you don't reach out to those who can help you objectively evaluate the investment, you set yourself up for some disappointing surprises.

Tip: Most franchise systems have scores of existing owners. Head out and talk to them. Sit in their stores, ride with them as they service their route, sit next to them as they make cold calls, or attend the seminars they teach. Not only will you get a solid feel for the

Watch Your STEP

Tips for avoiding the traps of buying a franchise

BY ANDREW A. CAFFEY

business, but you can ask the owners how they like the franchise. Consider asking these questions:

◆Do you enjoy this business? Is there anything about it you don't like?

◆Has the franchisor been supportive? Was the training program useful in establishing the business? How does the company respond when you call with a problem?

◆Knowing what you know now about the company, would you make the same decision to buy this franchise? Would you buy a second franchise if it were available to you?

◆Is the business seasonal? How do you staff up for the busy seasons, and how do you financially handle the slow times?

◆Is the advertising effective?

◆What sort of input do fran-

chise owners have in the system? What is the mood of the owners?

◆What were your gross sales last year? What are product costs? Is the supply of product adequate?

◆What can I expect to net from this franchise?

Make sure you speak to a fair sampling of franchise owners; do not allow the franchisor to give you only one or two names. Handpicked franchisees may be unusually successful, or worse, they may be shilling for the franchisor on the promise of a substantial commission if you make a purchase. It's rare, but it happens.

Trap: "I didn't read the fine print. I assumed it had air conditioning. Who would sell a car in this climate without air?" Purchasing a franchise is an occasion for a paper storm. The temptation to ignore it and assume it is meaningless lawyer-babble is almost irresistible for investors not inclined to wade through substantial documents looking for details.

Tip: Among the flurry of documents is the Uniform Franchise Offering Circular (UFOC), essential reading for your investment. This offering prospectus contains a mountain of useful information. Among its high points:

◆A description of the franchisor's officers and their business experience.

◆A summary of the franchisor's bankruptcy and litigation history.

◆A chart detailing the initial expenses you are likely to incur in setting up the franchise.

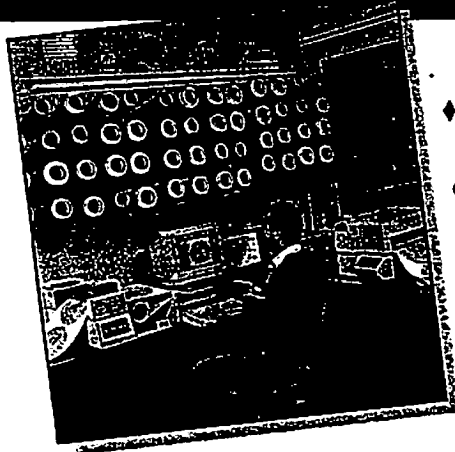
◆A description of the direct and indirect fees imposed by the franchise agreement.

◆The franchisor's three most recent annual audited financial statements.

◆A copy of the franchise agreement and related contracts to be signed.

"Be sure to check the franchisor's financial standing by reviewing its financial [statements]," says Minneapolis franchise attorney Tom MacIntosh, "and check with the Better Business Bureau. The last thing you want is to discover after you buy that the company is insolvent or is the recipient of numerous complaints."

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Bonus Tip: Read the darn thing. It's surprising how many people don't read the UFOC. (For more information about the UFOC, see "Understanding the UFOC" on page 106.)

Trap: *Your mechanic would have spotted that problem with one look under the hood.* A franchise investment is a complicated transaction. You will be offered an extensive, long-term franchise agreement, often written so that every advantage and every bit of control is reserved by the franchisor. For most investors, the franchise will require the savings and resources accumulated over a lifetime. The trap is to make such a commitment without evaluating the risks to your investment.

Tip: Get professional help. Lawyers and accountants are business mechanics and should be consulted whenever you are considering making a substantial investment. This is no time to pinch pennies. Yes, there are substantial fees involved, but compared to what is being put at risk, you can't afford not to buy the additional insurance and peace of mind that comes with a thorough professional review.

The Klinkhamers got their lawyer involved early in the process. "We looked at a lot of franchise programs before we found one that was right for us," says Jim. "We took the contract and disclosure document to our lawyer as soon as we got it. He told us the agreement was fair and well-balanced, so we knew we were on to a company we could be comfortable with."

Cheryl adds with glee, "He even asked us if we needed another investor!"

Trap: *It's a brand-new model; the bugs aren't out of it yet.* New franchise programs offer exciting upsides and dangerous downsides. The good news is a new franchise system can offer enormous opportunity and value for your investment. New franchisors are eager to locate willing investors and will often give major concessions to them just to get their new businesses up and running.

The bad news is the risks are high. New programs are untested in the

marketplace, and their trademarks are not well-recognized; in addition, their training and support services may be inadequate. "Often, the franchisor's executives can't answer questions about the system or simply do not understand the company's new culture," says MacIntosh.

Tip: Move cautiously if you are considering buying a franchise in a new program, and look over the

prospects for success with a critical eye. If there are any other investors in the program, be sure to meet them. Read over the franchisor's financial statements to determine whether the company has a substantial or minimal net worth. What is the business experience of the officers and managers listed in Item 2 of the UFOC? Tenaciously negotiate the terms of purchase so you can

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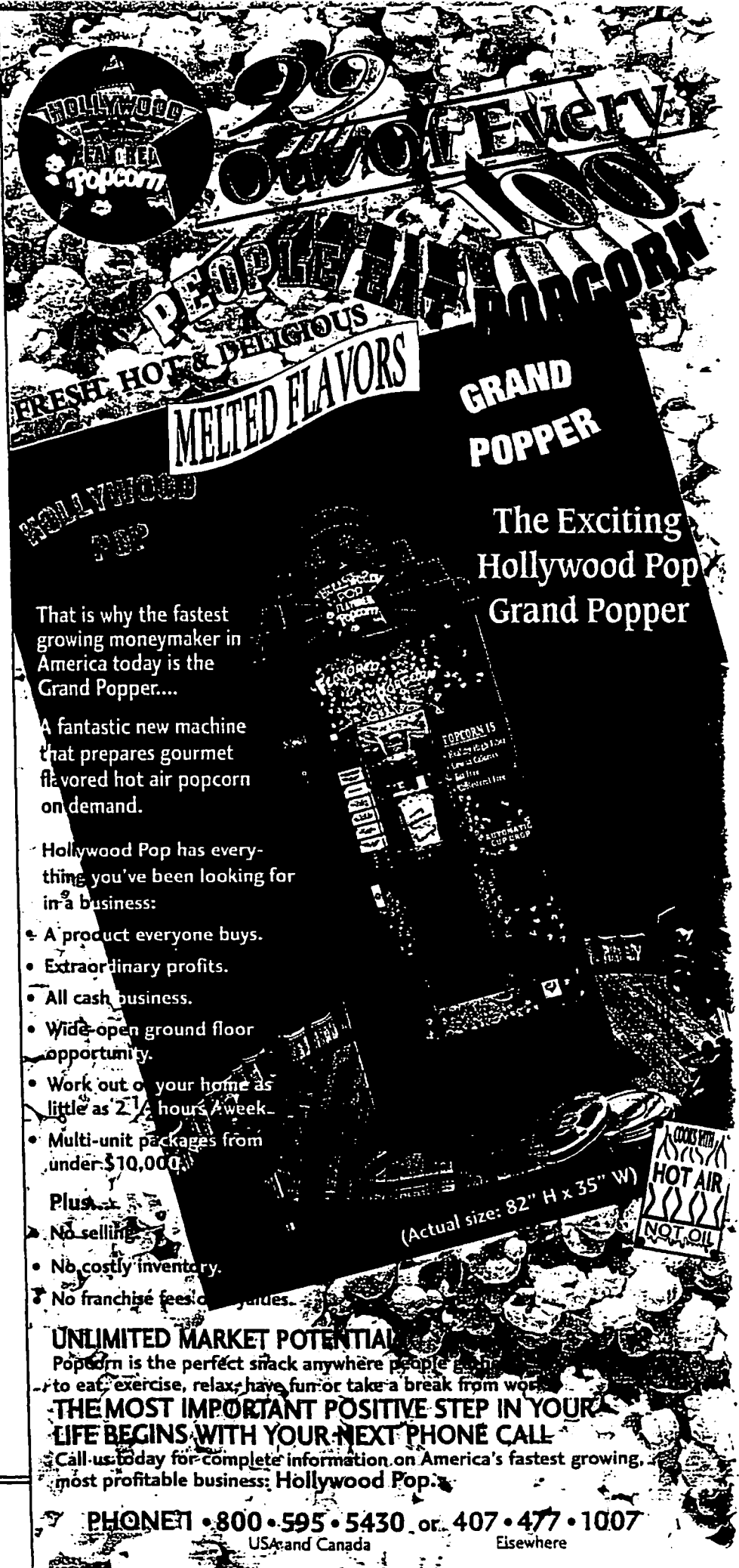
Trap: *The salesman told me this beast would get 29 mpg. Not even close!* If franchising has picked up a mixed reputation over the years, it's because of pie-in-the-sky promises of wealth and success. Franchising's history is studded with exaggerated statements and claims of how much an investor might make in the business. It is a formula destined to create disappointed investors. If you receive assurances of profitability that sound too good to be realistic, look out.

Tip: Franchisors should exercise great care in answering the question: "How much can I make with your franchise?" Earnings' claims—any statement that suggests to the prospective buyer a specific level of sales or profits—must appear in Item 19 of the UFOC and must have a reasonable basis in fact. In addition, franchisors must make data substantiating the earnings claim available to the prospect on reasonable request. Confirm any earnings claims with an existing franchise owner to make sure they're realistic.

Trap: *You bought what looked good, but you realize you have a lemon. You didn't check the warranty. Now what do you do?* It's an old story. For any number of reasons, the business doesn't work out. It's not as profitable as you had hoped, or it's harder work than you anticipated. What options do you have, and how can you protect your original investment?

Tip: Your franchise agreement will spell out what alternatives you have in the event you want out. "Make sure the agreement allows for a fair exit. The franchise laws in a number of states may also help," says attorney MacIntosh. "This is something you should review carefully with your lawyer before you invest in the business." 

Andrew A. Caffey is a practicing Washington, DC, attorney, the former General Counsel of the International Franchise Association, the founder of the American Business Opportunity Institute, and a nationally recognized specialist in the field of franchise and business opportunity law.



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