Budget-Friendly Franchise

Looking for a franchise you can afford? We've got all the answers you need to do your homework -- and spend wisely.

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Low-cost franchises have become hot commodities. Prospective franchisees know that if they can choose wisely and start businesses without the heavy front-end investment of a retail location, they can increase the potential return on their money. It's a well-known numbers game. For example, the typical new restaurant build-out, including franchise fees, can run you $400,000 or more. That means some serious lender financing for most people, as in signing a 30-year personal note and putting your house on the line. You'll find similarly sobering numbers when building out a franchised muffler shop or a convenience store. These businesses ratchet up the franchise investment to a level that puts it out of reach for mere mortals trying to make the jump into business ownership.

That's where low-investment franchises come in. This category includes perfectly robust businesses that can be run from inexpensive office spaces or executive suite arrangements, or even from home offices. Maid services, in-home care services, magazine publishing, trademarked product distribution, interior decorating, auto-mechanic tool distribution and a variety of mobile, van-based repair services are just a few of the categories. If you can get into the business for a total investment in five figures, consider it a lower-end franchise investment.

As with all franchises, however, it pays to assess the stability of the program and the financial risks you're undertaking. Just because the level of investment is manageable doesn't make it low-risk; being able to swing a $45,000 investment doesn't mean you can afford to lose it all. So here is a nugget of franchise advice that's worth its weight in pink slips: in a word, research.

With a modest amount of diligent research, you can lower many of the risks inherent in a franchise business investment. Don't let the idea discourage you--this is rather enjoyable research, gathering information that will make you better at running your franchise. It's asking people the right questions-and it's an organized way to investigate a serious investment.

Do Your Homework

Start with the quality of your search. Attending a franchise trade show is a great way to get your feet wet. Held in large cities nationwide, these shows allow you to meet dozens of franchise representatives, all eager to convince you that their programs are tailor-made for you.

Go with an open mind, but before you go, spend a few minutes writing down what would best meet your financial expectations and investment level. Know how much you have to spend on a franchise business and what type of business would excite your interests. Are you good at selling and do you want to deal with the public? Or do you see yourself involved with other businesses? Getting your thoughts straight before you arrive on the trade show floor will save you time and aggravation. If you're looking for a lower-level investment, you don't want to spend your valuable time talking to restaurant franchisors about $500,000 investments. Also, jot down a few qualifying questions so they're at the top of your mind when you approach a booth: "Can you tell me the total investment range for your program?" "What are your initial fees?" "Are there other franchisees in my town?" "How long have you been in this business?"

You should come back from a franchise trade show with basic information about a sampling of qualified programs. Follow up by writing a letter or e-mail requesting more information from the ones that interest you.

The internet provides a flood of information about franchising, and you should put it to work for you. The ratio of hype to fact is rather high, but there is no better way to shop for ideas and to get a sense of the programs available in the market. New, sophisticated tools that will help you search are showing up on the net. For instance, for a modest price, www.fransurvey.com provides a collected survey of franchisee opinions about their own experiences in a growing number of franchise systems.

Federal and state enforcement agencies are also helpful research sources. The FTC regulates franchise sales nationally and has a useful website that gives you a sense of the actions recently taken against franchisors that have not been playing by the rules.

If you live in one of the 14 states that also regulates franchise sales, you should check with the regulating agency to make sure a franchisor is registered in your state to actually offer and sell you a franchise. The registration states are: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington and Wisconsin. Contact the state attorney general or securities commissioner, and inquire about franchise registration information. If you are not in one of these states, contact your state consumer protection officials about franchise investments-you might be able to learn whether there are any current problems with a particular franchisor. The Better Business Bureau is also a reliable source of documented complaints lodged against franchise businesses.

The two prime areas of research on your list are the franchisor itself and existing franchisees in the system. Franchisors are required by law to provide an invaluable document to prospective franchisees, and you should look for a copy from a franchisor if you are serious about its offering. This document, called the Uniform Franchise Offering Circular (UFOC), must be delivered to a prospective franchisee at least 10 business days before a contract is signed or money is paid, or at the first personal meeting to discuss the sale of the franchise, whichever comes first. That means the company is not required to deliver a document to everyone who applies, just to those who have a face-to-face meeting or actually commit to buying a franchise. The franchisor may choose to give you a copy at any time, so by all means request one.

The UFOC serves essential information to you on a platter; it's research in its simplest form. You can read all about the company, summaries of the fees to be paid to the franchisor and your total investment (see Item 7), required purchases, territory and trademark rights, earnings claims, and system statistics. Attached as exhibits are lists of current franchisees and recently departed franchisees, the form of franchise agreement you will be asked to sign, and up to three years of the franchisor's audited financial statements. Be sure to read this vital document before you put your money on the line. Take the financials to a qualified accountant and the franchise agreement to an attorney for evaluation, and you'll have the right experts on your side.

Your final stop on your research quest is to talk to franchisees and interview as many existing franchisees as you can.

How Much Will You Make?

The most vexing part of research is finding business performance information. Any rational investor wants to know how much money he or she will make and how the franchise will perform financially. It's vexing because franchisors are restricted by law from providing any performance information (known as "earnings claims") unless it is disclosed formally in Item 19 of the UFOC. About two-thirds of all franchisors have no such disclosures and so, at least according to the rules of the game, give no earnings claims information. So where do you turn for answers to this vital question?

Your primary research source is franchisees. They aren't restricted in any way by the franchise laws and are free to share information with anyone. When you gather information from franchisees, note it carefully and use it as one factor when working with your accountant to prepare a conservative set of financial projections. Many factors affect how those numbers relate to your business performance.

Also ask your accountant to help you examine the franchisor's audited financial statements in the UFOC. Sometimes the presentation will break out royalty revenue from franchisees and may (if 100 percent is collected), with some simple math, give you an idea of the average franchisee's revenues.

If your franchisor is among the one-third of franchisors that provides earnings information, examine Item 19 and pay attention to the data qualifications and limitations discussed in the footnotes. There is always a wide range of performance levels in a franchise system-some locations are unbeatable, but some owners are fantastic managers and operators, and there are weaker locations and poorer performers among us all, franchisees included. Keep this in mind as you review the performance information in Item 19.

The action at the lower investment levels of franchising is white-hot, no question about it. Since the mid-1990s, the power of the PC has allowed many businesses to become homebased, dramatically lowering overhead and opening up a remarkable array of business franchise concepts that don't require the investment expense of a built-out retail location.

Even if it is a relatively low investment, you still need to take the time and spend the effort necessary to thoroughly research the opportunity. Read the UFOC, talk to current franchisees, call a few former franchisees, and ask tough questions. You'll form a clear picture of the company and its franchise program very quickly, and you'll be able to make the franchise investment with confidence.

Franchises Are Your Friends

Your best sources of information are existing owners in a franchise system-talking to them is a must. A good approach and a sensitive discussion makes all the difference. Remember:

- Owners are sympathetic. They immediately identify with you; they were in your shoes before they bought into the franchise. They want to help.
- Respect the franchisee's time. Don't show up at lunchtime and try to get a restaurant supplier's attention, and don't expect to get a franchised magazine publisher's attention when an issue is approaching deadline. Make an appointment for a convenient time before or after a busy period when you can meet in person and have a focused discussion.
- Ask about training value. In any franchise, training is a large part of what you pay for. With a low-cost franchise, you want to make sure the training is rock-solid. Ask current owners what they thought of the training and whether it equipped them well for operating the business.
- Confirm franchisor support. Just because you haven't sunk half a million dollars into a franchise does not mean the franchisor should be weak on support. Ask owners if they think the franchisor has

sufficient resources to provide the support franchisees need to be successful. Is there someone who's knowledgeable at the other end of the line when you need help?

- Explore business success. An important question to ask when you're interviewing a franchisee is whether the business has been successful in the owner's eyes. It's all right to ask a business owner what his or her company's gross sales were in the past year. Then pop the ultimate question: "If you had the chance to do it over, would you invest in this franchise?"

Take Your Money and Run

Keep an eye out for these warning signs that the franchise system is not healthy or the program isn't working well for investors.

- High turnover rate: Item 20 of the UFOC shows you the number of franchisees who have left the system in the past fiscal year, as well as their names and addresses. Is the turnover figure more than 20 percent? Ask why those people left: Did they sell their businesses for a tidy profit, or did they fail in the business and close their doors? Talk to several people who left. A high turn-over rate caused by business failure or franchisee unhappiness is a reason for concern.
- An aggressive franchisor dispute resolution style: If the franchisor has a history of suing its franchisees to collect fees or enforce the terms of the franchise agreement, it will be revealed in Item 3 of the UFOC. When you see a large number of disclosed cases, ask the franchisor and franchisees what it means.
- Disappointing franchisee reports: When you talk to franchisees, what do they say about their experiences with the program? If they are discouraged, not making money or mad at the franchisor for some reason, you need to understand the problem. Do not be quick to conclude that the same problems can't happen to you-they can.
- Little or no track record: Some of the most promising low-cost franchise investments on the market are new and don't have much of a track record. That's not fatal, but it should alert you to an elevated risk.

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