

HOW TO BUY A FRANCHISE: A LAWYER'S PERSPECTIVE

By Michael R. Liss

"Franchising is the wave of the future," according to the U.S. Department of Commerce. John Naisbitt writes in *Megatrends*: "Franchising is the single most successful marketing concept ever." Should you consider going into a franchised business? And how do you become part of this success?

Let's start with the most important considerations: Before you buy a franchise, be sure you know yourself, the franchise program, and the franchise agreement.

KNOW YOURSELF

Do what you like. This is your chance to choose to do what you really want to do. Take the time to determine what you and perhaps your family would really like to do while working. You can choose a business you love. It is not just a job. Your business becomes a part of you. It is a reflection of you.

Work the numbers. Know what you can afford. How much cash do you have? How much can you borrow? How much does it cost to start this business? How much does it take to keep it going until it becomes profitable? An accountant familiar with business startups will be very helpful in preparing these numbers. Your preparation of a business plan will help you get ready. Investigate before you invest.

KNOW THE FRANCHISE PROGRAM

Be prepared. When you buy a franchise instead of creating a business from scratch, you can know much more about the business you are starting. You can prepare. You can determine if a particular franchise program is right for you. Your access to more information comes from many sources. You can visit existing stores. You can examine and purchase goods and services from franchises that are already in the program.

Franchisees tell you the truth. Call these franchisees and ask them the tough and detailed questions listed in the "Questions to Ask Existing Franchisees When Buying a Franchise" chart that accompanies this article. Existing franchisees are typically very open and honest in relating to you how they bought their franchise business. They will tell you what they like and dislike about the franchisor and the franchise program. Franchise prospects have told

me stories about existing franchisees inviting them to come into their stores to actually review the store's profit and loss records. The existing franchisees remember how they wanted help when they bought their franchise, and now they want to help you.

Compare offering circulars. All franchise buyers receive a franchise offering circular from the franchisor. It provides you with written information about the franchise program and the franchisor's company. Every franchise offering circular is made up of 23 Items, and the Items always appear in the same sequence. For example, Item 5 in every offering circular will tell you about the upfront fees involved in buying the franchise. You can easily compare one franchise to another by comparing the information in these 23 Items.

Franchisor background. The offering circular provides you with extensive information. Items 1 and 2 identify the franchisor's company, type of business, industry, and the experience of each of the franchisor's key personnel whom you will be relying upon for support. You should contact the franchisor's personnel, visit their office, and determine if their knowledge is what you need and if they fit with your personality and style. Items 3 and 4 tell you about the company's litigation history and bankruptcies. Each lawsuit is summarized. You can tell what people are angry about, who is suing whom, and who is winning or losing.

Additional fees and costs. Money and cost information is in Items 5, 6 and 7. All the fees which you could be required to pay must be disclosed and explained. Item 5 is the upfront fees. Item 6 is the ongoing fees, like royalty and advertising charges. Item 7 is a chart that lists for you all the costs of going into this business. This information is very helpful in preparing your business plan.

Many franchisors make a significant amount of money by requiring you to buy products or services from them. This information and how much the franchisor makes are in Item 8.

Item 9 is a great cross-reference index to find various topics of interest. It tells you the Item number in the offering circular and the section number in the franchise agreement. For example, if you want to know if there is any sales quota involved, Item 9.k of every franchise offering circular will answer that for you.

Financing. Financing information is provided in Item 10. This item tells you not only if financing is available, but what it costs, who provides it and what type of items can be financed. It even provides you with copies of the legal documents you would be asked to sign to obtain this financing.

Support. Many franchisees buy franchises in order to obtain support and guidance in both opening and running their business. All of this is in Item 11: Pre-opening training, operation manuals, site selection assistance, operational consultations, advertising programs, and computer requirements. By comparing offering circulars from different franchise companies, you can see what you will get for your money.

Your legal rights. The next few Items in the offering circular cover many of the nitty-gritty legal issues of owning a franchise. Key issues include such topics as how long you can be a franchisee for, how you could ever sell your franchise, non-compete requirements, how the franchise rights can be taken from you, your rights to cure defaults and keep the franchise, and even where and how disputes will get resolved.

Franchisee phone numbers. Some of the most important information is towards the back of the offering circular: A list of every franchisee, their locations and their telephone numbers is provided. You must call them. They can tell you the truth about this franchise program. To know how financially strong this franchisor is, you are provided with three years of the franchisor's audited financial statements. If the franchisor is going to provide you information about how much money its franchisees make, it will be in Item 19. Most franchise programs do not and instead direct you to call existing franchisees to hear first-hand about money matters.

Finally, every contract, lease, or other legal document which this franchisor will ask you to sign is included in the back of the offering circular. You can read them now without being rushed.

KNOW THE FRANCHISE AGREEMENT

Read the franchise agreement, sublease, and other documents provided in the offering circular. You have time to read them because federal law prohibits the franchisor from rushing you to sign the contracts or pay money; in fact, the franchisor must wait at least 10 business days so you can get prepared.

Hire a franchise lawyer. You will need a franchise lawyer to work with you because the franchise program will need a careful legal review. Also, with most franchise programs, you can negotiate and change the terms of the franchise contracts to be fairer. The contracts start off one-sided because they are written by the franchisor. It is your responsibility to ask for the changes you want. A franchise lawyer will know what can be changed and how to negotiate for you successfully.

You can own a franchise and be part of the success if you:

- Investigate before you invest.
- You know what you want and can handle.
- Check out the franchise program with existing franchisees.
- Meet the franchisor's people who will be advising you and supporting your business.
- Carefully review the offering circular and franchise agreement.
- Hire a franchise lawyer to check out the franchise and negotiate the right terms for your franchise agreement.

Preparing now to make the right decisions will allow you to start and succeed in your own franchise business.

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QUESTIONS TO ASK EXISTING FRANCHISEES WHEN BUYING A FRANCHISE

1. Has owning a franchise been good for you?
2. Were you trained properly for running the business?
3. What does the franchisor do well for you?
4. What do you think of the franchisor's marketing and advertising programs?
5. What is the biggest advantage of your business?
6. What is the greatest weakness of the business?
7. Why might one fail in this business?
8. How long did it take before you started making a profit? Are you making the money you expected? How much money do you make with the franchise?
9. What did it cost you to build and start the franchise?
10. Did you finance the cost of the business? How easy was that?
11. How many hours a week do you work on the franchise?
12. What is the reputation of the franchisor in the industry?
13. Is the business different from what you originally expected?
14. Does the management have the expertise and experience to teach you how to operate the business?
15. Are you satisfied with what the franchisor is doing?
16. If you had to do it all over again, would you select the same business and the same franchisor?
17. Are there restrictions regarding suppliers from whom you can buy goods and services? Has that been a problem? Are costs okay?
18. How thorough a job did the franchisor do with the site selection and lease negotiation process? And with the whole pre-opening process?
19. How did you obtain sales and profit information to help you with your initial plans?
20. Does the franchisor seem financially healthy?
21. Is there any turmoil in the franchise system?
22. Are there any new products or developments coming out?