

*Buying a franchise is investing in your future. Because the **International Franchise Association** wants tomorrow's business owners to make educated decisions about their futures, it is providing the following information from the Federal Trade Commission's (FTC) "Consumer Guide To Buying A Franchise." IFA recommends enlisting the help of an attorney, business consultant and accountant when investigating franchise systems before investing. For this and other information about franchising, visit IFA's Web site at [www.franchise.org](http://www.franchise.org).*

## **Federal Trade Commission's Consumer Guide To Buying A Franchise**

Many people dream of being an entrepreneur. By purchasing a franchise, you can sell goods and services that have instant name recognition and can obtain training and ongoing support to help you succeed. But be cautious. Like any investment, purchasing a franchise does not guarantee success.

To help you evaluate whether owning a franchise is right for you, the following information will help you understand your obligations as a franchise owner, how to shop for franchise opportunities, and how to ask the right questions before you invest.

### **The Benefits And Responsibilities of Franchise Ownership**

A franchise typically enables you, the investor or "franchisee," to operate a business. By paying a franchise fee, which may cost several thousand dollars, you are given a format or system developed by the company ("franchisor"), the right to use the franchisor's name for a limited time, and assistance. For example, the franchisor may help you find a location for your outlet; provide initial training and an operating manual; and advise you on management, marketing, or personnel. Some franchisors offer ongoing support such as monthly newsletters, a toll free 800 telephone number for technical assistance, and periodic workshops or seminars.

While buying a franchise may reduce your investment risk by enabling you to associate with an established company, it can be costly. You also may be required to relinquish significant control over your business, while taking on contractual obligations with the franchisor. Below is an outline of several components of a typical franchise system. Consider each carefully.

### **I. THE COST**

In exchange for obtaining the right to use the franchisor's name and its assistance, you may pay some or all of the following fees.

#### **Initial Franchise Fee and Other Expenses**

Your initial franchise fee, which may be non-refundable, may cost several thousand to several hundred thousand dollars. You may also incur significant costs to rent, build, and equip an outlet and to purchase initial inventory. Other costs include operating licenses and insurance. You also may be required to pay a "grand opening" fee to the franchisor to promote your new outlet.

#### **Continuing Royalty Payments**

You may have to pay the franchisor royalties based on a percentage of your weekly or monthly gross income. You often must pay royalties even if your outlet has not earned significant income during that time. In addition, royalties usually are paid for the right to use the franchisor's name. So even if the franchisor fails to provide promised support services, you still may have to pay royalties for the duration of your franchise agreement.

## **Advertising Fees**

You may have to pay into an advertising fund. Some portion of the advertising fees may go for national advertising or to attract new franchise owners, but not to target your particular outlet.

## **II. CONTROLS**

To ensure uniformity, franchisors typically control how franchisees conduct business. These controls may significantly restrict your ability to exercise your own business judgment. The following are typical examples of such controls.

### **Site Approval**

Many franchisors pre-approve sites for outlets. This may increase the likelihood that your outlet will attract customers. The franchisor, however, may not approve the site you want.

### **Design or Appearance Standards**

Franchisors may impose design or appearance standards to ensure customers receive the same quality of goods and services in each outlet. Some franchisors require periodic renovations or seasonal design changes. Complying with these standards may increase your costs.

### **Restrictions on Goods and Services Offered For Sale**

Franchisors may restrict the goods and services offered for sale. For example, as a restaurant franchise owner, you may not be able to add to your menu popular items or delete items that are unpopular. Similarly, as an automobile transmission repair franchise owner, you might not be able to perform other types of automotive work, such as brake or electrical system repairs.

### **Restrictions on Method of Operation**

Franchisors may require you to operate in a particular manner, during certain hours, use only pre-approved signs, employee uniforms, and advertisements, or abide by certain accounting or bookkeeping procedures. These restrictions may impede you from operating your outlet as you deem best. The franchisor also may require you to purchase supplies only from an approved supplier, even if you can buy similar goods elsewhere at a lower cost.

### **Restrictions of Sales Area**

Franchisors may limit your business to a specific territory. While these territorial restrictions may ensure that other franchisees will not compete with you for the same customers, they could impede your ability to open additional outlets or move to a more profitable location.

## **III. TERMINATIONS AND RENEWAL**

You can lose the right to your franchise if you breach the franchise contract. In addition, the franchise contract is for a limited time; there is no guarantee that you will be able to renew it.

### **Franchise Terminations**

A franchisor can end your franchise agreement if, for example, you fail to pay royalties or abide by performance standards and sales restrictions. If your franchise is terminated, you may lose your investment.

### **Renewals**

Franchise agreements typically run for 15 to 20 years. After that time, the franchisor may decline to renew your contract. Also be aware that renewals need not provide the original terms and conditions. The franchisor may raise the royalty payments, or impose new design standards and sales restrictions. Your previous territory may be reduced, possibly resulting in more competition from company-owned outlets or other franchisees.

#### **IV. BEFORE SELECTING A FRANCHISE SYSTEM**

Before investing in a particular franchise system, carefully consider how much money you have to invest, your abilities, and your goals. The following checklist may help you make your decision.

##### **Your Investment**

- How much money do you have to invest?
- How much money can you afford to lose?
- Will you purchase the franchise by yourself or with partners?
- Will you need financing and, if so, where can you obtain it?
- Do you have a favorable credit rating?
- Do you have savings or additional income to live on while starting your franchise?

##### **Your Abilities**

- Does the franchise require technical experience or relevant education, such as auto repair, home and office decorating, or tax preparation?
- What skills do you have? Do you have computer, bookkeeping, or other technical skills?
- What specialized knowledge or talents can you bring to a business?
- Have you ever owned or managed a business?

##### **Your Goals**

- What are your goals?
- Do you require a specific level of annual income?
- Are you interested in pursuing a particular field?
- Are you interested in retail sales or performing a service?
- How many hours are you willing to work?
- Do you want to operate the business yourself or hire a manager?
- Will franchise ownership be your primary source of income or supplement your current income?
- Would you be happy operating the business for the next 20 years?
- Would you like to own several outlets or only one?

##### **Selecting A Franchise**

Like any other investment, purchasing a franchise is a risk. When selecting a franchise, carefully consider a number of factors, such as the demand for the products or services, likely competition, the franchisor's background, and the level of support you will receive.

##### **Demand**

Is there a demand for the franchisor's products or services in your community? Is the demand seasonal? For example, lawn and garden care or swimming pool maintenance may be profitable only in the spring or summer. Is there likely to be a continuing demand for the products or services in the future? Is the demand likely to be temporary, such as selling a fad food item? Does the product or service generate repeat business?

##### **Competition**

What is the level of competition, nationally and in your community? How many franchised and company-owned outlets does the franchisor have in your area? How many competing companies sell the same or similar products or services? Are these competing companies well established, with wide name recognition in your community? Do they offer the same goods and services at the same or lower price?

## **Your Ability To Operate A Business**

Sometimes, franchise systems fail. Will you be able to operate your outlet even if the franchisor goes out of business? Will you need the franchisor's ongoing training, advertising, or other assistance to succeed? Will you have access to the same or other suppliers? Could you conduct the business alone if you must lay off personnel to cut costs?

## **Name Recognition**

A primary reason for purchasing a franchise is the right to associate with the company's name. The more recognized the name, the more likely it will draw customers who know its products or services. Therefore, before purchasing a franchise, consider:

- The company's name and how widely recognized it is;
- If it has a registered trademark;
- How long the franchisor has been in operation;
- If the company has a reputation for quality products or services; and
- If consumers have filed complaints against the franchise with the Better Business Bureau or a local consumer protection agency.

## **Training and Support**

Another reason for purchasing a franchise is to obtain support from the franchisor. What training and ongoing support does the franchisor provide? How does their training compare with the training for typical workers in the industry? Could you compete with others who have more formal training? What backgrounds do the current franchise owners have? Do they have prior technical backgrounds or special training that helps them succeed? Do you have a similar background?

## **Franchisor's Experience**

Many franchisors operate well-established companies with years of experience both in selling goods or services and in managing a franchise system. Some franchisors started by operating their own business. There is no guarantee, however, that a successful entrepreneur can successfully manage a franchise system. Carefully consider how long the franchisor has managed a franchise system. Do you feel comfortable with the franchisor's expertise? If franchisors have little experience in managing a chain of franchises, their promises of guidance, training, and other support may be unreliable.

## **Growth**

A growing franchise system increases the franchisor's name recognition and may enable you to attract customers. Growth alone does not ensure successful franchisees; a company that grows too quickly may not be able to support its franchisees with all the promised support services. Make sure the franchisor has sufficient financial assets and staff to support the franchisees.

## **Shopping At A Franchise Exposition**

Attending a franchise exposition allows you to view and compare a variety of franchise possibilities. Keep in mind that exhibitors at the exposition primarily want to sell their franchise systems. Be cautious of salespersons who are interested in selling a franchise that you are not interested in. Before you attend, research what type of franchise best suits your investment limitations, experience, and goals. When you attend, comparison shop for the opportunity that best suits your needs and ask questions.

## **Know How Much You Can Invest**

An exhibitor may tell you how much you can afford to invest or that you can't afford to pass up this opportunity. Before beginning to explore investment options, consider the amount you feel comfortable investing and the maximum amount you can afford.

## **Know What Type of Business Is Right For You**

An exhibitor may attempt to convince you that an opportunity is perfect for you. Only you can make that determination. Consider the industry that interests you before selecting a specific franchise system. Ask yourself the following questions: Have you considered working in that industry before? Can you see yourself engaged in that line of work for the next twenty years? Do you have the necessary background or skills? If the industry does not appeal to you or you are not suited to work in that industry, do not allow an exhibitor to convince you otherwise. Spend your time focusing on those industries that offer a more realistic opportunity.

## **Comparison Shop**

Visit several franchise exhibitors engaged in the type of industry that appeals to you. Listen to the exhibitors' presentations and discussions with other interested consumers. Get answers to the following questions: How long has the franchisor been in business? How many franchised outlets currently exist? Where are they located? How much is the initial franchise fee and any additional start-up costs? Are there any continuing royalty payments? How much? What management, technical and ongoing assistance does the franchisor offer? What controls does the franchisor impose?

Exhibitors may offer you prizes, free samples, or free dinners if you attend a promotional meeting later that day or over the next week to discuss the franchise in greater detail. Do not feel compelled to attend. Rather, consider these meetings as one way to acquire more information and to ask additional questions. Be prepared to walk away from any promotion if the franchise does not suit your needs.

## **Get Substantiation For Any Earnings Representations**

Some franchisors may tell you how much you can earn if you invest in their franchise system or how current franchisees in their system are performing. Be careful. The FTC requires that franchisors who make such claims provide you with written substantiation. Make sure you ask for and obtain written substantiation for any income projections, or income or profit claims. If the franchisor does not have the required substantiation, or refuses to provide it to you, consider its claims to be suspect.

## **Take Notes**

It may be difficult to remember each franchise exhibit. Bring a pad and pen to take notes. Get promotional literature that you can review. Take the exhibitors' business cards so you can contact them later with any additional questions.

## **Avoid High Pressure Sales Tactics**

You may be told that the franchisor's offering is limited, that there is only one territory left, or that this is a one-time reduced franchise sales price. Do not feel pressured to make any commitment. Legitimate franchisors expect you to comparison shop and to investigate their offering. A good deal today should be available tomorrow.

## **Study The Franchisor's Offering**

Do not sign any contract or make any payment until you have the opportunity to investigate the franchisor's offering thoroughly. As will be explained further in the next section, the FTC's Franchise Rule requires the franchisor to provide you with a disclosure document containing important information about the franchise system. Study the disclosure document. Take time to speak with current and former franchisees about their experiences. Because investing in a franchise can entail a significant investment, you should have an attorney review the disclosure document and franchise contract and have an accountant review the company's financial disclosures.

## **Investigate Franchise Offerings**

Before investing in any franchise system, be sure to get a copy of the franchisor's disclosure document. Sometimes this document is called a Franchise Offering Circular. Under the FTC's Franchise Rule, you must receive the document at least 10 business days before you are asked to sign any contract or pay any money to the franchisor. You should read the entire disclosure document. Make sure you understand all of the provisions. The following outline will help you to understand key provisions of typical disclosure documents. It also will help you ask questions about the disclosures. Get a clarification or answer to your concerns before you invest.

## **Business Background**

The disclosure document identifies the executives of the franchise system and describes their prior experience. Consider not only their general business background, but their experience in managing a franchise system. Also consider how long they have been with the company. Investing with an inexperienced franchisor may be riskier than investing with an experienced one.

## **Litigation History**

The disclosure document helps you assess the background of the franchisor and its executives by requiring the disclosure of prior litigation. The disclosure document tells you if the franchisor, or any of its executive officers, has been convicted of felonies involving, for example, fraud, any violation of franchise law or unfair or deceptive practices law, or are subject to any state or federal injunctions involving similar misconduct. It also will tell you if the franchisor, or any of its executives, has been held liable or settled a civil action involving the franchise relationship. A number of claims against the franchisor may indicate that it has not performed according to its agreements, or, at the very least, that franchisees have been dissatisfied with the franchisor's performance.

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**Note To Editors:** The *FTC Consumer Guide To Buying A Franchise* is included in **IFA's Franchise Opportunities Guide**, a directory of hundreds of franchise companies that provides information to educate prospective franchisees. News media representatives may get a free copy of the guide by sending a request on company letterhead or by contacting IFA Media Relation's Terry Hill or Laura Fenwick, 202-628-8000. Visit the associations Web site at [www.franchise.org](http://www.franchise.org) to view the IFA's **Franchise Opportunities Guide Online**.

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