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Business Opportunities: Selecting a Franchise

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You want to start a business but have limited business experience. Buying a franchise may sound appealing since the advertisements for franchises indicate that the franchisor will train you to operate the business. Before purchasing a franchise, however, there are many things to consider.

A franchise is a legal and commercial relationship between the owner (franchisor) of a known trademark, trade name or logo and an entity who wants to use that business identity (franchisee). The franchisee pays a fee to use the franchisor's name for a predetermined amount of time. The franchisee also agrees to operate the business according to the directions of the franchisor.

Advantages of Buying a Franchise

A franchise may help an individual with limited business management skills reduce the risk of business failure, but success is not guaranteed. Ongoing training helps the franchisee develop business skills. As a general rule, a franchise business provides:

- * risk reduction,
- * ready to use operation,
- * operation manuals,
- * standardized products,
- * collective buying power,
- * supervision and consulting,
- * cooperative advertising programs,
- * uniform packaging,
- * ongoing research, development and training,
- * financial assistance,
- * site selection assistance, and
- * sales and marketing assistance.

Disadvantages of Buying a Franchise

A franchise is not for every business owner.

Some of the downsides of a franchise business include:

- * loss of control of the business,
- * a binding contract,
- * the franchisee will likely have problems if the franchisor has problems,
- * loss of independence,
- * an inadequate training program,
- * advertising on the national level, not local level, and
- * non-fulfillment of expected benefits

Disclosure Statement

Before investing in a franchise system, it is important to get a copy of the franchisor's disclosure document. The Federal Trade Commission's Franchise and Business Opportunity Rule requires the franchisor to provide potential buyers with a Franchise Offering Circular. Requirements for the disclosure statement are available at www.FTC.gov. The disclosure document must be received by the potential buyer at least 10 business days prior to signing documents or paying money. The document should include the following: names, addresses and telephone numbers of at least 10 purchasers who live closest to you; a fully audited financial statement of the seller; background and experience of the franchise's key executives; cost of starting and maintaining the franchise; and the responsibilities you and the franchisor will have to each other once you have made the investment.

Be sure to study the document closely and check facts. Begin by interviewing current owners in person and asking about their experience with the business. Ask if they have had problems with the franchisor, and if so, how they were handled. An in-person interview can help

identify “skills,” or people who are paid to give positive reports about the franchisor. An in-person interview could provide you with the opportunity to see the franchise in operation. Develop a list of questions you want to ask the franchisees.

Check out all financial claims regarding your potential income from the business. If statements are included regarding earnings claims, the franchisor must provide a written basis for making the claims. The franchise seller must provide written documentation of the number and percentage of franchisees that have made the earnings they claim you will make. Check with other franchisees to be sure their earnings are as the agreement states.

Costs of a Franchise

Costs associated with a franchise include the initial franchise fee and other expenses which may not be refundable. You may also incur additional costs to rent, build and equip a facility for the franchise as well as obtain operating licenses and insurance. In addition, some franchisors may require you to cover the costs associated with a “grand opening.” Contracts usually require that royalties be paid to the franchisor. You may also have to pay the franchisor advertising fees. The advertising fees may not cover advertising for your target market area, but rather may be used for national advertising as well as ads to recruit more franchise owners.

Control of a Franchise

Franchisors typically control how franchisees conduct business. The franchisor may have to approve the site selection for the franchise as well as the facilities design or appearance. Some franchisors may require seasonal or regular renovations. Franchisors may restrict the goods or services that can be offered by the franchise. For example, if you operate a restaurant, you may not be able to add items that appeal to your target market. You may be required to purchase supplies only from an approved supplier.

Termination and Renewal

A franchisor can end your franchise agreement if you fail to pay royalties or do not comply with standards set forth in the agreement. This may result in you losing your investment. Franchise agreements typically are made for 15 to 20 years. A franchisor may not renew the agreement or may change conditions in the agreement at any time. Determine if there are any restrictions on renewing, selling, transferring, or terminating the business.

Pre-Purchase Considerations

Before investing in a franchise, consider how much you have to invest, your abilities and interest, and your goals for operating a business. Determine if the franchise requires special skills. Do not rush into signing an agreement until you have investigated the franchisor. This can be a 20-year commitment. A lawyer who is familiar with franchise law can help you understand the terms and conditions of the franchise agreement. Be sure to obtain a written contract that gives the specifics of the terms of the arrangement. An accountant can help you determine if the franchise has the potential to be a viable business opportunity.

As with any business, a written business plan is essential. Creating a plan will help you think through the issues and challenges you will face in starting and operating a business. If you need third party financing, a business plan will be one of the first things the party will request. A franchisor should be able to assist you with the information needed for the business plan. However, you need to write the plan and adapt it to your particular business needs. The business plan will help you determine if there is a demand for the product or service the franchisor offers as well as identify your competition. The financial projections will help you determine if the franchise has the potential to provide the income you desire.

Additional information on buying a franchise is available from the Federal Trade Commission at www.ftc.gov or the Small Business Administration at www.sba.gov.

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