

# GUIDELINES FOR PROSPECTIVE FRANCHISEES



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Dear Prospective Franchise Owner:

Michigan amended its Franchise Investment Law in June 1984. The amendments simplified the process by which franchisors register to do business in Michigan and place upon the prospective franchisee more responsibility in the evaluation of his/her new business relationship.

As Attorney General of Michigan, I am concerned about the rights of the prospective franchisee. In order to help individuals evaluate a franchisor, the Office of Attorney General developed this publication.

The Michigan Franchise Investment Law defines a franchise as a contract or agreement (expressed or implied, oral, or written) between two or more people to which **all** of the following apply:

1. A franchisee is granted the right to engage in the business of offering, selling, or distribution of goods or services under a marketing plan or system prescribed in substantial part by the franchisor;
2. A franchisee is granted the right to engage in the business of offering, selling, or distribution of goods or services substantially associated with the franchisor's trademark, or other commercial symbol designating the franchisor or its affiliates; and
3. The franchisee is required to pay, directly or indirectly, a franchisee fee.

There is some degree of risk in every investment. Investing in a franchise is no different. To protect yourself from these risks, there are certain elements of a franchise that you should consider before you purchase one.

This booklet has been set up so you can first read an explanation of what you should be looking for and then use the checklist to evaluate the franchise. The headings of each section correspond with the headings in the checklist. When you finish the evaluation, you should have a fairly complete picture of most aspects of the franchise.

Evaluating a franchise in this manner will take a great deal of time and patience, but the results should make it worthwhile. It is important to remember throughout your evaluation that you should be sure to consult an expert (an attorney and/or an accountant). Their advice and help will be invaluable to you.

Sincerely,

**BILL SCHUETTE**  
Attorney General

## **THE PRODUCT OR SERVICE**

What is the reputation of the company and its products or services? To answer this question, talk to people who are familiar with the product, check it out yourself, and write to the Better Business Bureau in both your city and in the city of the franchise headquarters. Ask for a report on the company.

The product or service does not always have to be part of a growing market since many markets are on the borderline between slow growth and "taking off." What you have to watch out for is a declining market. The best way to check for information on growth or near growth is to request marketing data from the franchisor, check with your broker, write to the trade magazine covering the market in question, check it out at your local business library, and discuss it with your regional Small Business Administration office.

The product or service should be needed and/or in demand in your area. This need and/or demand should be expected to continue in the future based upon a careful and thorough evaluation of information received and uncovered in your research of the franchise. A snow-ski shop franchise may not be appropriate in Florida. Make sure that the products or services have year round appeal in your area.

If a product rather than a service is involved, be sure that it is safe, that it meets quality standards, and that there are no restrictions upon its use. Is the product protected by patent or liability insurance? Is the same protection afforded to you as a franchisee? If a guarantee is involved, obtain a copy and be aware of your responsibilities and obligations as a franchisee.

## **THE FRANCHISE**

Chances are that a franchise that is now only local or regional is in the beginning or test stage and will go national once the test has proved successful. The national and international franchises are probably older, better established, and better known. That latter point is important to you particularly for the purpose of proving/determining whether your product has mass appeal as in the fast food or motel fields.

You should always consider time requirements. Unfortunately, there are very few part-time franchises that are as good as they profess to be. Those that are good involve a considerable amount of time if they are to be successful. There is no short-cut to a second income. Also, it is highly doubtful that you can sit back, as some part-time franchises profess, make some mailings, and watch the money roll in. Investigate the part-time franchises just as thoroughly as the full-time ones. If you do get involved in a part-time endeavor, take a look and see whether it could later be expanded into a profitable full-time venture. This is a good test. Full-time franchises are what they say. . . you have no other job and, therefore, no other income. Make sure that you have at least one year, or possibly two years, of personal financial reserve. You should also consider having a reserve for projected expenses which may be incurred during the first year of business including initial start-up costs (which may immediately become due), franchise fees, operating expenses, and capital investments. There are some franchises, usually in the personal service field, that can be started on a part-time basis with full-time status one or two years away.

### **EXISTING FRANCHISE**

Finding out how long the company was in business before the first franchise was awarded will tell you what came first . . . the product idea or the desire to enter the franchise field. Favor should be given to the company that was established before it entered the franchise business.

Establish the period of time that the company was in business before it went the franchise route of distribution. Keep in mind that the dates you want are related to the franchise and not to the parent company. In this day and age of mergers and acquisitions, many major franchises are owned by major corporations. It might also be interesting to find out whether the original franchise is still in operation.

The number in operation and geographical spread will give you an idea as to the popularity of the franchise. This information, coupled with the preceding answer, will give you an idea whether this is an "overnight" growth pattern or a gradual pattern. The gradual pattern tends to give more stability if the rate of failure is low. You should also find out whether there is a geographical cluster (i.e., is there a large number of existing franchises in one specific area; or are

they evenly spread across the country). This information is important for purposes of determining the demand for the product or service involved and the competition you will likely face in your area. You will usually find a cluster around the home office area of the franchise. A cluster can be expected in the early stages; but, if a franchise claims to be national and if they have been in business three years or longer, the spread should be fairly even.

The franchisor should provide you with the name and address of several franchises in operation in markets like yours. Determine which franchises operate in a market equal in size to your own. Evaluate and verify their success. Ensure that the market demographics present in their area are also present in your area. Market demographics to consider include population, average age, income, family size, and property value. Call or visit these locations, at least one of which should be a relatively new franchise. Ask the questions that are of greatest concern to you. Try to get a feel concerning whether you would like the work and could earn enough to support your family.

### **WHY FRANCHISES HAVE FAILED**

The number of franchises that have failed is not the most important factor unless there is a high number in relation to the current number in operation. However, it might be helpful to find out how many of the failures and/or terminations were in the past two years and their locations. If the failure and/or termination rates are high, perhaps the reasons have been corrected and/or are based on good cause. If the reasons for the failures and/or terminations have been corrected, the failure rate would be clustered prior to the past two years.

Asking why franchises have failed is one of the most important questions that you can ask. It is also one of the most difficult for the franchisor to answer because it reflects on the franchise program. The answer to this is found in three ways. First, ask the franchisor why he/she thinks the franchises failed. Have him/her list the reasons in order of importance. Then, ask for the names and addresses of franchisees who have failed. Contact them and ask the same question. Finally, check the Better Business Bureau in the city where the franchise failed and ask the same question. Check the answers. If they agree, find out from the franchisor if the reasons have been corrected.

If the answers from the franchisee and the franchisor do not agree, discuss them with the franchisor and find out why they do not agree. Remember, in talking to the franchisee that failed, he will probably be biased against the franchisor. On the other hand, the franchisor might lay failure at the feet of the franchisee. Use your own judgment in this case and draw your own conclusions.

### **FRANCHISE IN LOCAL MARKET AREA**

Many franchises (such as the multi-level distribution type) are on a non-exclusive basis. Therefore, the franchise you are investigating might already be in operation in your market. This is not a negative. In fact, in the case of fast food and personal service franchises, it is better to have several per market as each benefit from the visibility of the other. On the other hand, a franchise might have failed at some time in the past in your area. Investigate why this franchise failed.

A final important point is the amount of interest shown by others in this franchise in your area. If the interest is high, that means that there is a reasonable chance that the general interest level would be high on the part of customers. On the other hand, if the interest level is low, this could be a negative. Ask the franchisor for the franchisee inquiry count from your area. If there is a franchise in operation in your market, get the name and address of the owner, visit with him or her and discuss the franchise. He/she should be glad to answer your questions. Also, if there has been a failure, get the name and address of the person involved and talk to him/her too.

You could also consider other franchise opportunities in the area. The U.S. Department of Commerce publishes the Franchise Opportunities Handbook (Handbook) on an annual basis. It describes more than 1,400 companies that offer franchises. Consider contacting those that interest you. Request their disclosure documents and compare their offerings. To obtain a copy of the Handbook, contact the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402 at 1-202-783-3238.

## **COMPETITION**

The Yellow Pages can assist you in finding out about your competition. You might have to check more than one directory depending on the type of franchise you are considering. The Handbook referenced above may also be helpful for this purpose. Make a complete list of competition, listing addresses and telephone numbers of all locations. Visit several of the major ones and observe appearance, traffic, and attempt to appraise the current situation. Make notes for future reference. If the franchise looks particularly promising, talk to the manager and get the name of the franchisor. Write to the franchisor for the franchise package. Maybe it will be better than the one you are now investigating. You need to get a feel for competition. Can you do the job? Is the market saturated with the product or service?

## **ARE ALL FRANCHISES INDEPENDENTLY OWNED**

A recent development in franchising is the situation where franchise companies buy back franchises so that stronger corporate control can be maintained. You should find out whether all outlets are independent franchises. If not, how many are company owned.

If there is evidence of recent company repurchase, find out the terms of the repurchase agreement. If the date of the last company acquisition is recent, then you may be reasonably sure that a repurchase program is underway unless the franchise was repurchased or taken over for a contract violation. In the event the latter is the reason, it is not a negative but a strength, indicating franchisor interest and a policing program.

Upon defining your needs and expectations, consider the costs/benefits to you associated with investing in a company-owned outlet rather than owning an independent franchise. Investing in a company-owned outlet may result in lower costs to you. Ask whether the property, including land, equipment, and/or inventory, has already been purchased by the company thereby decreasing your overall expenses. On the other hand, investing in a company -owned outlet may also restrict your ability to exercise your own business judgment in the operation of the franchise.

Also, if buying an existing outlet, inquire about prior owners, how long each operated the outlet, over what period of time, and why they are no longer operating the outlet. Talk to prior owners.

### **FRANCHISE DISTRIBUTION PATTERN**

A major distribution pattern in the franchise industry, for both products and services, is the two-step method. Briefly, this means that the franchisor "packages" the product, sells it to distributors, who in turn sell it to dealers, who sell it to the customer. The distributor usually covers a fairly large area. The dealer covers a small local area, usually his/her "backyard market."

Many franchises are not exclusive as far as territory is concerned. In some cases, both the distributor and franchisor retain the right to sell direct in the franchisee territory. Also, they retain the right to sell more than one franchise in a given territory. There is nothing wrong with a non-exclusive franchise providing you are aware of the situation before you buy the franchise and agree to work this way. The obvious disadvantage of the non-exclusive franchise is a smaller sales potential. This should be spelled out to your satisfaction in the contract.

Is your franchise a distributorship or a dealership? You will find that the distributorship costs considerably more than the dealership and, at the same time, requires more business knowledge and leadership capabilities. If you do not have a strong business background and financial reserves, stay away from the distributorship. Start with the dealership. It will be close to home, require less capital, and your time will be concentrated on the management of that particular location rather than on a group of locations. The return, however, from the dealership is usually less than from the distributorship. If your franchise is a dealership, get the name and address of your distributor, visit with him/her to see if you can get along with him/her. It will be the distributor with whom you will conduct much of your business, not the franchisor.

## **FRANCHISE OPERATIONS**

### **Physical Plant**

If the franchise requires office space or the construction of a building, make sure the franchisor offers guidance and assistance as this is the most important role he/she will play in getting your business started.

In most situations, there are specific items to note. For example, a lease is usually signed for a specific period of time . . . one year, two years, etc. If it is a lease situation, be sure of the time involved. If the space leased is too small and not expandable and your business grows to the point you need additional space before your lease is up, a penalty may be charged by the building management to break the lease. Construction is a different situation and requires a different set of considerations. Labor problems can delay completion and weather can be a major factor in completion. You should talk to a reputable realtor about these details.

If you must build, once again the franchisor should be your guide. In fact, he/she should guide you every step of the way. In checking what you get for the franchise fee, you will find most times that this type of service is a major reason for a fee at all. If it is not offered, consider it a negative.

### **Feasibility Study**

Determine what is needed. This is usually obvious in the literature that is provided by the franchise.

If your franchise requires that customers come to your place of business (fast food outlets, home remodeling stores, income tax preparation), the critical starting point and the pivotal point on the success of your future business is the feasibility study. This should be done for you by the franchisor. If you are told to conduct your own, view this as a negative. The feasibility study considers the experience gained by the franchisor in setting up successful franchises and applies it to your market. For example, the following information would be developed and evaluated: traffic count of various location possibilities, average income of the area, number of target prospects in the area (fast food may require a high concentration of young families), and other

factors critical to the success of the franchise. The past experience of the franchisor will tell what is required to ensure that any money "put down" on the basis of having the feasibility study conducted would be returned to you in the event the results are negative.

### **FRANCHISE COMPANY**

The primary purpose of this section is to get enough information about the company to be convinced that it is reputable, financially strong, and recognized as a leader in the field.

As outlined earlier, many times the franchise company is part of a larger company. This information should be easily accessible. When researching the franchisor, ask for, in addition to the name and address of the franchise company, the name and address of any parent company. Remember that being part of a large company can be a very important asset to you in terms of financial stability and visibility. Also, it won't hurt when dealing with a bank for financing.

Find out if you are dealing with public (stock sold to the public) or a private (stock held by a small and private group) company. Checking on a public company is a relatively easy matter, whereas investigating the private company is more difficult.

Learning more about a public company can be done via published sources. The federal Securities and Exchange Commission (SEC) requires public disclosure of all publicly traded stock. Determine how the stock is traded and check the appropriate stock listing.

Use this information to contact your stockbroker and ask him/her to send you a stock report on the company. This report will give you all the basic information on the financial structure of the company. Look for rising trends in sales, profits, and earnings per share. The report will also give you the address of the company and the name of the officers, including the treasurer. Write to the treasurer on a postal card requesting a copy of the most recent quarterly and annual reports, as well as product literature. It is best to mention that this information is for your investment program. From this literature you will learn all additional information you need to know about the company. If you do not have access to a stockbroker, consult a local college or public library. Most will have standard reference volumes that contain information on most public companies.

As noted earlier, private company research is more difficult than investigating public companies. If you have access to a financial reporting service, request a report on the private company in question. In any event, you should ask the franchisor for references including a bank and major supplier. Write to each, asking specific questions, and, in particular, attempt to determine their financial soundness. Also ask some questions the answers to which have already been supplied by the franchisor. See if the answers are the same, this acts as a cross check.

Under both federal and Michigan law, a franchisor is required to provide you with a pre-sale disclosure, known as an "offering circular." The franchisor is not required to file this disclosure with the federal government or the Michigan Attorney General.

Under federal law, the disclosure should provide:

1. names, addresses, and telephone numbers of at least 10 previous purchasers who live closest to you;
2. a fully audited financial statement of the seller;
3. background and experience of the business' key executives;
4. cost of starting and maintaining a business; AND
5. the responsibilities you and the seller will have to each other once you've invested in the opportunity.

Federal Trade Commission Facts for Consumers: Franchise and Business Opportunities,  
<http://www.ftc.gov/bcp/online/pubs/invest/franchse.htm>

This disclosure must be provided to you before either the first face-to-face meeting with the franchisor or 10 days before money is paid or the contract is signed. (The contract must be provided to you 5 days before you are required to sign it.)

Use the disclosure information. Interview the current owners in person. (Do not simply rely on a list of references because it may contain "shills" – people paid to give favorable reports.) Ask current owners about their general business backgrounds, experience in managing a franchise system, and if they have had any formal training. Inquire about their total investment, additional and unanticipated expenses. Verify whether a reserve consisting of personal living expenses and

estimated operating expenses for the first year of operation is sufficient. Ask them how long it took to earn a reasonable income (i.e. money received after expenses were paid). Determine if you are similar to them in terms of goals, income requirements, education, and training.

You may need the assistance of a lawyer or an accountant to thoroughly review the financial statements. You will want to determine whether there has been steady growth. Request information about the franchise growth plan. Determine whether most of the franchisor's income is derived from continuing royalties or from the sale of franchises.

The disclosure should assist in you in evaluating the experience and backgrounds of the franchisor or any of its executives. Are they similar to your own? Determine whether the franchisor or any of its officers have been involved in prior litigation or are the subject of an investigation by any state or federal agency. The disclosure should also tell you if the franchisor or executives have recently been involved in a bankruptcy. Ensure that all of the key players of the franchise are identified in the disclosure. (Some franchisors may attempt to conceal this information by not listing the person.) If all this information is not provided in the disclosure, then ask for it from the franchisor.

It is also recommended that you write to the International Franchise Association, Inc. to find out if the franchisor is a member. The address to write is: International Franchise Association, Inc., 1350 New York Avenue NW, Suite 900, Washington, DC 20005.

Financial stability and stock checks should be conducted whether the franchisor company is public or private. What you want to look for once again is rising trends in sales and profits, how much money is being invested in research and development for the future, credit situation, and whether any negative comments have been registered against the franchisor.

### **FINANCIAL AND LEGAL**

You want to determine exactly what you will receive in your franchise package, what you can expect to get in return for your investment, and what all that fine print says. There are some excellent aids on going into business for yourself that can guide you. The Small Business Administration (SBA) in Washington, DC has a vast amount of free information covering this

subject. Write to the SBA outlining what you want to do or, better yet, visit your closest regional office.

Before you sign anything that commits your money, you should have a lawyer advise you to make sure that you understand your responsibilities. Make sure that you understand what legal liabilities are possible when you get into business and, more importantly, that these liabilities are covered by insurance – either your own or that of the franchisor. Check with your own attorney. If you do not have one, check with friends or another local small businessperson and get the name of a qualified attorney. Make sure the attorney you select has interest and experience in advising small businesspeople.

To be meaningful, figures must be interpreted by a "pro." An accountant, as in the case of the attorney, should be knowledgeable in advising small business owners. The best way to find a good accountant is to ask local small businesspeople for a recommendation, or perhaps your local Chamber of Commerce might have a suggestion.

Business management involves the merging of legal and financial structures with the overall operation of the business. The Small Business Administration Regional Office is your best source. In fact, the SBA offers periodic seminars on starting and managing a small business. Also check with your local Chamber of Commerce to see what it has to offer. Discuss your proposed new business with a successful businessperson and get his or her views. As you get started, you can also draw on an excellent source, Service Corps of Retired Executives (SCORE). Contact the Small Business Administration for information.

### **TOTAL FRANCHISE COST**

Do not be fooled by claims such as "Own Your Own Business For Only \$3,500." Make your own forecast of required finances and include the franchise cost, first-year operating expenses, and personal funds required for up to two years. Keep in mind that starting a business does not mean that income will automatically be produced. In some franchises, you might go as long as six months before a penny flows into your bank account. In any event, there is start-up time regardless of whether it is a personnel agency, fast food outlet, motel, rental agency, or

whatever. The two-year period is the accepted break-even "rule of thumb" for a new business. A franchise, however, should break even much earlier because part of what you are buying is a proven product, program, and procedure. In any event, be wary of any franchisor that promises "riches" in less than two years. It just doesn't happen that way.

What you have to pay the franchisor to get started consists primarily of two things – the franchise fee and inventory and material or construction costs. Make sure you get a complete answer to what you need to pay. It's too late once you have started in business to discover that the true costs are more than you can handle. Consider each of the elements that go into making up the initial amount you pay the franchisor.

1. Franchise Fee: Is there a franchise fee? If so, how much? What does it include? Is it refundable? What you are paying for in the franchise fee is the right to use and promote a name and identification program. The value of this depends on how well known the name and trademark are. Therefore, verify that the trademark is registered, the length of time the franchisor has been in operation, the reputation of the products or services, and whether there are any complaints on file with either the Better Business Bureau or the Michigan Attorney General's Consumer Protection Division. The more widely recognized the name and/or trademark, the more popular the good or service and the more likely for potential in growth of the consumer base. The right to use and promote a name and identification is directly related to marketing. Ask the opinions of your attorney and accountant and make sure you are getting true value for the fee. There are many good franchises that have a very low fee and others who will consider negotiating the fee.
2. Services: Are you paying for home office services as part of the initial franchise cost? If so, what are they? Find out what specifically you will get. Included should be complete operating manuals on all phases of the operation. These should be updated as required. Also, is on-the-spot assistance of "home office experts" available? If so, who, when, what, and how long? In addition, find out if the franchisor offers a computerized accounting

system. Accounting is a costly and time-consuming chore if you have to do it yourself. This service from the franchisor is a plus.

3. Product: Does the initial cost include an "opening" inventory? Is the price fixed for this and any reorder? Is the price competitive? Can you buy elsewhere more cheaply? Are you permitted to do so? Can you continue to do so? Get an itemized list including your cost and the cost to your customers. Find out what percentage of your total initial cost can be recovered by the resale of the inventory. Also important in this evaluation is the cost to your customer:
  - a. Is the price competitive with equal products?
  - b. Is the quality worth the price?
  - c. Will the customer be a repeat customer based upon the quality of the product?
4. Real Estate/Company-Owned Outlet/Leasehold Improvements: How much of the initial money required is for the purchase of land and construction of your place of business? Does the site have to be approved by the franchisor? If so, are your interests aligned with the interests of the franchisor? If owned by the company, is it in compliance with local ordinances, such as zoning, waste removal, and fire and safety codes?
5. Equipment and Fixtures: Is the cost of start-up equipment and fixtures in the initial costs? Does the franchisor have an equipment subsidiary from which you can purchase all equipment, furniture, and supplies at a favorable cost? Are they priced competitively? Could you save money buying them elsewhere? If so, can you? If all the supplies and equipment you need are not included in the package price, you must allow for this in your personal start-up costs. Personal service-type franchises usually require only office furnishings. Fast food and education franchises usually require a physical plant and various types of equipment and supplies.
6. Royalty Payments: Carefully review the contract to determine if you are required to pay royalty payments. If so, are they based on a percentage of your weekly or monthly gross income? Are they due even if no income is derived?

7. Method of Operation: Determine what sort of control the franchisor will retain. For example, will you need to confer with the franchisor regarding site approval and methods of operation (bookkeeping or accounting procedures, advertisements, hours, pre-approved signs, or uniforms)? Are there design or appearance standards? Is there a requirement of periodic renovations or seasonal design changes? Are there restrictions on the supply or sale of goods or services offered for sale?
8. Other: Always check to see if there are any unique features of the franchise. If so, are they part of the initial cost? Also, are there any "employee benefits"? Some franchises include benefit programs of life insurance, hospital insurance, and retirement plans.
9. Is any of the initial cost refundable? Some franchises make it possible to get back the initial cost if the franchise is successful and maintains a pre-defined sales volume. This is a good thing to look for. It provides a real incentive for the franchisee to "stick with it" and "follow the rules." If there is such a plan, find out exactly what it is and make sure it is covered in your franchise agreement.

### **FINANCING**

In most cases where the start-up costs are high, the franchisor will finance a portion of the cost. Usually the franchisor will require that you pay the franchise fee in cash. Then on the basis of any acceptable financial statement, the franchisor will finance the balance of the start-up costs.

Federal banking laws now require that the "cost of borrowing" be disclosed to the borrower. Find out what the interest rate is and shop around for the best rate. Remember that many franchise companies have finance company subsidiaries who lend money to the franchisee. Make sure they are competitive. Check your local bank. Also, try the Small Business Administration and see if you qualify for a SBA loan. Remember, every dollar you can save in interest is a profit dollar for you.

### **FORECAST OF INCOME AND EXPENSE**

The forecast, the product or service to be sold, and the written agreement are the three most important areas that must be considered in the evaluation of a franchise. Remember that

computing the forecast of income and expenses should be based upon the experience of successful franchises and a conservative forecast of sales. Do not be carried away by impressive figures that show amazing profits at the end of one or even two years.

Find out if a forecast of income and expenses is provided. If possible, get a copy. Ask your accountant to review it. If he/she does not agree with the franchisor, have him/her prepare one. Review the two opinions with the franchisor and require that he/she provide reasonable answers for the differences. Under federal law, if a franchisor makes earnings claims, whether historical or forecasted, the franchisor must have a reasonable basis for them. Additionally, the franchisor must provide you with this substantiation in writing at the same time they provide you with their disclosure.

Carefully consider earnings claims. Determine if they represent all current franchisees or merely a sample size. The claims may be deceptive if the information provided is not typical of franchisees in general.

Carefully consider income forecasts. For example, figures provided relating to "average" income earned could be inflated by a few very successful franchisees. Also, if there are forecasts related to "gross sales," it is important to ask for the franchisees' actual costs or profits. An outlet with high gross sales can still be losing money due to overhead, rent, and other expenses.

Compare the information you are provided with information provided by other current franchisees. If the franchisor does not supply a valid forecast of income and expenses in writing or if he/she cannot give reasonable answers to your questions, consider these as strong negatives against purchasing the franchise.

Forecasts can be projected to relate to your market. Make sure, however, that this is the case. Find out if the forecast is based on experience. If so, make sure that the forecast you follow is based upon a market equal in size to your own and compatible with the profile of your market demographics (average age, income, race, family size, property value, etc.).

Is there sufficient income so that you can meet expenses and payroll and, at the same time, pay yourself a salary that will support your family adequately? Only you know the answer to this.

A good idea is to put the family budget on paper. Start by listing month by month all regular expenses. Then take annual costs such as medical, clothing, recreation, etc. and divide them, equally assigning a portion to each month. This gives you a monthly "break-even" point for the family. What you will be doing is paying regular bills as they come up and building an escrow account for other annual bills. Savings, when you are building your own business, will probably not be possible for a while. But remember every day you operate a successful business, you are building an equity which will be your future.

In starting your own business, you are investing in yourself. Like any investment, you expect a return on the principal invested, as well as safety of the principal. See that the return you have set as your goal is there. (This is in addition to the money you take out as salary.)

Sales to obtain orders and people to fill them are the key factors to the success of any business. One without the other can spell disaster. Make sure that there is adequate money assigned to the payroll and advertising promotion accounts.

### **DETAILS COVERED IN A WRITTEN FRANCHISE CONTRACT**

The contract is the instrument that is the formal understanding between the franchisor and franchisee. All the major points about your franchise should be spelled out in it. Do not accept a "gentleman's agreement" from a representative of the franchisor. Get it in writing. Under federal law, the contract must be provided to you 5 days before you are required to sign it. Have both your attorney and accountant review the contract before signing.

Be guided by your attorney and accountant but also be sure to look for such details as: franchise fee; termination, selling, and renewal clauses; cooperative advertising and promotion funds; does franchisor patent and liability insurance protection extend to the franchisee; are the home office services spelled out; does the franchisor have an operating license; are all the details as to commissions, royalties, etc. spelled out; is the training program and who pays for what spelled out; are financing and financing details spelled out including repayment and interest; is the territory covered outlined, including is it exclusive or non-exclusive, and can the franchisor or his representative sell direct in your area.

The termination clause should be carefully reviewed to make certain that you have a sufficient grace period and that your rights, as well as those of the franchisor, are represented.

### **TRAINING**

An important advantage in investing in a franchise, as opposed to starting your own business, is the access you should be afforded to training and assistance. The franchisor assumes the role of educator and is responsible for the training and education of the franchisee and his/her staff. This training should be very concentrated at the start and should be continuing to keep the franchisee and his/her staff current on new products, techniques, methods of operations, etc. You should, however, consider your ability to continue operations if the franchisor goes out of business or is no longer able to provide training, advertising, or assistance.

### **INITIAL TRAINING**

Initial training is the critical area. What does the franchisor provide in the way of a training school to teach you the business of your franchise, such as how to operate your business and how to recruit and train personnel? In other words, is a "how to" course provided? Usually this training is of a formal nature and conducted at the home office.

Duration of the training depends on the franchise and how complicated the business is. It can range from one day to two months. How long is your initial training program? Equally important is, what happens after you have "graduated?" Are you sent home to run your business? Does a field representative work with you at home to give you "on-the-job training" and guide you as you start out? If "on-the-job" assistance is not provided by the franchisor, this should be considered a negative. Remember that while you are gone from home you will not be generating any income. There are, however, some franchises that pay you while you learn. This should be the case when the training period is quite long.

Cost should be part of your franchise contract. Usually your franchise fee includes the cost of training, supplies, and your personal expenses while training. Check to make sure that everything is covered including transportation, room and board, as well as training and supplies.

The franchisor should be able to provide you with a training schedule so that you can see what is included. If you are dealing with a reputable franchisor, you will have no problem here as the success of your business and, therefore, that of the franchisor, is determined by how well you know your business. Make sure that the following is covered: franchise operations, sales, finance, promotion, personnel, management, manufacturing, and maintenance (if the franchise includes this), and training.

In many franchises you will be hiring employees who have to be trained. Usually this becomes the job of the franchisee and field trainers of the franchisor. Very seldom does the franchisor provide employee training at the home office. There are exceptions to this, of course. Find out which is the case with your franchise. If the job becomes yours, there are two things to find out: do you get assistance from the home office in the form of a field representative with the training, and what does the training program provide? Training is not as difficult as it may sound. Most franchisors have "canned training programs" which are either on film or video. The franchise package may include all that is needed to run the program. Find out exactly how this will be handled and what you will get.

Once again, look to the franchisor to keep you and your staff up to date through continuous training:

- a. Program: What is the specific program of continuous training? Is there a formal "refresher course" for franchise principals? Are the staff training programs updated regularly? Are there seminars? Is there a constant flow of home office educational materials? Request samples.
- b. Cost: What is the cost of the continuing program? Is it part of the franchise package or is it an additional cost?
- c. Materials: You should be given a complete list of training materials as well as an outline of both initial and continuing training programs.

When you interview present and past franchisees, include training as part of your questioning. Find out if the franchisor provides the training he/she promises at the time of signing the contract. Is the training effective and complete?

### **MARKETING**

This is the lifeblood of your franchise once you are in business. How you market or sell your product or services is important because it determines size of staff, capital required, and, most important of all, the type of work to which you will be devoting your future. It is important that you understand how you will market your products or services. In some cases, you will sell only and the franchisor provides the leads. In other cases, it is up to the franchisee to generate leads and to follow up on them. Also important is who will be your prospects and customers.

The way you get the sales leads takes various forms. In some cases the franchisor, through national advertising, public relations, and direct mail, generates all the leads, either with or without cooperative advertising support from the franchisees. It is important, then, to ask whether you are required to contribute to a cooperative advertising fund. If you are required to contribute, determine if it is a national advertising fund and how the fund will directly/indirectly benefit your franchise.

An important thing to remember is that a satisfied customer is your best advertisement. Develop and use a technique to get referral prospects from your satisfied customers. Other methods of securing sales leads are telephone solicitation (subject to federal/state law on home solicitation) and trade show booths. Trade show attendance is usually handled by the franchisor or a distributor.

It is imperative that you know who your prospects are. In most businesses, an accurate rule of thumb is 20 percent of your customers account for 80 percent of your business. You need to know what that 20 percent is for your franchise. In consumer products, the profile of your best customer will probably be described by age, sex, and income, whereas your best business customer would be described by type of business, annual sales volume, number of employees, and title of

purchaser. Ask for a profile of the prospect. If this information is not available, it should be viewed as a negative.

Most franchises are sold through advertisements much like the one you probably answered. Many franchisors will include the franchise sales advertising program as part of the answer to how much they are spending in advertising. Others will include the dollar value of publicity appearing in newspapers, magazines, or on radio and TV. What you want to know is what is the national advertising program promoting the products or services of the franchise to the prospective customers? Public media such as television, radio, newspaper, magazine, and outdoor are important to the visibility of the product and franchise trademark. Therefore, make sure they are properly and effectively promoted. Samples of national advertising should be available to prospective franchisees. Find out in what publications the advertising appears so that you can look for it and form your own opinion as to its effectiveness.

The local advertising and promotion program in support of your franchise in your market should be an extension of the national program. Make sure it is. For this reason, the programs should include such items as ad mats, radio scripts, TV commercials, sample media programs, direct mail programs, point of purchase material, sample publicity releases and accompanying photographs. The establishment of your business is news. Does the franchisor provide plans for a grand opening, including advertising and publicity? Ask to see a sample kit.

### **HOME OFFICE SUPPORT**

Even though you will be in business for yourself, your success is tied directly to the franchisor. Look to your home office as a branch manager of a company would look to his/her home office. For the most part, the home office of the franchisor will consist primarily of people as opposed to manufacturing facilities and warehousing. You will probably find that the number of home office personnel might seem low when compared to companies with company-owned distribution systems. It is important to keep in mind, therefore, that it is not quantity but quality that is important to you. You want to find out the qualifications of the franchisor in respect to the product or service of the franchise.

Who are the key persons in the day-to-day operation of the business? What are their backgrounds and accomplishments? If all have financial and/or sales backgrounds and no particular experience in the field of the franchise, this should be considered a negative. Look for sound business and financial experience and a depth of expertise in the business of the franchise.

Who are the members of the board of directors? These board members usually serve without pay and many times are majority stockholders. What you are looking for are directors who have backgrounds related to the business of the franchise. The more the better for you.

Service departments are in existence to be of service to the franchisee so it is in your best interest to find out what they are, who is in charge, what is his/her background, and the specific services provided. Critical departments to look for are: finance and accounting, advertising and promotion, sales and marketing, research and development, real estate, construction, personnel and training, manufacturing, and operations.

Research and development is very important to any organization since it is charged with plotting the future of the product or service lines. This should be an active department with an adequate budget. Also the operations department (many other names are assigned to this) with which you will have much of your contact is important. This is the department that is charged with the responsibility of liaison between franchisor and franchisee. In any event, make sure that there is a clear channel of communication between you and your distributor or franchisor.

What you want to find out is specifically what you will receive as assistance at your place of business. You will note that most franchise package benefits mention field support, but the questions are when, how often, who, and what does he/she do? Be sure to learn the name of this person and talk to him/her to get an understanding of what he/she really can do for you.

## CHECKLIST FOR EVALUATING FRANCHISES

### A. FRANCHISE – GENERAL

	Yes	No
1. Is the product or service:		
a. Considered reputable	_____	_____
b. Part of a growing market	_____	_____
c. Needed in your area	_____	_____
d. Of interest to you	_____	_____
e. Safe	_____	_____
f. Protected	_____	_____
g. Covered by guarantee	_____	_____
2. Is the franchise:		
a. Local	_____	_____
Regional	_____	_____
National	_____	_____
International	_____	_____
b. Full time	_____	_____
Part time	_____	_____
Full time possible in future	_____	_____
3. Existing franchises:		
a. How long was the company in business before the first franchise was awarded? _____ years		
b. What date was the company founded and what date was the first franchise awarded? Company founded in _____ First franchise awarded in _____		
c. Number currently in operation or under construction? _____		

Information on those to contact:

Franchise #1:           Owner \_\_\_\_\_  
                              Address \_\_\_\_\_  
                              \_\_\_\_\_  
                              Telephone \_\_\_\_\_  
                              Date started \_\_\_\_\_



5. Franchise in local market area

a. Has a franchise ever been awarded in this area?

1. If so, and if it is still in operation:

Owner \_\_\_\_\_

Address \_\_\_\_\_

Telephone \_\_\_\_\_

Date started \_\_\_\_\_

2. If so, and if it is no longer in operation:

Person involved \_\_\_\_\_

Address \_\_\_\_\_

Date started \_\_\_\_\_ Date ended \_\_\_\_\_

Reasons for failure \_\_\_\_\_

b. How many inquiries have you had for your franchise from my area in the past six months? \_\_\_\_\_

6. Competition:

a. What is my competition? \_\_\_\_\_

7. Are all franchises independently owned?

a. Of the total outlets, \_\_\_\_\_ are franchised and  
\_\_\_\_\_ are company owned.

1. If some outlets are company owned:

did they start out this way \_\_\_\_\_

or were they repurchased from a franchisee \_\_\_\_\_

Date of most recent company acquisition \_\_\_\_\_

8. Franchise distribution pattern:

a. Is the franchise exclusive \_\_\_\_\_ or non-exclusive \_\_\_\_\_?

- b. Is the franchise a distributorship \_\_\_\_\_  
 or a dealership \_\_\_\_\_?
1. If it is a dealership, who is the distributor in my area:  
 Name \_\_\_\_\_  
 Address \_\_\_\_\_
2. How long has he/she been a distributor? \_\_\_\_\_

9. Franchise operations:

- a. What facilities are required, and do I lease or build?

Operated out of home? \_\_\_\_\_

	Build	Lease
Office	_____	_____
Building	_____	_____
Manufacturing facility	_____	_____
Warehouse	_____	_____

- b. Getting started . . . who is responsible for what?

	Franchisor	Franchisee
Feasibility study	_____	_____
Design	_____	_____
Construction	_____	_____
Furnishing	_____	_____
Financing	_____	_____

B. FRANCHISE COMPANY

1. The company:

- a. What is the name and address of the parent company, if different than the franchise company:

Name \_\_\_\_\_

Address \_\_\_\_\_

- b. Is the parent company public \_\_\_\_\_ or private \_\_\_\_\_?

- c. If the company is public, where is the stock traded?

\_\_\_\_\_

- d. If the company is private, the president is:

\_\_\_\_\_

- e. The following bank can be used as a reference:  
 Name \_\_\_\_\_  
 Address \_\_\_\_\_  
 \_\_\_\_\_  
 Contact person: \_\_\_\_\_

C. FINANCIAL AND LEGAL

1. a. Attorney  
 Name \_\_\_\_\_  
 Address \_\_\_\_\_  
 \_\_\_\_\_  
 Telephone \_\_\_\_\_
- b. Financial  
 Name \_\_\_\_\_  
 Address \_\_\_\_\_  
 \_\_\_\_\_  
 Telephone \_\_\_\_\_
- c. Management  
 Name \_\_\_\_\_  
 Address \_\_\_\_\_  
 \_\_\_\_\_  
 Telephone \_\_\_\_\_

2. Total franchise cost:
- a. How much money do I have to have to get started?
- | Item                 | Amount   |
|----------------------|----------|
| Franchise start-up   | \$ _____ |
| First year operating | \$ _____ |
| First year personal  | \$ _____ |
- b. What do I have to pay the franchisor to get started?  
 \$ \_\_\_\_\_
- Basis of cost:
- | Item           | Amount   |
|----------------|----------|
| Franchisee fee | \$ _____ |
| Services       | \$ _____ |
| Product        | \$ _____ |

Real Estate \$ \_\_\_\_\_  
 Equipment \$ \_\_\_\_\_  
 Other: \_\_\_\_\_ \$ \_\_\_\_\_

c. Is any of the initial franchise cost refundable? \_\_\_\_\_  
 If so, on what basis? \_\_\_\_\_

3. Financing:

a. Is part of the initial cost to the franchisee financed?  
 \_\_\_\_\_  
 If so, how much? \$ \_\_\_\_\_  
 This represents \_\_\_\_\_% of the total initial cost.

b. What is the interest rate? \_\_\_\_\_%

c. When does financing have to be paid back? \_\_\_\_\_

4. Forecast of income and expenses:

a. Is a forecast of income and expenses provided? \_\_\_\_\_  
 Is it: based on actual franchisee operations? \_\_\_\_\_  
 based on a franchisor outlet? \_\_\_\_\_  
 properly estimated? \_\_\_\_\_

b. If a forecast is provided does it:

	Yes	No
Relate to your market area	_____	_____
Meet your personal goals	_____	_____
Provide adequate return on investment	_____	_____
Provide for adequate promotion and personnel	_____	_____

5. Are all details covered in a written franchise contract?

Yes \_\_\_\_\_ No \_\_\_\_\_ (Get copy for attorney and accountant review)

a. What to look for – are these included?

	Yes	No
Franchise fee	_____	_____
Termination	_____	_____
Selling and renewal	_____	_____
Advertising and promotion	_____	_____
Patent and liability protection	_____	_____

Home office services	_____	_____
Commissions and royalties	_____	_____
Training	_____	_____
Financing	_____	_____
Territory	_____	_____
Exclusive vs non-exclusive	_____	_____

D. TRAINING

1. Initial training:

a. Does franchisor provide formal initial training? \_\_\_\_\_  
 If so, how long does it last? \_\_\_\_\_

b. Cost

	Yes	No
Included in franchise cost	_____	_____
Includes all materials	_____	_____
Includes transportation	_____	_____
Includes room and board	_____	_____

If not included in franchise cost, what is total cost including all outlined above? \$ \_\_\_\_\_

c. What does the training course include?

	Yes	No
Franchise operations	_____	_____
Sales	_____	_____
Finance	_____	_____
Promotion	_____	_____
Personnel	_____	_____
Management	_____	_____
Manufacturing and maintenance	_____	_____
Training	_____	_____

d. How do you train your initial staff? Is a training program provided?  
 \_\_\_\_\_  
 Does the franchisor make available a staff member from the home office to assist? \_\_\_\_\_  
 What materials are included in staff training?  
 \_\_\_\_\_

2. Continuing training:
  - a. What is the continuing program? \_\_\_\_\_
  - b. Is there any cost? \_\_\_\_\_
  - c. If so, how much? \_\_\_\_\_
  - d. Are there any special materials or equipment required? \_\_\_\_\_
  - e. If so, what? \_\_\_\_\_
  - f. What is the cost to the franchisee? \_\_\_\_\_

E. MARKETING:

1. How is the product or service sold?
 

	Yes	No
In home – appointment	_____	_____
In home – cold	_____	_____
Telephone	_____	_____
In store or place of business	_____	_____
At business – appointment	_____	_____
At business – cold	_____	_____
Mail	_____	_____
_____	_____	_____

2. How do you get the sales leads?
 

	Yes	No
Franchisor	_____	_____
Franchisee	_____	_____
Both	_____	_____
Advertising	_____	_____
Direct Mail	_____	_____
Telephone	_____	_____
Trade Shows	_____	_____

3. Who are the prospects for the products or services?  
Outline a brief profile: \_\_\_\_\_

4. What is the national advertising program of the franchisor?

- a. What is the national advertising budget? \$ \_\_\_\_\_
- b. Are you required to contribute to the national advertising budget?

- c. What are the primary advertising media?
 

Television _____	Radio _____
Outdoor _____	Newspaper _____
Direct Mail _____	Magazine _____

- 5. What kind of advertising and promotion support is available for the local franchise?
 

	Yes	No
a. Is a packaged advertising program available?	_____	_____
b. Is there a co-op advertising program?	_____	_____
c. Is there a grand opening package?	_____	_____
  
- 6. Should you have an advertising agency?
 

	_____	_____
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F. HOME OFFICE SUPPORT

- 1. Principals and directors:
  - a. Who are the key persons in the day-to-day operation of the business?
 

Name _____
Title _____
Background _____

  

Name _____
Title _____
Background _____

  

Name _____
Title _____
Background _____

  

Name _____
Title _____
Background _____

Name \_\_\_\_\_  
Title \_\_\_\_\_  
Background \_\_\_\_\_

b. Who are the directors (do not include those from above)?

Name \_\_\_\_\_  
Business Association \_\_\_\_\_

Name \_\_\_\_\_  
Business Association \_\_\_\_\_

2. Consultants:

a. Who are the consultants to the company?

Name \_\_\_\_\_  
Business Specialty \_\_\_\_\_

Name \_\_\_\_\_  
Business Specialty \_\_\_\_\_

Name \_\_\_\_\_  
Business Specialty \_\_\_\_\_

3. Service departments:

a. What service departments do you have?	Yes	No
Finance and accounting	_____	_____
Advertising and promotion	_____	_____
Sales and marketing	_____	_____
Research and development	_____	_____
Real estate	_____	_____
Construction	_____	_____
Personnel and training	_____	_____
Manufacturing and operations	_____	_____
Purchasing	_____	_____

4. Field support:
- a. Do you have a field person assigned to working with a set number of franchises? \_\_\_\_\_
  - b. Who would be assigned to my franchise? \_\_\_\_\_  
\_\_\_\_\_
  - c. How many other franchises is he/she assigned to? \_\_\_\_\_
  - d. May I contact him/her? \_\_\_\_\_

Hopefully this checklist and evaluation has helped you to determine whether investing in a franchise is a good investment for you. You should be aware that although a franchise may score high on the evaluation, there is no guarantee that your investment is foolproof. You must decide whether you want to take the risk or not.

There are governmental agencies that you can contact if you have further questions, including:

Michigan Department of Attorney General  
Consumer Protection Division  
Franchise Section  
PO Box 30213  
Lansing, MI 48909  
[www.michigan.gov/ag](http://www.michigan.gov/ag)

For first-time, start-up business only:  
Michigan Economic Development Corporation  
300 N. Washington Square  
Lansing, MI 48909  
[www.medc.michigan.org](http://www.medc.michigan.org)

Federal Trade Commission  
600 Pennsylvania Avenue, NW  
Washington, DC 20580  
[www.ftc.gov](http://www.ftc.gov)

The FTC publishes many guides including:

- 1. Buying a Franchise: A Consumer Guide:  
<http://business.ftc.gov/documents/inv05-buying-franchise-consumer-guide>
- 2. Amended Franchise Rule Compliance Guide:  
<http://www.ftc.gov/bcp/edu/pubs/business/franchise/bus70.pdf>

3. Amended Franchise Rule FAQs:  
<http://www.ftc.gov/bcp/franchise/amended-rule-faqs.shtml>
4. Basic Franchise and Business Opportunity FAQs:  
<http://www.ftc.gov/bcp/franchise/faq1.shtm>

Council of Better Business Bureaus, Inc.  
4200 Wilson Blvd. Suite 800  
Arlington, VA 22203-1838  
[www.bbb.org](http://www.bbb.org)

(You may want to check at the office in your local community and in the location of the franchisor's home office.)

Your local library will also probably have magazine articles and books which can be consulted for information about franchises in general.