The Do's and Don'ts of BUYING A FRANCHISE

Due diligence is important when buying any business. A franchise is certainly no different.

By Rajiv Singh

One of the first things to consider before buying a franchise is what you are passionate about. That accomplishes two things: it drives the business, and the love for what one is doing drives the owner. When the business and the owner are operating as one, it is a powerful combination.

The next step is to meet with more than one of the franchisees currently operating in the franchise. Look at the location and determine if you like its look and feel. Ask the franchisee if their startup and ongoing training has been sufficient, whether the franchisor aides in advertising and marketing efforts, and how much freedom the franchisee has in selecting advertising, the product line, etc. Also ask how many hours the franchisee spends on their business. Confirm with them what their startup costs were, and how long it took to see returns on their investment.

Another important requirement is to carry out a good amount of research before you start up your business. Make sure you research the following:

- **The market**
- **The system**
- **The company**
- **The competition**
- **The franchisees**

What to look for?

If you are thinking about investing in a franchise and want to know if the brand you are looking at has a trademark worth paying for, then look at their marketing and growth. Has its recent marketing been effective or ineffective? Is the brand growing or has it reached a plateau? Is it consistently coming out with new products and / or services? Researching your potential brand's history can give you an idea of where it is are most likely heading.

Key questions to ask before buying a franchise

1. Do you know the franchisor?

Carry out all kinds of background research on the franchisor. Going for established brands is always good.

Opting for an emerging franchise business for sale is also good, provided you have done sufficient research on the business and the sector it is in.

2. What is the brand recall / equity of the franchise?

Franchises work well when there is brand recall / equity of the franchise. Everyone knows about Subway, McDonald's, etc. If a franchise has little or no name recognition, launching it will almost be identical to launching a brand new business.

3. What is the success rate of the franchisees?

Many franchisors have ways to make the success rates of franchisees look better than they actually are.

4. What will it do to help you market your business?

Ask what the brand is going to do to promote the name of the franchise in your area or target market. If you are paying marketing fees as part of ongoing payments, how will this fees benefit you?

5. What exactly are you buying?

What do you actually get from spending money to buy the franchise—name recognition, intellectual property, marketing support, lead generation? Is the concept of the franchise mature enough, so you don't have to constantly innovate the product or service on your own?

6. Are you a good fit?

Know your strengths and weaknesses. A franchisee is often restricted by what's there in the franchise agreement. If you take up a concept in which you have no interest just because it is profitable, it may soon turn into a burden for you—you just might lose all your interest!

7. Do you know the market?

Knowing the present market trends is very important for finding success as a franchisee. Most franchise agreements are for 10 years, so you must choose franchise opportunities that belong to categories that have a promising future. It's always better to go for products / services that will be needed in every kind of market.

Do's and Don'ts

DO:

1. **Investigate franchise opportunities.** Be careful: there are thousands of franchise offerings, and not all of them are good opportunities. If possible, work for someone else in the business first.
2. **Talk to the present owners of the franchise.** Ask them how pleased they are with their decision, how good their business is doing, and whether they met their projections. Inquire if the franchisor is responsive to their needs and whether the training was adequate.
3. **Consult any and all the advisors you feel can help you.** This includes having your accountant and lawyer review the audited financial statements and legal documents.
4. **No question is too trivial.** Confirm and challenge the information that is provided to you.
5. **Compare other franchise systems** in the same field. Look for franchises that are solidly managed, well financed, and are positioned in a growth industry. Investigate any regional franchises that are doing well but have not yet gone national in their distribution.
6. **Evaluate yourself.** See if franchising is really for you. Appraise your experience, skills and likes to determine if the business you are considering is a good fit. Evaluate yourself in comparison to other franchisees that you meet and talk to.
7. **Check the history and experience** of the franchisor's officers and managers.
8. **Research, research, research.** The more you know, the better your decision is likely to be. Only you can determine if owning a particular franchise is right for you. Most likely, your decision will be based on two factors: your investment and risk capabilities.
9. **Decide whether you want to be in business full time.** Or would you prefer to be in it part time, or perhaps with your family?
10. **Look to the seller as the best source of financing** when purchasing a business.
11. **Consider the economics of the business** more than how well or poorly it has been run.
12. **Verify receivables (through written verification)** from people who owe the business money.
13. **Deal only with established franchisors** who are well-financed and widely successful.
14. **Plan for more expenses and slower profitability** than you think you need.

DON'TS

1. **Don't permit any expert to decide for you** whether or not you should buy a business.
2. **Don't buy a business or franchise without your lawyer** approving all documents.
3. **Don't buy a business or franchise without your accountant** reviewing the franchisor's records.
4. **Don't rely on information or advice from the franchisor** or other selling agents.
5. **Don't rely on pro-forma financial statements** (future predictions).
6. **Don't be in a rush.** Wait patiently for the big opportunity by looking at lots of them.
7. **Don't rely on the seller's evaluation** of inventory and other assets.
8. **Don't deal with startups** or poorly financed / inexperienced franchisors.
9. **Don't hesitate to walk away** from a deal that isn't a potential home run.
10. **Don't overlook** comparing what you can do as an individual verses as a franchisee.
11. **Don't hurry.** Cutting corners on your research can increase your likelihood of failure.
12. **Don't overextend yourself** or be overly optimistic about your personal finances. Be realistic, and if anything, be conservative.

> **"A FRANCHISEE IS OFTEN RESTRICTED BY WHAT'S THERE IN THE FRANCHISE AGREEMENT."**

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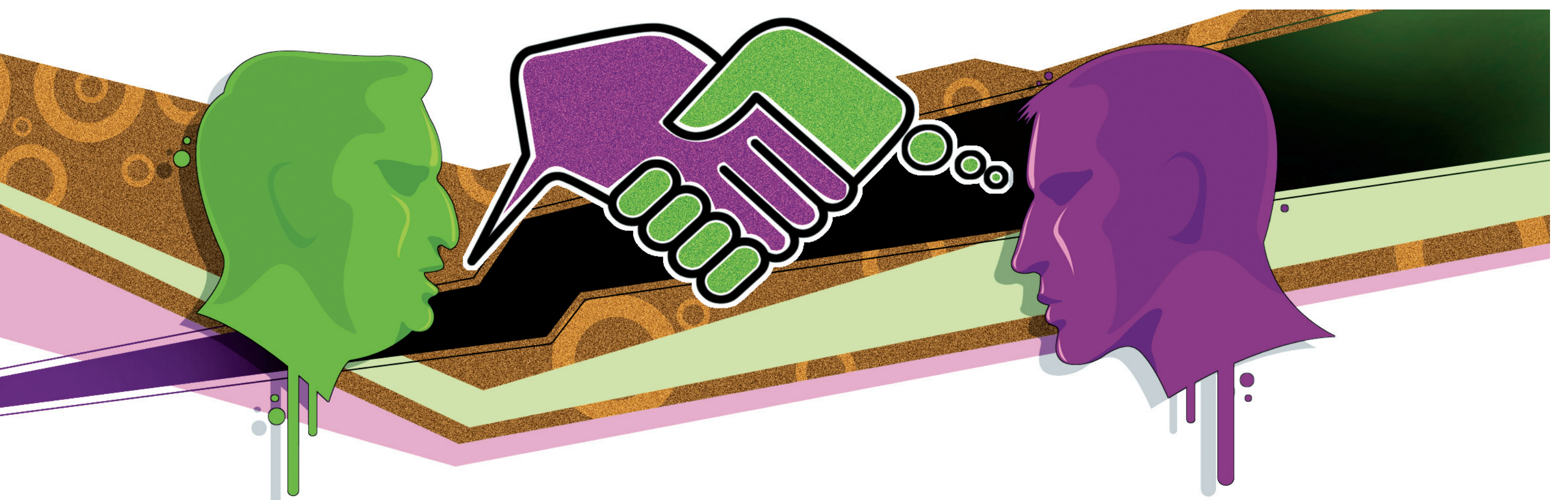
Negotiating WITH A FRANCHISOR

You don't have to accept all the franchisor's terms—not without putting up a fight!

By Rajiv Singh



Whether or not you can negotiate the terms and conditions of your franchise agreement depends solely on the franchisor. When it comes to making changes to their franchise agreement, certain franchisors will negotiate the terms of their franchise agreement, while others will not. In some cases, the distinction is based upon the size and maturity of the franchisor. For example, McDonald's wouldn't negotiate their agreement, but a new franchisor may be far more willing to agree to changes in order to sell a franchise.

Successful brands may not negotiate because:

- They have a history of successful and happy franchisees
- They know there are plenty of potential franchisees who would like to buy into their system

For an entrepreneur to get into negotiations with the franchisor, the later will first want to be sure that you fit in with the team—the people in the franchisee support infrastructure, the network's suppliers, and other franchisees.

It is important to remember that a franchisee can never succeed in isolation. It's a team effort. This does not mean that you should accept every clause in the agreement at face value. Good franchisors appreciate it if you ask probing questions. If a clause in the agreement bothers you, ask for an explanation, then talk it over with your attorney. Should it remain a sticking point, you always have the option of walking away from the deal. It is much better to do so at this stage than to sign on the dotted line and regret it for a very long time to come.

Settling on a price is only the first step in negotiating the sale. Actually, the structure of the deal is often more important than the actual price. Be prepared to pay between 30 and 50 percent of the price in cash, and finance the remaining amount.

If the franchisor establishes that you are qualified and serious, some franchise cost items can be open for negotiation:

- The franchise fee—especially if you buy more than one unit
- Protected territory—it is feasible to negotiate a larger one
- Royalty payments—if not the amount, then the timing
- Marketing fund payments—control how the money is spent
- Additional training—always a good value
- Options on additional units—expansion possibilities
- Travel expenses—every bit helps
- Existing units—only the franchisor may know that they are available
- Start-up costs—the franchisor can help with marketing and financing

Even before you arrive at the point of negotiations, there is a process you need to follow:

1. Engage an experienced franchise attorney to review the agreement.
2. Confirm that the franchisor will negotiate the terms of the agreement.
3. Recognize that certain terms are non-negotiable.
4. Focus on the important points in the agreement.

Examples of provisions in the agreement that you should definitely negotiate:

A. Restrictions on products and services that you wish to sell
B. Marketing or selling in "open" territories
C. Indemnification provisions
D. Advertising
E. The Transfer and Assignment Section
F. The minimum guarantee of return on investment or actual costs until the business actually starts earning returns

Tips for negotiating franchise agreements:

- Ensure that the franchise agreement complies with the law of the land.
- Ensure that the franchise agreement does not contain elements that may constitute unconscionable conduct.
- Outline for the franchisor (in writing) a list of objections to the franchise agreement and the changes that you seek.
- Make a note of all correspondence and communication with the franchisor.

If you come across a franchisor who is reluctant to pass along a list of current franchisees, makes promises of earning a fortune on a limited amount of money invested, insists on deposits for holding a franchise unit, tries to convince you to sign before someone else does, or is full of empty advice when answering your questions, warning bells should ring! The fact is that responsible franchisors don't act in this way.

Like any good relationship, the one between a franchisor and franchisee is based on respect and mutual benefit. Do your due diligence and respect the process.

> **"IT IS IMPORTANT TO REMEMBER THAT A FRANCHISEE CAN NEVER SUCCEED IN ISOLATION. IT'S A TEAM EFFORT."**

During negotiations, franchisors need to consider the impact of negotiations on their overall system:

AREAS OF PROTECTION. Most franchisors are loathe to grant areas of protection with their franchises, because they don't want to limit the geographical area in which they can advance with new projects. When areas of protection are granted, they are done on a case-by-case basis and usually cover a modest geographical area.

ROYALTY REDUCTIONS. Franchisors are reluctant to reduce their royalties in their franchise agreement in order to maintain consistency and fairness within their franchisee community. Franchisors do consider, in special circumstances, royalty reductions, especially when they are dealing with multiple franchises, or when a franchisee is significantly impacted by a development by its franchisor in its market area.

LIQUIDATED DAMAGES. Franchisors are reluctant to reduce their liquidated damages. The franchisor orientation is that the franchise agreement is for a specified term. If the franchise term is terminated prior to its normal completion date, the franchisor has lost its presence in the marketplace and is entitled to receive liquidated damages to replace its lost income stream.

TRANSFER OF FRANCHISE. Franchisors will insist on approval rights upon the transfer of a franchise by a franchisee, or will prohibit the transfer of a franchise and will require a new franchise agreement. Franchisors reserve absolute discretion in transferring or selling their hotel franchise systems; this is done so that they can sell their system without being handicapped by their franchisees.

UPGRADING. While franchisors will discuss the particulars of a product improvement plan in order to maintain product quality, they exercise their best efforts to ensure that plans are consistent with their standards manual and are consistent with the integrity of their brands.

RENEWAL. Franchisors normally do not provide renewal rights due to changing market conditions and new business strategies. When they do allow for renewal rights, franchisors will consistently provide that they have broad—if not absolute—discretion in approving a renewal.

LITIGATION. Franchisors are careful to provide rights to litigate in the state where their principal office is located. Oftentimes, franchise agreements provide for mediation and arbitration clauses as a more effective way of resolving disputes expeditiously.

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