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Fascinating by franchises? 5 things to know

By Mya Frazier • Bankrate.com

Highlights

- Seek independent advice.
- Don't be afraid to walk away.
- Recognize you can't change the franchiser.

Laid-off professionals with severance packages and a lifetime of savings often view a franchise deal as a quick exit from unemployment and a steppingstone to financial and personal independence.

Sadly, it doesn't always end that way. Many would-be entrepreneurs have ended up bankrupt and out hundreds of thousands of dollars after falling for dubious franchise concepts hawked by pushy salespeople.

If you're thinking of opening a franchise, here's what to know about your legal rights, the franchise marketplace and the research you must do before signing a contract and handing over that nest egg.

Franchise advice

1. Seek independent advice.
2. Don't be afraid to walk away.
3. Research, and research some more.
4. Recognize you can't change the franchiser.
5. Know and understand your legal rights.

Seek independent advice

If you do a Web search for franchise consultant, you'll find thousands of sites created by self-declared "experts." Fees can reach $300 an hour, and a well-known industry secret is that many of these self-proclaimed consultants aren't exactly independent. It's understood that many of them push would-be entrepreneurs into specific franchise brands and concepts for financial gain.

"You are better off going to people that do not have an agenda," says retired franchise owner Betty Otte, who often counsels would-be franchise owners for free as district director of the Santa Ana, Calif.-based Orange County office of SCORE, the nonprofit group that offers free business counseling at 370 chapters in the United States.

Her consistent word of advice: Read, reread and then read again the the Uniform Franchise Offering Circular, or UFOC. The document, required by the Federal Trade Commission, defines the relationship between the franchiser and franchisee. It's often long, arduous to complete and chock full of confusing legalese. Unless you're an out-of-work attorney, don't review it alone. Seek unbiased help from an attorney and a business counselor.

"I always have people read it and come with questions," says Otte. "It usually runs about 23 different components. It's like a lease. It's a very binding document, and it's very hard to dig your way through it."

Otte also recommends that would-be franchisees not rely solely on the franchiser for business planning. When Otte started as a franchise owner in 1980, opening a NutriSystem location in Orange County, she created and constantly updated an independent business plan.

"We looked at it as a business," Otte says. "Yes, it was true that we had the support of the franchiser. Yes, it was true we had a community of other franchisees we could relate to. But we still had our own business plan and our business goals. We operated as a freestanding business in parallel to it being a franchise."

Don't be afraid to walk away

Howard Sherman has come close not once, but twice, to signing on the dotted line, handing over a big check and entering the ranks of America's franchise owners. He even spent a week in Las Vegas visiting the store operations of a used baby-clothing franchise chain.

Then he walked away.

As an expert in PC repair and programming, Sherman decided to take a serious look at the handful of computer-support franchise concepts, often referred to as "geek franchises."

The franchise deal he decided to pursue required a hefty initial investment, upward of $80,000 and a monthly franchise fee to cover a national advertising campaign. Sherman was skeptical of the requirement to put a toll-free number on his local advertising so calls could be redirected to him if they originated in his territory in central New Jersey.

"I would have actually had to pay for and voluntarily agree to introduce a middleman into my business at the rate of 15 percent of gross revenue for the next 10 years," he says. So Sherman walked away, again.

He never regrets listening to that skeptical voice in his head. After all, in 2003, he successfully launched his own brand and company, RoyalGeeks.com, based in Matawan, N.J. RoyalGeeks focuses on remote and on-site tech support.

Sherman now employs five full-time employees and 15 contract and part-time employees. From day one, he has been profitable and has been able to invest in new business ideas and strategies because he's not paying monthly franchise fees.

"I can experiment and get it wrong because I don't have to pay out that 15 percent. It gives me more leeway," Sherman says.

"If I had signed the paperwork, I would have only been able to serve the area of central New Jersey," Sherman says. "If I had wanted to expand, I would have had to buy a second territory."

Research, and research some more

A franchise deal is about more than just the financials. The old investment adage that past performance is no indicator of future success rings true in the franchise world, too.

Signing a franchise deal means connecting your livelihood, savings and future earnings not just to a business model, but a brand. And if one thing is abundantly evident in today's marketplace, it's that brands rise and fall, especially in the retail industry, where there are hundreds of retail franchise concepts.

That's why it's critical to research and read everything you can about the company, brand, leadership experience and existing relationship with franchisees.

Research the franchise concept by searching blogs and other feedback Web sites such as Complaints.com, where you can find out if a franchise concept has a positive reputation among consumers, according to Complaints.com Chairman Rob Monster.

"It is a leading indicator to problems that may emerge later in a franchise network," says Monster. "What we have seen is that the consumer complaints are the first indication that the franchiser may have lowered the standards for who can be a franchisee and that they are diluting the brand."

Additionally, call up franchise owners in your region and in other states. Don't just take stock answers. Push for insight and ask for the inside story on whether the franchiser lives up to the promises hyped in presentations. After all, the retail churn, or customer loss over time, for many second-rate retail brands can be brutal, with some concepts lasting less than five years.

Finally, ask yourself how original and unique is the brand concept? Is it a derivative, copycat idea, jumping on a consumer fad?

Recognize you can't change the franchiser

John Hayes is a former franchise owner who runs HowtoBuyaFranchise.com and has written 18 books on business and franchising. He sees the recent uptick in interest in franchising as a symptom of the business cycle.

"In all the recessions, that's what always happens. The unemployed and downsized folks with severance packages and golden parachutes try franchising," Hayes says. "People often do not understand that a franchise is a system for operating a business. It's not your system. You can't do it your way. You can't change the franchiser. Why buy the system and (not) follow it?"

The transition to franchise owner can often be frustrating for former executives with an independent or creative streak.

Hayes has a list of 92 questions all would-be franchisees should ask before making a choice, including No. 9: Would I really prefer to create my own system rather than follow another system?

Many frustrated franchisees fail to recognize the tight restrictions of a franchisee-franchiser relationship. The systems can be painstakingly strict and dictate the minutiae of how the business is run, from the kind of napkin holders used to the hours a certain food item can be sold in a restaurant franchise.

If you harbor dreams of creative expression and the life of an experimental chef, you'll likely be unhappy running a franchise food concept and should be thinking about starting your own restaurant instead.

Know and understand your legal rights

The Federal Trade Commission offers "Buying a Franchise: A Consumer Guide" as a guide that includes a somewhat sobering take on franchise growth:

"A growing franchise system increases the franchiser's name and brand recognition and may enable you to attract customers. But growth alone doesn't ensure successful franchisees. Indeed, a company that grows too quickly may not be able to support its franchisees with the support services it promises them. Investigate the franchiser's financial assets and resources; are they sufficient to support the franchisees?"

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