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DARE TO FRANCHISE

BY C. J. PRINCE

Thinking about a franchising opportunity? Here's how to sift through your options and get the best deal.

Julie Marcus was only three months into her job as a national sales manager at a Florida-based distributorship when the company took a nosedive and laid off 90 percent of its staff, including Marcus. Eight weeks pregnant at the time, the first-time mother-to-be didn't feel comfortable interviewing for a new job without mentioning her pregnancy, and was skeptical about getting maternity leave after working such a brief period. "Finally it just made sense to me—why don't I do this myself?" she recalls.

So in October 2003, Marcus opened her own promotional products distribution business. She knew the industry well and loved the flexibility sole proprietorship afforded. But after several months, she found herself reconsidering. "As much as I wanted it to be 100 percent me and 'on my own' I was having a lot of cash flow issues," she says. Marcus struggled to maintain solid relationships with factories because she might use a vendor and then not call the company again for six months, depending on the orders received. "I was also fronting all these orders on my own, which really limited my growth," she adds.

The answer, she decided, was to buy a franchise from Pro-Forma, a promotional products franchise company in her industry, with a recognized brand. The deal allowed her to benefit from the parent company's vendor preferred program, as well as its marketing and support. "Even though I'm on my own, I'm not alone," says Marcus. "I didn't think that would make a big difference, but it really does."

The boost from a franchisor's central office is one of the main attractions of owning a franchise, and piggybacking on an established brand and proven track record can help ease the stress of going solo for new entrepreneurs. But even the most turnkey of operations isn't a quick or automatic success. Given the considerable investment required—the flat fee for purchasing the franchise, the ongoing royalty and advertising fee as a percentage of sales, plus a hefty reserve of working capital until you turn a profit—you naturally want to choose very carefully.

A host of factors besides the price tag will, or should, go into your decision to buy a particular business, says Steve Hockett, president of Eden Prairie, Minnesota-based FranChoice, a franchise broker that pairs would-be franchisees with companies. "First, back up a few steps and start with an introspective self-examination to identify your motivation," he suggests.

Hockett learned that lesson early in his career, when he bought a hair care franchise business simply because a friend had one to sell. "I was young and I ran out of money and couldn't expand," he recalls. "I landed on my feet, but a lot of people get burned in franchising because they didn't take the time to sit back and figure out who they are and what they wanted to do, and then find a franchise that matches with that."

Clarifying your goals will help in sorting through the dizzying list of possibilities. "People are always absolutely shocked to find there are hundreds upon hundreds of options to choose from," says Kathryn Tito, director of product development for Franchise Solutions, a Portsmouth, New Hampshire-based company and web site that helps entrepreneurs find franchises. In fact, there are more than 1,500 active North American franchise systems—and you might find yours in an unexpected industry. "This may be your long-awaited opportunity to branch out and make a career transition you wouldn't have considered before," explains Tito, who notes that experience in a given industry is not critical. "It's fundamental business skill sets that will make you a successful franchise owner—general business acumen, sales, marketing, the ability to satisfy clients."

> **"Even though I'm on my own, I'm not alone."**

WHAT TO LOOK FOR To narrow down the options, attorney Joyce Mazero with Jenkens & Gilchrist suggests following some basic criteria. "The first is a great brand," she says, along with an ability to successfully promote that brand. Next, look for a company with a coherent and comprehensive operating system, one that continually reinvests in that system so that the company stays competitive. Be sure the company offers economies of scale so you're getting price and purchasing benefits you wouldn't achieve alone—particularly if the entry fee is high. A younger franchise operation, with fewer franchisees, may not have the same economies of scale as a more established company, but will likely cost less to get into.

Finally, look for a company with a reputation for good communication, collaboration, and relationship building. "That doesn't mean that the franchisor always agrees with the franchisee on particular issues, but that it listens and takes into consideration solid business input," Mazero says.

That's a quality that Robyn Sweardlow-Sprauer, co-owner of a Relax the Back franchise, has come to rely on over the 10 years she's run her business. A cooperative association of more than 100 franchisees, which Sweardlow-Sprauer helped found, contributes to the Relax the Back corporate office's various strategic committees, including marketing and merchandizing.

"We participate in all their major decisions," she says.

The company also hosts an intranet that franchisees use to communicate both with vendors and with one another and holds annual conventions designed to facilitate dialogue among the 90 percent of franchisees who regularly attend, says Richard Palfreyman, CEO of La Palma, California-based Relax the Back. "We're a big believer in communications and feedback," he notes.

ANALYZING THE AGREEMENT

Based on the conceptual criteria and your own goals, narrow your list to no more than four strong candidates, preferably from different industries, Hockett recommends. Contact each of the franchisors and request information that will include the Uniform Franchise Offering Circular, a thick, legal document they are required to provide to potential franchisees. The UFOC offers a wealth of information, including the standard franchise agreement or contract. You'll want to review the contracts and the full UFOC with an attorney specializing in franchise law in order to evaluate the offering for its potential risk and opportunity. The attorney can also help you comb through the franchisor's financial statements to be sure the company is stable, but plan to do your own due diligence as well by ordering up a Dun & Bradstreet report and checking in with the Better Business Bureau.

Among the more important UFOC sections to review is Item 7, or the initial investment chart. "Study that carefully because some of the expenses noted in the chart are ranges based on the experience of franchisees in particular geographic areas," says Mazero. Also pay special attention to Item 8, which reveals any purchasing arrangements the franchisor has and restrictions to specific vendors. "You'll also find out whether the franchisor makes money, rebates, or a discount based on its volume purchasing power—and where that money goes," she adds.

What you may not find as easily—to the frustration of many aspiring franchisees—is financial information, or more specifically, the kind of detailed numbers telling you just how much you're likely to gross in your first year and beyond. Item 19 of the UFOC contains financial performance information, but that item is optional and only some companies include it. With a little tenacity and due diligence, however, you can get some useful predictive information. First, develop your business plan just as you would for any startup, based on the information you have about the company, the industry, and the market, as well as the initial investment costs and other data found in the UFOC. Then take your business plan to the field.

"I would talk to and visit with as many current franchise owners as possible," says Susan Kezios, president of Women in Franchising and the American Franchisee Association in Chicago. "Have all your numbers laid out and ask, 'Is this realistic?'" Ask whether the franchisor's estimates for initial or ongoing costs are on target, and pose other key questions about unexpected or hidden costs, how long it took to cover operating costs, how easy or hard it is to train new employees, whether they're satisfied with ongoing assistance, and so on.

ASKING THE ROI QUESTION

Hockett notes that to really get a sense of moneymaking potential, you'll want to speak to owners who've been in the business one, three, or five years, since most don't make a profit in the early months. He also advises taking advantage of franchisor "discovery days," which is an opportunity to visit the franchisor's headquarters, to meet the folks in charge, view the operation, and get a sense of the company. Kezios agrees. "You want to eyeball the management, try to see, 'Are these people like me?'" she says. "Don't try to buy a franchise over the phone." Ask the franchisor how many franchises have been sold but not yet opened, since many fast-growing franchises have a

THE LICENSING ALTERNATIVE

NOT SURPRISINGLY, Richard Palfreyman, CEO of Relax the Back, a franchisor with 106 stores, is a big fan of franchising. But he also thinks it's smart to paint a realistic portrait for would-be franchisees. "A franchisee is not an independent businessperson," he says. "Your sign can't be any color you like and the store can't be laid out any way you want. You will be your own boss—but with limitations."

If those constraints are a deal-breaker, but the thought of starting something from scratch is just as unappealing, then licensing might be the right compromise. By licensing a company's technology or product, you get the brand recognition associated with that product without the limitations on how you use, display, or sell it. You also don't have to pay the ongoing royalties associated with franchises, points out Judy Patterson, CEO of Imagine Tomorrow, which creates software-based computer classes for kids.

Licensing gives you brand recognition without the limitations on how you use, display, or sell a product.

Patterson, who has signed more than 35 licensees since 2004, says flexibility has been a big draw. The package, which costs $16,500 to run on five computers or $32,500 for 10 computers, includes a week of hands-on intensive training, plus all manuals and marketing materials. "We give them everything they need to run Imagine Tomorrow classes. But how they run their business is their business," she says. Entrepreneurs can follow Patterson's computer class model or go their own way, she adds. "If our licensee wants to paint every wall blue, that's their choice."