FRANCHISE OR BUSINESS OPPORTUNITY
MAKING THE CHOICE

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It is a quiet Saturday morning. While having coffee and watching your morning news program the television commercial announces that a Franchise and Business Opportunity Show is at the Coliseum this weekend. If you are the typical American you have become concerned about the economy and how it will effect your company and your career. You may even have begun thinking about the "Great American Dream" of business ownership. The franchise and business opportunity exhibition is a good place to begin your search.

As you enter the exhibition hall you are met by a sea of professionally produced trade booths offering investments which range from the instantly recognizable brake and muffler franchises to businesses which offer you the opportunity to place beverage vending machines in offices. While on the surface, the messages from the various salesman seem similar, the legal and business relationships are widely different.

Business Opportunity

A business opportunity is a highly regulated method in which one company provides the opportunity, for a fee, to another company or individual to go into business. Because of the historic high rate of fraudulent schemes the federal government and many states have enacted regulations and disclosure requirements which govern the relationship. Because of the apparent similarities of many franchise programs and business opportunities in some states franchisors have the added burden of meeting the business opportunity statues as well. Even competent legal counsel sometimes have difficulties in sorting out this regulatory moras.

Under the Federal Trade Commissions rule governing franchise and business opportunity relationships, a business opportunity exists if each of the following elements are present.

1. The "licensee" sells goods supplied by the "licensor" or its affiliates, or by suppliers with whom the "licensor" requires the "licensee" to do business.

2. The "licensor" secures outlets or accounts for the goods or services sold by the "licensee", or secures locations for vending racks or machines, or provides the services of someone who can perform either of these functions; and

3. The "licensee" is required to make a payment of $500.00 or more to the "licensor" or a person affiliated with the "licensor" or a person affiliated with the "licensor" at any time before or within six months after the franchisee commences business operations.

Business opportunities describes the specific product or service associated with the delivery not the system of delivery as in business format franchising.

Primarily there are three types of business opportunities.

Rack Jobber

The purchaser buys a route from the company enabling them to service the company's clients by restocking the client with the company's products.

Distributorship

The purchaser buys the rights to sell the company's product with a territory which may or may not be exclusive. The purchaser does not typically use the company's name or logo in identifying the business.

License

The purchaser obtains the right for access to proprietary data or technology from which products or services can be offered to the public.

The major advantage of a business opportunity over a franchise is that it offers a buyer a greater degree of flexibility in conducting their business than a franchise at a lower cost of entrance and without royalty payments. It is often a good method for home-based, part time or second income businesses.

Its most significant drawback is that typically the business owner does not receive significant management systems, training, ongoing support and marketing which are typical of a franchise relationship.

Depending on the business opportunity, there may be system-wide savings on the purchase of products and services sold or offered which are also standard with most franchise systems. The often used expression in franchising is that "you are in business for yourself and not by yourself". With the independence offered in a business opportunity this is not the case. After being established in business, generally the lack of support services from a licensor ensures that you are in business for yourself...period. Depending on your entrepreneurial nature and talents this may be the perfect opportunity for starting a new business.

Franchising

Franchising finds its roots in the Middle Ages. It first appeared on the U.S. retail scene at the turn of the century. It emerged as a force to be reckoned with in the post war 50's. It boomed in the 60's. It policed itself in the 70's and it matured in the 80's. Franchising has become the dominant retail force in the economy of the 1990's and beyond, accounting for over 35 percent of all retail sales in the economy with in excess of 500,000 locations.

The regulations and understanding of the definition of a franchise is considerably more structured than a business opportunity. There is a variation between federal and state definitions and some variations from state to state. Under the Federal Trade Commission rule, the following three definitional elements are required to be present for a company to be defined as a business format franchise.

1. The franchisee is given the right to distribute goods and services which bear the franchisor's trademark, service mark, trade name, advertising or other commercial symbols;

2. The franchisor exercises significant control over, or provides the franchisee with significant assistance and, the franchisee's method of operations; and

3. The franchisee is required to make a payment of $500.00 or more to the franchisor or a person affiliated with the franchisor at any time before or within six months after the franchisee commences business operations.

Lewis Rudnick, a well known franchise attorney in Chicago describes the franchise relationship as "a pooling of the capabilities, know how and experience of a franchisor with the capital and motivational efforts of the franchisee". The results of this symbiotic relationship is a greater likelihood of success for a franchisee than for an independent entrepreneur embarking on a start-up business.

Franchising describes the system of delivery, not the specific product or services associated with the delivery as in a business opportunity.

The chief differences between Business Opportunities and Franchising is in the degree of the relationship:

Franchising:	Franchisee is identified by the trademark
Business Opportunity:	May not be identified by the trademark which is incidental to the products or services offered.
Franchising:	Franchisee receives training, marketing and other support on a continual and ongoing basis.
Business Opportunity:	Training, marketing and other support may not be provided and is incidental to the relationship.
Franchising:	Franchisee offers products or services typically on an exclusive or semi-exclusive basis and based upon standards of performance and product line dictated by franchisor.
Business Opportunity:	Typically may handle a variety of lines.

Franchising:	Franchise fee is typically higher than the minimum payment of $500 and is for the right to enter into the relationship and use the franchisor's system and trademark.
Business Opportunity:	Business opportunity fee is typically lower than the minimum payment of $500 and is for the purchase of identified products or services.
Franchising:	Franchisee pays a continual royalty typically based on gross sales for the right to continue the relationship.
Business Opportunity:	Continual payments, if any, are for identifiable products or services supplied by the company to the business owner.

The growing perception today is that franchising is a "sure fire" method of expansion for business and a safe investment for franchisees. While a properly designed franchise program can be an exceptional method of expansion, poorly designed or operated franchises, are not. This is not just a franchise reality but a business reality.

Your decision to purchase a franchise should be based upon two broad understandings:

1. An understanding of the advantages and disadvantages of franchising in general.

2. An understanding of a particular franchise and how to evaluate them.

Advantages of Franchise Ownership

The benefits of franchise ownership are only as strong as the franchise you select. Generally speaking, the benefits can be classified in these broad areas:

Overall Competitive Benefits

The public has become accustom to a certain level of quality and consistency from brand name franchised locations. Whether you believe a company's product is superior or mediocre, the secret for their success is that it is consistent. The consumer knows the level of quality they will receive in every locations they visit. This trademark identification will often provide the new franchisee with an established customer base accustomed to shopping at the franchise. Brand identification makes it easier to compete with well established independent operators and even against other well established franchised competitors. The advantage extends to the national accounts program many franchise systems benefit from.

Pre-Opening Benefits

Franchisors have made mistakes. Another advantage of franchising is that they have survived their mistakes and can guide their franchisees not to make the same mistakes. Upon joining with an established franchisor new franchisees receive comprehensive initial training in the operating of the franchise system, its product, services and methodologies. While the cost of entrance into a franchise system includes a franchise fee, which is often cited as a disadvantage, the franchisee benefits from, among other things; operations manuals, site selection, store design, construction programs and reduced cost of equipment to name just a few. Additionally, they have not only their franchisor as a seasoned partner to ask questions to but the network of other franchisees within the system who can be of assistance.

In essence, the major stumbling block for pre-destined failure is removed by the franchisor. Lack of preparedness. Most independent businesses don't fail because their product or services were inadequate. They fail because they did not anticipate problems. Chief among these is working capital. Well developed franchise programs ensure that before they accept a new franchisee that they have adequate capital, even after servicing their debt and taking into account seasonally adjusted cash flow.

Without this guidance many independent operators fail soon after opening.

Ongoing Benefits

In exchange for paying an ongoing royalty and other payments, franchisees benefits from continual training programs and ongoing home office and field assistance. Often through buying groups established by the franchisor, franchisees have more reduced cost of goods that their independent competitors.

Leveraging off the contributions of the entire franchise system, franchisors are able to create professionally designed point of sale, advertising, grand opening programs and other marketing materials which independents could never afford. Franchise programs can also afford to continue to modernize the system through ongoing research and development and the test marketing of new products and operating programs.

Franchising is a critical mass business. The spending power of the individual dollar, combined with their fellow franchisees within their market and the rest of the system enable franchises not only to dominate local markets and established independents but compete effectively against the established large chains.

Disadvantages for Franchisees

One of the benefits cited above for the selection of a business opportunity is the most serious disadvantage for some people in selecting a franchise as a business. It is the loss of independence. by definition, franchisees are not entrepreneurs. If they were, they would never buy a franchise. For the truly entrepreneurial person, franchising is the wrong choice because the structure of the system requires the loss of their independence.

This loss of independence, if taken to the excess leads to a further disadvantage of franchising. That of over dependence on the system. Franchising succeeds best when franchisees are at risk and are motivated by their financial and emotional risk to succeed.

Where franchisees rely totally on the system for their success their over-dependence can cause problems. The franchisee therefore must balance system restrictions and their personal ability to manage their own business.

As stated above the principal reason for franchising's success is the public's perception of quality and consistency throughout the system. Therefore when the public receives great service at one location the assumption is that the system has great service. This is also the major weakness inherent in franchising. You are not only judged by your performance but by the performance of the other franchisees. Poorly performing fellow franchisees will damage your business even where they do not share your market. If the hamburger is bad in one location, the public assumes it is bad throughout the system. While good franchisors try to protect against it, some franchisees have unrealistic expectations concerning the income they will earn from their location. Their expectations when unmet will cause a franchisee personal financial problems and make them regret the investment in dollars, time and effort that they made in the business. While this is a weakness of franchising, its also weakness of every business. Realism is important in making investment decisions.

Some of the other often cited disadvantages of franchising are the same restrictions which make it successful including; restrictions on product and services offered, limitations on territory, the possibility of termination for failure to follow the system, the cost of transfer and renewal, and restrictions on independent marketing. In addition are the added costs for royalty, advertising, additional training and other service costs.

Therefore, every restriction placed on a franchisee which benefits the system as a whole strips the franchisee of some independence and therefore on a unit basis can be cited as a disadvantage.

Making Your Franchise or Business Opportunity Selection

Most any business can be offered as a franchise or business opportunity and many appear the same on the surface. It is important that you sort out the good from the bad before making a poor decision.

The first step in franchise selection is a personal audit. Make certain that the industry you select is one which meets your personal needs. If you will be embarrassed to tell your friends that you own a drycleaning business, even it is highly lucrative, then do not buy one. Personal happiness is important. There are some 60 different types of franchised opportunities, both in product and service related areas. Personally examine you feelings toward each one to begin to make an industry selection.

Once you have created a short list of industries you are comfortable with, begin with an examination of the industries and the companies within the industries. Make certain that the industry has legs and is not just the next fad or worse the next association of buggy whip manufacturers. Look not only at the franchised competition in the industry but the established company owned chain operations as well.

Finally, when you have selected the industry for you, begin your examinations of the companies. The obvious choice may be the well established company with hundreds of franchisees but keep in mind that many of the newer opportunities have entered the market with innovations that may not be possible in older systems. Also, older established systems are less flexible should you want to negotiate any terms while newer systems may be willing to consider certain points as negotiable. Here again is a double-edged sword. Franchising's strength is its consistency. Should the franchisor be willing to negotiate with the franchisee on significant issues, they are likely to do so with others. Their reasons may be based upon their need to sell you a franchise to meet next weeks payroll and even if this isn't the reason, another word for flexibility is inconsistency. And inconsistency is not what you or the public want from a franchise.

Contact each franchisor in the industry and obtain their information package. Read them carefully. Glossy brochures are not a good reason to select a company. Understand the philosophy of the company. Compare their services as well as their fees. Lower fees should be the least important reason to select a company over another. How are the fees structured? If franchise fees are high but royalty fees low can you surmise that the franchisor is more interested in selling their franchises than having continual revenue to provide you with services? If royalty fees are high, are the services provided by the franchisor worth the extra percentages?

Your answer will come from two sources, personal meetings with the franchisor at their headquarters and contact with their franchisees.

Visit the headquarters of each franchisor you are seriously interested in. Do not buy a franchise without visiting the headquarters Even large established franchisors have problems which can only be determined from personal visits. Allow the franchisor the opportunity of introducing you to the system, its services and key personnel. Make certain that you meet with those individuals who you will be having a long term relationship with including the Operations, Training, Marketing and Field Organization. Ask questions and do not accept superficial answers. What are the continuing services provided and by whom? How long is the training, who conducts it, where is it conducted and what topics are covered? Does the company have solid marketing? Do they own their trademarks? and a hundred other questions you may think of. Remember, the franchisor has been through this process many times before, it is likely your first time. Come prepared with your questions written down and ask them. Be satisfied with the answers and do not be reluctant to probe for further information. Buying your franchise is likely to be one of the most important business decisions you will ever make. The library and bookstores are full of franchise books which contain additional questions you should ask.

Issues of serious interest should include profitability and return on investment; proven product and service; operating systems; training; marketing; expansion plans (is the franchisor more interested in worldwide expansion or individual franchisee success); field services; research and development; franchisee relations; franchise system goals and ability to support the goals; and of course the financial health of the franchisor. At the meeting with the franchisor you will receive, as mandated by the franchise laws, a copy of the franchise disclosure documents. If possible, try to obtain a copy in advance of your meeting so you can ask your questions about the document in person. Most franchisors do not send out their disclosure documents before the meeting because they are costly to produce and franchisors want to explain many of the items in the document in person. Failure to receive a disclosure document in the mail is not a sign of franchisor deceit. It is a recognized practice in the industry.

The disclosure document will provide you with a wealth of information which should also be reviewed by your accountant as well as a qualified franchise attorney. Unfortunately many prospective franchisees rely upon their general counsel for advice on franchising matters. Franchising is a complicated and unique method of distribution and requires experienced legal counsel. Contact the International Franchise Association or your local Bar Association for a list of franchise legal specialists. If you are working with a franchise broker his relationship to you is the same as a real estate broker. None. Do not rely upon advice from that quarter.

Among the areas included in the disclosure documents are: the franchisor and franchisor's staff experience in managing the franchise business; the systems litigation and bankruptcy history; the cost of opening a franchise as well as the initial and continual fees; an explanation of the relationship and responsibilities of the franchisor and franchisee together with financial information on the franchisor; the number of franchises opened, closed and most importantly a list of existing franchisees. Start with the A's and proceed toward the Z's and call enough franchisees until you are satisfied that you have adequate information to make an educated decision. Visit as many of the franchisees as possible. This is a time consuming process, but after all, it is only you and your family's financial life.

The one piece of critical information which you may expect may not be in the disclosure document. An earnings claim or any projection of franchisee profitability. For a host of supportable reasons the majority of franchisors do not include this information. It is therefore critical that you base your financial assumptions on available information, information available from articles about the company and discussions with franchisees.

Franchising or Business Opportunity - The Choice

There is a difference and each has its merits and problems. Remember, the franchise or business opportunity salesman has been through this before, you probably have not. Suppress your emotions and base your decision on the facts and what will benefit you both personally and financially.

California Franchise and Business Guide