How to deal with real-life scenarios

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I often get emails or phone calls from prospective franchisees that are reading Franchising for Dummies, thanking me for the information Dave Thomas and I included in the book. Sometimes people will recommend topics to include in a future update and on a frequent basis we respond pro-bono to email questions regarding real life scenarios that we could not fit into the book.

For most prospective franchisees, researching and investing in a franchise goes smoothly and successfully. However, successfully does not always mean, without any hitches. Lets look a few that came across our desk this past year.

The Deal Is Different

A couple had been looking at buying a franchise for over a year. During that time they investigated a number of industries and met with several franchisors. They established for themselves benchmark criteria that they felt were important in a franchise opportunity and those included certain levels of fees, types of services they thought were important and experienced management. Finally, they made their choice and with great excitement went back to the franchisor they had met the prior year to tell them they were ready to invest in a franchise. Everything was great until the franchisor sent them a copy of the latest UFOC (disclosure document) and the couple realized that the franchise opportunity had changed. They felt that the franchisor was trying to pull a fast one and asked us what to do.

Franchisors routinely and frequently re-evaluate their franchise system for ways to improve its performance. Often, a prospective franchisee won’t see the changes since they might impact operating procedures or field services or training or hundreds of the other details of running the business and would be apparent if your read the franchisors operations manual.

Franchisors also modify their franchise offering to reflect changes to the business or to reflect competitive changes as they relate to franchise sales. Any time a franchisor makes those types of changes, they will be included in the new UFOC, which is typically published annually. Changes to franchise offerings are routine and unfortunately for this couple, the royalty rate had increased since the prior year as had the overall investment required to become a franchisee and those are the changes that disturbed them.

Once we were able to explain what had occurred, we recommended to them that they reevaluate the franchisor based upon the criteria they had originally established. In addition, we suggested that they speak again with some of the existing franchisees to determine what they thought of the changes and whether those franchisees would be investing in additional franchise units in the future. We also suggested that they talk to the franchisor about buying an existing franchise and see if the franchisor would allow them to simply transfer the agreement leaving in place the terms of the original agreement.

Improper Earning Claims

In franchising, with limited exceptions, the only way a franchisor can legally provide you with information about what you can expect to make as a franchisee is to provide that information in writing and include it in the UFOC in Item XIX. In this particular franchise, the franchisor had not included an Item XIX earning claim. During the sales process, the prospective franchisee was informed inadvertently by the franchise salesperson that the average location has a certain level of sales once it reached maturity. The salesman immediately realized his error and told the franchisee that he should not have given them that information and asked them not to let anyone know that they slipped because it would cause the salesman his job.

At the closing on the franchise, the franchise salesperson gave them a lengthy document to sign. The pages were in the form of a questionnaire and dealt with the franchise sales process. Asking a franchisee to sign such a document at the closing is routine and is geared to ensure that the franchisor did not break the rules as they recruited the prospect and also ensures that the franchisee provided honest answers to questions to the franchisor during the selling process. This questionnaire asked the franchisee to state that they had not received any information on unit performance and if they did that they did not rely upon that information. While they wanted the franchise, they really had relied upon the financial slip up in making their decision. They did not want to sign anything that was untrue and refused to sign. They called us and asked us what to do.

Had they followed the advice in the book they would be working with a qualified franchise lawyer and they would have dealt with the matter long before they got to the point of signing the franchise agreement. Since I knew the franchisor personally I felt fairly comfortable that the slip up was an accident – but that might not be the case all the time – especially if there is no Item XIX disclosure. Since they still wanted to move forward, we put them in touch with a local franchise lawyer who met with the franchisor to seek a solution to the problem.

Prior to closing on the franchise, the prospective franchisee did a very thorough and independent reevaluation of the franchise and created a business plan for the business. They called several franchisees in the system and determined for themselves the range of sales they could likely expect. At that point, while the franchise salesman had made a mistake the prospective franchisee could honestly state that they were no longer relying on that information because indeed they had gotten the information they relied up from independent sources. They were then able to now sign off on the questionnaire honestly and close on the sale.

The Salesman is a Broker

A couple had been looking for a franchise and went surfing the web for information on what was available. They were both schoolteachers and had never bought a business and were intimidated by the pressure they felt in just researching franchise opportunities. Late one night they discovered to their delight a few professional service firms who stated on their web sites that they could provide them with coaching on the perfect franchise for them and that they would not even have to pay a fee since the company was paid by the franchisor only when they bought a franchise. They contacted the firms and made a selection of which coaching firm they would work with as their advisor.

The coaching firms all said that they had researched thousands of franchise opportunities and had selected several that met their criteria for return on investment, failure rate and other important attributes. The couple was sold. Through a lengthy interview the advisory firm they selected was able to narrow the list of franchises that seemed right for the couple down to a few. The consultant then introduced the couple to the franchisors. During the coaching session the couple was provided with information on what they should be looking for in a franchise opportunity so that they were prepared to ask the right questions when they met the franchisor.

Somewhere during the process they picked up a copy of Franchising for Dummies and there on page 50 they saw that Dave Thomas and I had recommended not working with franchise brokers. It was then that they understood that their “coach” was really a “broker” and while he was advising them on making an investment, in reality he had been hired by franchisors for the sole purpose of convincing them to buy a franchise from his clients.

They truly thought that the broker had helped them and prepared them for the task of buying a franchise but they were concerned, since they were about to invest their life’s saving based upon the advise of the broker. They asked us what to do.

Dave and I had a lot of reasons why we made our recommendation about brokers. I think the most important one is that brokers try to look independent to the prospective franchisee and even call the prospective franchisee their client and tell the prospect that what they really are franchise counselors and coaches. They emphasize that they are helping the franchisee make a selection that is right for them when in reality, they work for and are the agents of the franchisor and are steering the prospect usually only to their clients so that they can earn a commission on the sale. In the age of Enron it is very clear the danger of taking advise from someone who has a clear conflict of interest.

We looked at the list of franchisors that the broker has “picked for the couple”. We had the couple research all of the other franchise offerings in those industries which they were able to do quickly and cheaply on line from the world wide web by going to web sites like Entrepreneur.com. We asked them to make their franchise decision based upon complete facts and not limited only to the few companies the broker had recommended.

The broker had told them that if they were serious about buying a franchise they should be prepared to make a decision in two to four weeks. We stressed to them that they should take their time and that the process, to be done right, is likely to take four to six months from beginning to end. What they found by doing the research themselves was a much broader franchise offering than the broker had led them to. Through their research were able to find several alternatives that offered different fees, different services, and different brand personalities and in some cased improved return on investment potential. Some of the franchisors were more mature and some had new and exciting possibilities that the brokers clients did not have. We strongly recommended however that they not discount the broker’s recommendations entirely since some of those franchisors were also good candidates for them.

We stressed that they should use an advisor and that the advisor should work for them and not the franchisor because of the clear conflict of interest that the broker had. We suggested several local franchise lawyers for them to call. Franchise brokerages is fairly unique as it is one of the few places in business today someone will try to convince a buyer they work for them while in reality they are a commissioned agent of the seller.

The couple made their franchise selection based upon their research.