

How to deal with real-life scenarios – Part Two

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A few months back we responded in an article to some of the emails we regularly get asking us to provide some advice on real life situations folks were going through. We received a slew of questions and thought that we would take some of the situations and answer them here.

Undoing a mistake

A young couple purchased a franchise only to discover a few weeks later about that the franchisor had not mentioned some significant hidden costs and also had not mentioned problems at the franchisors headquarters related to lawsuits, locations closing and staff layoffs. It also turns out that the franchise was not registered to offer franchises in their state. They wanted to know if the lack of state registration gave them a loophole to demand their money back.

If a franchisor is required to register in a particular state, a lack of proper registration might give them some significant leverage in getting their money back. But, the state in which the Company has its offices is not a registration state and neither is the state in which the couple bought the opportunity. Therefore, a lack of registration was not really an issue.

Upon a closer look we discovered that the problems with the Company were very real. Many of the locations the Company said were open were not. The company had several pieces of litigation that they had not mentioned and some were significant. Some of the people the couple had met were really not employees of the Company although the salesman had introduced them as employees. The equipment and inventory the couple needed to buy to get the business open was much more expensive and they could not obtain any of the equipment used, as they had been led to believe. There was also some problems in getting the type of retail space they were going to need in their area.

If this were a franchisor, unless it was intentional, it would be hard to understand how the franchisor had made so many errors in their disclosure. However, as it turns out, the Company the couple had paid money to was not a franchisor after all. The owners of the company said they did not even know the requirements for being a franchisor. They thought that since their state did not require any franchise registration that they could just call themselves a franchise because it sounded good. The couple was their very first “franchisee”.

Had the couple read any articles or books on buying a franchise they would have understood that a franchisor was required to provide them with pre-sale information in

the form of a disclosure document. They would have also known that they should have hired a qualified franchise lawyer to help them understand their rights under the franchise agreement and maybe even an accountant to help them understand the investment and some of the business risks. They hadn't done any of those.

While the couple could have gone directly to the state regulators or attorney general's offices we thought it was time for them to get some professional legal help. The money they saved on not hiring an attorney to help them determine if their investment was going to be reasonably safe was now going to be spent on seeing if there was anything left of their investment at all.

Researching Rates of Return

We received the following email:

"I've been investigating a number of franchises, and they don't seem to be very consistent in terms of rate of return on investment. In fact, it sometimes appears that there is very little correlation between the total investment and the amount of money I can make in the business. Has there been a study or which franchises offer the best Return on Investment based upon a 3 to 5 year period after opening? If not, where can I go to get this information and how do I know if it is accurate?"

The short answer to his first question is no. Many years ago statistics were quoted on the success rate in franchising as compared with independent businesses. You rarely see anyone quote these old statistics any longer because as it turns out the studies were significantly flawed and likely invalid even then. A few years ago, the International Franchise Association sent out a recommendation that franchisors stop using those questionable statistics. If you are investigating a franchise opportunity and the franchisor or broker are still quoting those old DOC or SBA studies about franchising to show you how safe your investment in a franchise will be, I would be a bit concerned.

There are no studies that we know of that have examined the return on investment in franchising. Franchising is now used in over 85 different industries and returns are going to vary widely between industries and even between the companies in those industry subsections. Indeed, given the wide variations in type of franchises being offered within some companies (in-line, mall based, free standing, express, mass gathering, kiosk, seasonal, single unit, multi-unit, dual branding), and not to mention differences in the maturity of the locations and demographic differences such a study would be difficult if not impossible to complete with any real meaningful information.

To do your own examination, there are two key disclosures items in a franchisor's Uniform Franchise Offering Circular (UFOC) that investors focus on. The first is Item VII, which explains the investment in the franchise, and the second is Item XIX, which discusses the earnings of locations within the franchise system. Unfortunately, the majority of franchisors still do not disclose earnings in their Item XIX. Even if you have

a franchisor's UFOC you still may not be able to do a three to five year return on investment projections because the franchisor may include the necessary detail in their documents.

To shorten the learning curve a bit, purchase a copy of Robert Bond's book called "How Much Can I Make". It contains earning information on 140 franchise systems. Using that information may allow you to make some basic determination on companies you are interested in. You can order the book on line at www.sourcebookpublications.com. You can usually obtain general information about the required investment in a franchise from many online sources, including Entrepreneur.com or the franchisor's own web site.

Another source of information would be Frandata, a firm in Washington DC that can provide you with copies of most franchisor's UFOCs. Frandata can also do a data base search to tell you which companies include earnings information in their documents. You can either order the entire document or just the sections you think you need. Frandata can be reached at 1-800-793-8640.

The International Franchise Association's Education Foundation conducts the most comprehensive research on franchise industry issues today. Some of their studies are on line and are free and some need to be purchased from the foundation. You can access their web site at www.franchise.org.

Should I Relocate My Family

We received the following email:

"My husband and I are very serious about investing in a franchise and at the same time would like to open the business in another state. We think the business will thrive in the location we have selected but it means we have to move away from our family.

We have three children ages 16, 14 and 7 and they are very excited about the possibility of moving but my parents and my husband's parents are very much against us leaving. My husband is torn up on what to do. Stay in a job that that he is not happy with and has no room for advancement just to make his parents happy or better our lives and give us an opportunity to prosper. What should we do?"

Uprooting a family and moving away from all of your support network is not only a difficult thing to do, for most people it strikes terror in their hearts. Not only do the kids need to go to new school, make new friends and play on new sports teams you are giving up a support network you have spend a life time building including your family, friends, house of worship, and even the ease of knowing which restaurants are the best in town and which market has the freshest tomatoes. Having moved many times in my career, it can be traumatic and at best difficult, if you do not plan and do your research and make a few contacts before the move.

The nice thing about moving to a new city is new opportunities and often a fresh start. It seems that is just what you are looking for – a new business that may be able to provide you with the lifestyle and income you want for your family. It is natural for grandparents to want to be near the grandchildren. My parents and my wife's parents certainly did and still do.

But, while family is always a part of us, one of the responsibilities of parents is to make decisions for their family. If you have assessed your present situation and made a determination that the opportunities for you no longer exist at home, and, you have been fortunate enough to find the right opportunity elsewhere, your decision seems clear. Start packing.

Before you do though do what ever you can to stay connected with your family. You're moving – not abandoning them. If your parents and in-laws don't have access to the Internet get them hooked up and show them how to send emails and download all of the pictures you are going to send them. Some of the systems today even come with cameras so that you can see each other while on line. Most of the cell phones companies today offer plans that have unlimited time in the evening or on weekends. Burn up the airwaves with phone calls. If you are within driving distance, plan a weekend a month to visit. Ask your parents and in-laws to visit you.

You really don't have to give up much when you move – if you make the effort. The Great American Dream of financial independence though the ownership of your own business is very exciting. Get the support of your parents and in-laws by planning with them how to stay connected and good luck.