

## Item 20 – What information does it provide?

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Question: I am very interested in investing in a franchise and met with several franchisors. Each of them gave me a copy of the Uniform Franchise Offering Circular – and Item 20 confuses me – the columns don't add across. What's up?

We know. Blame it on the regulators.

Item 20 may be the most important and at the same time the most confusing section of a franchisor's disclosure document. It is the place where prospective franchisees can generally find a list of names, telephone and addresses of each of the franchisees currently in the system together with a list of former franchisees.

While almost every franchisor lists every franchisee in their UFOC some don't and for a very good reason – the disclosure document would become too long and heavy. The rule on disclosing franchisees allows the franchisor to limit the list to those franchisees within the state where the offering circular is going to be used. If there are less than 100 franchisees in the state, the franchisor is required to list the franchisees in the contiguous states until they get to that magic number. For most franchisors listing all of their locations is not really an issue and they simply provide a list of locations as an attachment to the disclosure document regardless of what state the document is intended for.

For former franchisees, the company is obligated to list the last known address and telephone number for each franchisee that has left the system during the past year because they were terminated, chose not to renew their agreement, sold their business or for any other reason they voluntarily or involuntarily left the franchise system.

These lists contain some of the most important information a franchisor is required to provide you simply because it gives you a way to reach the people with the answers to your most important questions:

- Are you making money as a franchisee?
- How long before you were able to take a salary?
- What did it really cost to get into business?
- Does the franchisor provide you with the services they promised?
- Would you have invested in this franchise today if you had the information then that you have now?

And, a hundred more questions that help you make the decision about whether to invest or not. No matter what you can learn from a franchisor directly – it is satisfying to learn from the actual operators what the real story is.

With equal – and some will say more importance – is that list of former franchisees. Former franchisees don't always leave because they were unhappy. Some retire on all the money they have made and are thrilled to have been a franchisee. But former franchisees often are a great source for information on what they liked and what they did not like about being a franchisee. They often are willing to tell you about issues that current franchisees may not want to talk about. Keep in mind though, if the franchisee and the franchisor did not part as friends, you may need to weigh the information.

Start with the current and former franchisees and call as many of them as you can until you get all of the information you think you need. Beginning on page 351 of Franchising for Dummies, Dave Thomas and I included about ten pages of questions we thought were important. Use that list as a starting place as you decide the information that you think is important for you to make your decision.

Now we can discuss the charts you will find in Item 20. We need to be honest with you - the current charts are often so confusing and subject to potential manipulation that some professionals think they don't really provide any useful information at all. Others go much further in their criticism.

In one section of Item 20 the franchisor is required to provide, for each of the last three years, how many locations have been:

- Transferred – or had a change in controlling ownership
- Cancelled and terminated
- Not renewed
- Been re-acquired
- Left the system or been abandoned
- Opened at the end of the year.

Seems like important information because in one chart you should be able to see how well the system is growing from year to year. You can see why units have changed hands or closed. And, you can see that information on a state-by-state basis. Right? Not really.

A location can be listed in more than one category and therefore the columns don't add up and that in itself is confusing and misleading. A location might be listed as a transfer simply because the franchisee gave the business to their children. It might be listed as a transfer because they made so much money they sold the business and retired to Florida. Or they could have sold the franchise because they lost every dime on a losing proposition. That same unit may have

been purchased by the company and then resold to a new franchisee during the year.

Changes can and often do fall into several categories and the chart doesn't add up. When you couple that with the fact that the categories don't distinguish when things are good and when bad things happen, the chart has limited value.

What is important is whether the system is growing and whether the franchisees and the franchisor are profitable and stable. The last column – Franchises Operated at Year End will give you part of the answer – the rest you get primarily from your interviews and looking at the financial statements of the franchisor.

The franchisor must also disclose by state, the number of company owned locations that were opened and closed during the past three years. That information is useful because it can tell you whether the franchisor has any of their own "skin in the game" by operating locations themselves.

Of little value at all and potentially the most misleading part of the disclosure document is the projected units to be opened. I consider it the Faith Popcorn section of the offering circular. (Faith Popcorn is a noted futurist).

In this section, franchisors get to guess on how many units will be opened in each state next year. Now this does not mean that they have signed franchised agreements for every franchised location they predict will be opened. Nor does it mean that they have a signed lease and are in the process of building out the new company owned locations. It often doesn't mean anything more than somebody made a guess. They may not have a franchise candidate for that state or even be advertising for franchisees in the state. It's a guess and the franchisor can guess high or low – the future will be the judge of how accurate they were.

Even the section that discloses how many franchise agreements have been signed but are not yet opened can be misleading. Some franchisors include franchises covered by area development agreements and some only list as franchise agreements those individual unit agreements that have actually been signed. One franchisor may be aggressive and based upon their development pipeline and history correct in their approach while another franchisor may be more conservative. For the prospective franchisee, peering into the future does not really provide any value.

Our advise is don't spend too much time on trying to understand the charts in Item 20. They baffle even the pros. If you have questions, ask the franchisor. Use Item 20 primarily for the contact information on the current and past franchisees. That is its real value.