

FRANCHISE OR BUSINESS OPPORTUNITY? MAKING YOUR CHOICE

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It is a quiet Saturday morning. If you are the average American, the downturn in the economy has started you to think about how it will impact your career and the opportunities for your children as they enter the workforce. Articles about Enron and Tyco and Global Crossing and other corporate scandals abound and some of the most respected brand names internationally are talking about layoffs and bankruptcy.

Surfing the web you read stories about entrepreneurship and wealth creation by individuals who grabbed a piece of the “Great American Dream” of individual business ownership. But you don’t know where to start to look for your opportunity. One-way may be to simply open up your own independent business – but even here you don’t know where to begin. The simplest way may be to join a growing franchise or business opportunity network. But you don’t know which one is right for you. You are not even sure of the differences between a biz-op and a franchise and you are not certain you really need to care.

The investment opportunities for business ownership that you find on the web today range from the instantly recognizable fast food and 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 sites seem similar; the legal and business relationships being offered are vastly different.

Business Opportunity

Business opportunities are a highly regulated method of business expansion where a company provides outsiders the opportunity, for a fee, 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 that govern these types of relationships. Unfortunately, the rules regarding business opportunities can vary between the federal government and the states and even then they can vary from state to state.

Determining whether an opportunity is a franchise or a business opportunity can be tricky and even competent legal counsel will occasionally find it difficult. The distinction is usually most noticeable in two key areas:

- The franchisor generally will generally insist on consistency from location to location and that includes requiring the franchisee to operate their business under their brand name. Business opportunities are frequently more entrepreneurial and less structured.

- While both may provide training, the hallmark of franchising is in continual support to its franchisees – something that most biz ops lack.

There are three primary types of business opportunities.

Rack Jobber

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

Distributorship

The purchaser buys the rights to sell the company's product within a territory and the territory may or may not be exclusive. Generally, the local business is not known by the company's name nor does it use the company's logo in identifying the business.

License

The purchaser obtains the right for access to proprietary data, marks or technology from which products or services can then 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 does the typical franchise - and usually at a lower cost of entrance and without the need to make ongoing royalty payments. It can be a very 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. Franchising provides an infrastructure and ongoing support that business opportunities generally don't.

Depending on the business opportunity, there may be system-wide savings on the cost of products and services sold to customers – a standard also with most well developed franchise systems.

An expression frequently used in franchising is that “You are in business for yourself but not by yourself”. In most biz ops your business is your own and ongoing support is generally not something you can count on. However, depending on your entrepreneurial nature and talents a biz op may be the perfect opportunity for you to start your new business.

Franchising

Franchising finds its roots before the Middle Ages. It first appeared commercially in the United States before the Civil War, likely with Robert Fulton and his licensing of his

steamboats and emerged as a force to be reckoned with in the post World War II 1950's. It boomed in the 60's. It policed itself in the 70's and it matured in the 80's and 90's. Franchising has become one of the most dominant forces in the world economy today.

Franchising is considerably more structured than business opportunities. However, just as with business opportunities there are variations in the definitions used by the Federal Trade Commission (FTC) and some states and there are even variations among the states. The most common definition cited though is the one promulgated by the FTC which makes the distinction between a simple license and a license that has crossed the barrier and become a franchise.

1. The licensee is given the right to distribute goods and services that bear the licensor's trademark, service mark, trade name, advertising or other commercial symbols;
2. The licensor exercises significant control over, or provides the licensee with significant assistance and, the licensee's method of operations; and
3. The licensee is required to make a payment of \$500.00 or more to the licensor or a person affiliated with the franchisor at any time before or within six months after the licensee commences business operations.

When these three elements are in place, the license is generally considered a franchise and the franchisor must abide by certain rules generally focused on how they offer their opportunity to the public.

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: The franchisee's business is identified by the franchisor's trademark and consistency from location to location is usually important to the franchisor.

Business Opportunity: Biz Ops generally are not identified by the franchisor's trademark and the trademark if used is generally incidental to the products or services being offered.

Franchising: Franchisees generally receive training, marketing and other support on a continual and ongoing basis from their franchisor.

Business Opportunity: Other than some initial training, ongoing training, marketing

and other support is usually not provided and is incidental to the relationship.

Franchising: The franchisee offers products or services typically on an exclusive or semi-exclusive basis and operates their business based upon standards of performance and product line dictated by their franchisor.

Business Opportunity: Business opportunities typically allow the business owner to handle a variety of lines since consistency from location to location is generally not part of the opportunity being offered.

Franchising: The cost of entering into the franchise fee is typically significantly higher than the minimum payment of \$500. The payment is made for the right to enter into the relationship and for the use the franchisor's system and trademark.

Business Opportunity: Under a business opportunity the cost of entrance usually relates to the purchase of identified products or services that will be resold and any fee to join the system can be very modest.

Franchising: The franchisee generally pays a continual royalty to the franchisor, which is often based on the gross sales from the franchisee's business. The payment allows the franchisee to continue in the relationship.

Business Opportunity: If there are any continual payments, they are usually for the identifiable products or services supplied by the company to the business owner for resale.

There is a growing perception today that franchising is a "sure fire" method of expansion for business and is always a safe investment for franchisees. While it is true that a properly designed franchise program can be an exceptional method of expansion – that is not always the case. The same is true for local franchises. Business comes with risk – and a well-structured and managed franchise system can only reduce some of those risks. Franchising can never be a guarantee of success.

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 several broad areas:

Overall Competitive Benefits

The public has become accustomed 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 usually that it is consistent. The consumer knows the level of quality they will receive in every location they visit. This brand identification often provides the new franchisee with an established customer base accustomed to shopping under the company's brand and that makes it easier to compete with the well-established independent operators and even against other well-established franchised competitors.

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 an established franchise system new franchisees generally 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 - often cited as a disadvantage - the franchisee benefits from a host of services including 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 that 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 generally receive continual training programs and other ongoing home office and field support and assistance.

Group purchasing power is a major benefit of well-developed franchise systems. Frequently buying groups established by the franchisor allow the franchisees to benefit from a lower cost of goods, equipment, and supplies than that available to independent operators.

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 that 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 both with a market and system wide. 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 also to compete effectively against the established large chains.

Disadvantages for Franchisees

One of the benefits most often cite for becoming a franchisee may also be one of its major disadvantages. It is the loss of independence that is necessary in any good franchise system. By definition, franchisees are not entrepreneurs. If they were, they would never buy a franchise. At best, franchisees are “entrepreneur lites”. For the truly entrepreneurial person, franchising is the wrong choice because the structure of the system requires them to give up considerable independence in the way they conduct their business.

This loss of independence, if taken to the excess leads to a further disadvantage of franchising - 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 also cause problems. The franchisee therefore must therefore balance the system’s restrictions with their personal ability to manage their own business.

Another strength that is also a weakness is the expectations of the public when they shop at a branded location. The principal reason for franchising's success is the public's perception of quality and consistency throughout a franchise system. Therefore when the public receives great service at one location the assumption is that the system has great service in all its locations. This can be a major problem as well – because the reverse is also true. Poorly performing fellow franchisees will damage your business even when they don't even share your market.

If the hamburger is bad in one location, the public assumes it is bad throughout the system. If one location makes the nightly news, all of the other locations under the brand are impacted by that news – both the good and the bad. To protect its franchisees, great franchise systems are usually the ones that impose the strongest controls necessary to ensure that standards are met in each location.

Some prospective franchisees have unrealistic expectations concerning the income they

will earn from their business. If unmet these unmet expectations can cause the franchisee financial problems and make them regret the investment they made. While unmet expectations are a weakness inherent in franchising, it is also a weakness of every business whether franchised or independent. Realism is important in making investment decisions. In franchising though, if the prospect conducts an independent and thorough evaluation of the opportunity this risk can be significantly reduced.

Almost every restriction placed on a franchisee by the franchisor takes away a bit of the franchisee's independence and therefore can be considered a disadvantage. Some issues such as restrictions on product and services offered, limitations on territory, the possibility of termination for failure to follow the system, restrictions on independent marketing and advertising are a double edge sword – depending on how you perceive the relationship. However ask any franchisee whose investment has been put at risk by another franchisee's poor performance if they benefited by the franchisors ability to terminate the other franchisee. You will likely understand the importance of selecting a franchise system that has the ability and the track record of enforcing its standards.

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 your decision.

The first step in franchise selection is a personal audit. Make certain that the industry you select is one that meets your personal needs. If you will be embarrassed to tell your friends that you own a dry-cleaning business or have a janitorial service, even if they are highly lucrative, then don't buy one. Personal happiness is important. There are at least 85 different industries using franchising spanning any number of product or service related areas. Personally examine your 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 companies within those industries. Make certain that the industry has legs and is not just the next fad or worse, a fad that is already passed. 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 though is a double-edged sword. Franchising's strength is its consistency. Should the franchisor be willing to negotiate with the prospective 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 week's payroll or to ensure that their franchise broker won't drop them as a client because they are not flexible enough for the broker to earn their commission. Remember, brokers only make money when you make a purchase. Even if these are not the reasons they are willing to negotiate, another word for flexibility is inconsistency. And inconsistency is not what you or the public wants from a branded operation like a franchise.

Most franchisor's today have web pages with tons of information on their companies and their franchise opportunities. Examine each one thoroughly and contact each franchisor you are interested in for any additional information they may have available. Fancy graphics is not a good reason to select a company. You need to 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 answers 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 that 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 program, 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. We have provided a workbook at the end of this article that can be used as a guide.

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 not to provide a UFOC before you meet with a prospect. Some franchisors though will provide a copy of their disclosure document electronically and there are even private companies and some state agencies that will sell you a copy of the franchisor's UFOC.

The disclosure document will provide you with a wealth of information that you should have reviewed by your accountant as well as a qualified franchise attorney. Many prospective franchisees unfortunately rely upon their local lawyers for advice on franchising matters. Franchising is a complicated and somewhat unique branch of the law and requires you to work with lawyers that practice in this area. A good source for locating a qualified franchise attorney is through this web site or through the International Franchise Association at www.franchsie.org or your local bar association. Today, in increasing frequency you may find yourself working with a franchise broker or a company that represents that they are your coach, even when their fees are paid by the franchisor. Since brokers are paid by the franchisors to get you to buy one of their franchises, they are the franchisor's agent and not your advisor. Care should be taken when working with any brokerage therefore since they only make money when you buy a franchise from one of their clients – and from no other franchise opportunity. If you need an advisor, hire and pay for your own counsel. This is likely to be the most important investment you will ever make – take care.

The UFOC a host of information including the experience of the franchisor and its staff in the business being franchises; the system's 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. If you can find a franchisee willing to let you work in their location – most franchisors will support that decision because it enables you to truly understand if you are going to like becoming a franchisee.

The one piece of critical information that you may expect to find in the disclosure document may not be there - 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. Ask the franchisees you speak with about their financial performance and don't forget to check public filings for any franchisor that is a public

company.

Franchising or Business Opportunity - The Choice

There is a difference between a franchise and a business opportunity and each has its merits and its potential pitfalls. Keep in mind that the salesman has been selling for a long time and is experienced in their craft. Their job is to get you excited about the opportunity and have you make a decision to buy from them sooner than later. It is likely your first time making your own franchise decision.

Suppress your emotions and base your decision on the facts and what will benefit you both personally and financially. Seek out independent advice. Read articles and books on the subject. There is a tremendous amount of information on the web that you can easily access for free.

I should also point out that Franchising for Dummies, a book I wrote with Dave Thomas the founder of Wendy's is available in most bookstores and on line and may be a very worthwhile tool for you to have. (Dave and I donated our proceeds to the Dave Thomas Adoption Foundation so in addition to learning quite a bit about franchising, you will be helping a wonderful organization do great things.) Franchising for Dummies will provide you with an understanding of franchising and give you a step by step approach to selecting the right franchise for you.

Good luck in finding your own Great American Dream.