

Risks and rewards of being the first franchisee

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Question: I am looking for information about being the first franchisee with a new company. I need specific information about the pros and cons of being first.

In some ways being the first franchisee is exciting. If you believe in the franchisor's management and concept you're probably hoping that as the system grows, the value of your investment will grow also. After all, doesn't everybody wish they were the first franchisee for McDonalds or Wendy's?

A word of caution: While having a Uniform Franchise Offering Circular (the disclosure document required in the United States) makes the franchisor legally able to offer franchises, it is far from being an indication – in a business sense – that they are qualified to be a franchisor.

Support services that you may be expecting from a franchisor like headquarters and field support, cooperative buying, marketing and advertising, among a host of other support services, may not only be underdeveloped, they may not even be there. Manuals and training programs may be extremely basic, updates may be infrequent, research and development may be lacking and franchisor personnel may be doing two or three jobs and are too stretched to help you out much. The franchisor may be undercapitalized, lacks experience and may be even be using the services of a franchise broker to sell franchises rather than to select franchisees. You want a system that is as careful in selecting franchisees as you are in selecting a franchisor.

In fact, just about everything the franchisor will know about operating a franchise system will come from working with you. You are paying for the privilege of being a guinea pig.

Now, not all start up franchisors are unprepared for the challenge and there can be some potential benefits in being the first franchisee. The franchisor will likely be more flexible than more established systems. You'll probably have your pick of locations, may be able to negotiate some concessions that subsequent franchisees won't get such as an exclusive territory or expanding the size of the one they are offering, additional training, additional headquarters and field support, more customized marketing and advertising support, and maybe even some reduction or deferment in their standard fees. Some new franchisors might even offer you financing for your initial investment. They are just as excited about having you come on board as you are in joining them and may be willing to do quite a bit to get you to sign that first franchise agreement.

The big question is – Is it worth the risk? We can't answer that for you because it depends on the company, its management, its products and services, how well it is capitalized and whether they have a plan and structure for developing the franchise system. But, we'll give you a trick on how to improve your chances – or at least lessen your downside risk. Let's assume you do your homework about the company, the industry and its future potential and are ready to join. Try to negotiate a pre-nuptial agreement. During the courtship, the franchisor has certainly been telling you about the future of the company – its expected growth and why this is the opportunity for you. Put those projections in the contract. Negotiate a walk-away clause that gives you the option to leave the system if the franchisor is not able to grow the system. What number should you pick? Try the one the franchisor has been predicting for the growth in the size of the system during the next two years. You're basing your investment at least in part on how well the franchisor is predicting they will grow the system. Let them back up their predictions.

Being the first franchisee of a new system has some risks but it certainly has some advantages. You can lessen the risk by doing your homework and negotiating changes in the terms offered to you. Remember – every franchisor – started with a very first franchisee. But not every franchisor grew up to become McDonalds and Wendy's.