

How to understand earnings claims.

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New prospective franchisees are often surprised to find that most franchisors don't provide any information on how much money they can make if they buy the franchise. It's not that the franchisor is legally prohibited from providing any information about earnings potential (a myth repeated by some franchise salespeople and brokers). But for a host of reasons—some good and some not so good—many franchisors choose not to.

Every franchisor in the United States is, however, required to provide prospective franchisees with a disclosure document called the Uniform Franchise Offering Circular, which includes information about the franchisor and the franchise they're offering. If the franchisor has chosen to include earnings information in their document, you'll find it in Item 19.

While the format and types of earnings claim information provided by different franchisors, even those within the same industry segment, varies greatly, in general for those franchisors providing this data the UFOC contains information on specific levels or ranges of sales at their locations, information on costs, statistical data about the operations and other important financial information. It's important to recognize though that your location may not perform as well as others in a franchise system and this earnings claim information is only a useful starting point for your research.

Most, if not all, earnings claims also contain further explanations about specific line items or more detailed facts not included in the financial information. Often, it's these added notes that provide prospective franchisees with the extra information necessary to project earnings for a location in their specific market.

Even if the franchisor provides you with detailed earnings information in Item 19 of the UFOC—and, more important, if they don't—you can use the information provided elsewhere in the document to help you estimate earnings. These include:

Financial Statements: Some franchisors offer their financial statement information on company-owned unit performance. If they do, that information is contained in Item 21 or as an addendum to the disclosure document.

Structure of Fees: Not every franchisor bases its royalties as a simple percentage of gross sales. Often their fees are based on formulas that may provide sales or other performance information. You'll find information about fees in Items 5 and 6.

Investment: Item 7 of the UFOC provides information on how much you need to invest to become a franchisee. Typically, this includes a chart of investment as well as

information such as size of staff, types of locations, equipment or inventory—a potential gold mine of information from which you can build local projections. Information in the notes to Item 7 often contain operating financial data that can be incorporated in your business plan.

Other Franchisees: Item 20 provides a list of current and former franchisees, with their contact information. Often the most accurate information about unit performance comes from franchisees actually operating a location. Put together a list of questions and call them.

Other Sources

The Internet provides access to financial information specific to the franchise. Often companies will post press releases containing information about unit performance; news articles about that company often indicate this as well. If the company is public, review its SEC filings. The reports are available from most stockbrokers or can usually be obtained directly from the franchisor's Web site.

It's also important to understand how your franchisor's competition is performing. Robert Bond publishes a comprehensive compendium of earnings claims made by franchisors, entitled "*How much can I make?*" For more information, go to www.worldfranchising.com.

Putting It All Together

Investing in any franchise is an important decision, and putting together enough accurate information takes some effort and certainly some time. You should never rely on one source to make your decision, especially when so much additional information is available to you.

If you are not a sophisticated investor, seek the assistance of a franchise attorney, consultant or accountant. They can help you dig through the data and put together a meaningful projection for your future business. It's usually better to avoid asking for assistance from a franchise broker, as they work for the franchisor and therefore have an interest in your purchasing the franchise. Stick to independent advisors who have your interest at the forefront.