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Jeff Elgin: Buying a Franchise

Expensive Mistakes to Avoid as a New Franchisee

Building a business has many hidden costs. But learning from those who've gone the road before you can be a great money-saving tactic.
By Jeff Elgin | October 04, 2007

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They say that wisdom comes from experience and experience comes from making mistakes. How true. This article intends to help you gain wisdom from the experience of others rather than having to pay the cost of learning from your own mistakes. These mistakes can represent real dollars--and avoiding them can make a big difference in the total investment you need for your new business and ultimately how profitable the business becomes.

Franchise companies will almost certainly have manuals, training programs and other support documents and services designed to help you avoid making costly mistakes. The challenge is that most new franchisees are trying to learn and execute many new things at once and sometimes make what they feel are logical decisions without remembering or consulting all the advice provided by the franchisor.

It's always a great idea, during your due diligence conversations with existing franchisees in the system, to ask them if they made any expensive mistakes when they were first building or operating their new business. A good form for this question is, "Knowing what you know now, what would you do differently if you got to start all over again in building your business?"

Most existing franchisees will have a number of suggestions based on their personal experience. By looking for common denominators in this feedback, you can determine the areas of greatest opportunity for avoiding common mistakes that cost others money they didn't need to spend.

Some of the most common answers seem to come up all the time and affect the following areas of the business:

- **Lease Terms.** Most franchise businesses operate out of leased space, typically in a retail environment. The total cost associated with this real estate often represents one of the largest investments you make in setting up your business. A number of economic factors are involved in the negotiation of a lease that can make a big difference in the timing and your total costs. The first of these is the base rent. You want to not only get this factor as low as possible in the beginning (with escalation clauses in future years), but try to get at least three to six months of free rent at the beginning, when your business is brand new and not making any money. You also need to carefully evaluate and include in your cost assumptions the CAM (common area maintenance) and tax charges--these can sometimes be larger than the base rent. It isn't uncommon for a landlord to provide leasehold improvement allowances (if you push for it) that give you money for the buildout of your business location. Even if receiving this allowance results in slightly higher monthly rent, it can save tens of thousands of out of pocket dollars for the franchisee. Getting better lease terms is often the first example you'll hear from existing franchisees of things they'd do better if given the chance to do things over again.
- **Construction and Fixture Costs.** Most new franchisees assume that buildout costs are what they are, and it probably doesn't make much difference who you pick as general contractors or subcontractors to get the required work done. This can be an expensive assumption. You'll often hear from existing franchisees that they should have used competitive bidding before contracting for their fixture construction or selecting their general contractor because it would have saved them many thousands of dollars in the cost of setting up their new unit.
- **Business Equipment.** Many franchise businesses require the purchase of extensive capital equipment. This could be anything from ovens to printing presses to tanning beds, and this equipment can sometimes be very expensive. What you'll often hear from existing franchisees is either: 1) they feel they should have shopped more vendors to find the

best prices, 2) they should have considered buying used equipment or researched aftermarket suppliers to find considerable savings, or 3) they should have considered different financing options (loans or leases) with their purchase in order to conserve their capital for other business needs.

- **Inventory and Supplies.** Though the initial inventory and supplies aren't usually as large a purchase item as the other examples above, they can be. If you're looking at a franchise with significant inventory investment needs, make sure to ask the franchisees if they've learned any way to save on these costs that they didn't know initially. This can not only reduce your initial costs, but also raise your margins on an ongoing basis.
- **Marketing Costs.** Almost every new franchisee will tell you that they wasted a bunch of money in relation to their initial marketing efforts. The mistake I personally made in this area with my first franchise is a story I've heard from any number of others. The franchisor had been quite specific in laying out a marketing plan for me to follow--complete with budgets down to the last penny. What I didn't anticipate was that every local market advertising salesperson (radio, newspaper, yellow pages, direct mail, etc.) was going to descend on me as they do on all new business owners. They were going to do their best to convince me that the plan the franchisor had put together (based on successful experience with hundreds of new unit openings) was flawed and that I needed to modify it to feature whatever it was that the salesperson was selling. They were persuasive and I was an idiot, and that combination proved to be very expensive. Make sure you are confident that the franchisor has the experience to help you put together an initial marketing plan that will work--and then follow it to the letter--and you'll avoid one of the costliest areas of mistakes for new business owners.
- **Labor Costs.** The largest ongoing expense line for almost all franchise businesses is the cost of labor. All good franchise companies will have specific guidelines for what personnel you need and how much you can afford to pay for these positions. One of the most common mistakes new franchisees make is to hire too many people or to pay too much for the ones they hire. This is a very easy mistake to make, but it is also the quickest way to change a business from a winner into a loser from the standpoint of profitability. It takes discipline and focus to stick to the plan in terms of labor, but it can make all the difference in the long-term success of your business.

These examples represent the most common and expensive areas where new franchisees can make mistakes, but there are always lots of other little things that can be done better. The secret to success is to do your research and then take advantage of the advice you receive from the franchisor and the existing franchisees to avoid making these or other mistakes yourself. Do that and you'll be the exception to the rule when a prospective franchisee calls you in the future to find out what expensive mistakes you made and what you learned from them.

Jeff Elgin is the "Buying a Franchise" coach at Entrepreneur.com and has almost 20 years of experience in franchising, both as a franchisee and a senior franchise company executive. He's currently the CEO of FranChoice Inc., a company that provides free consulting to consumers looking for a franchise that best matches their needs.