Fort Worth Business Press

The pros and cons of buying a franchise business

BY WARREN HUMMER
June 30, 2008

The recent downturn in the economy is influencing (voluntarily and otherwise) many to change careers, take early retirement and go into business for themselves. Many are considering purchasing a franchise.

Franchise advertisements on the Internet, in classified advertisements and on television beckon potential investors with seductive phrases such as “Be Your Own Boss” and “Control Your Own Destiny” beckon. To these should be added another- “Buyer Beware!!!!”

Franchise ownership isn’t always what it seems. Armed with personal savings, loans from family members and severance or retirement funds, many consider purchasing a franchise. And, many who do will be seeking financial security, only to watch their dreams turn into nightmares. Increasingly, I receive frantic calls from financially struggling franchisees seeking help with franchise-related problems. Very often, the only legal advice they can afford is that of a bankruptcy lawyer.

In many cases, franchisors are to blame. While many franchisors are honest and attempt to comply with the various state and federal franchise laws; others, either ignorant or downright dishonest, don’t take these laws and regulations seriously and fail to provide or intentionally withhold required information or misrepresent information about the franchise “opportunity.”

Franchise salespeople who, wholly or partially, work on commission, pitch their products to unknowing investors as businesses with a proven track record for success; a defect-free operating system that has been fine-tuned to provide the investor every opportunity to achieve success and financial independence. However, too often, those stories don’t track with the facts.

Undercapitalized franchisors dependent on initial franchise fees to meet monthly overhead expenses will sell franchises to anybody anywhere – no matter how unqualified the franchisee may be. Some companies have limited resources to provide meaningful pre-opening, training, operation and marketing assistance to the franchisee. Others, in order to make a sale and “make budget” so the sales staff looks good and the shareholders are happy, make unlawful and insupportable claims of revenues and profitability. Believe me, it happens.

A risky franchise

Not all the blame rests with franchisors. Franchise purchasers often lack the knowledge, and won't or can't afford to hire lawyers and financial advisers with the knowledge to evaluate the franchise offering. It is not unusual to discover that a failed franchisee, facing the closure of the business, bankruptcy, the loss of savings and retirement funds and a lawsuit by the landlord and franchisor, neglected to have the franchise documents reviewed by knowledgeable advisers prior to making the investment decision.

Purchasing or starting any business, including a franchise, is risky. Contrary to statements tossed about by franchisors and franchisor trade associations, the failure rate of franchises may be near that of other small businesses. A recent study concluded that within a 10-year period, nearly 75 percent of all franchises fail. In a conversation with the in-house attorney for a well known business services franchisor, I was told that over 90 percent of their franchisees who fail will seek bankruptcy protection. The wise investor, therefore, should take plenty of time to investigate a franchise offering prior to purchase.

Some areas to consider

The following are some areas to be considered before deciding to purchase a franchise:

The business must be a business, not merely a concept.

The business must be profitable.

The break-even point can be achieved in a reasonable period of time.

The return on investment must be acceptable to you.

Has the business been in operation for a sufficient time to project its future?

How competitive is the industry?

Is the industry fragmented?

Is the product or service based on a trend or fad?

Is the product or service distinguished from its competition?

Has the public accepted the product or service on a repeat basis?

Does the franchisor own the trade name and trade marks?

Do you have knowledge of the industry?

Have you studied and do you understand your market?

What is the “labor pool” in your market for qualified employees?

Is the business based on an organized concept?

Is the business simple for you to operate?

Can the franchisor afford to support a system in expansion?

Can the business be operated in your market?

Can the franchisor teach you to operate the business in a reasonably short period of time?

Will the initial training be adequate for you to operate the business?

Can all operating procedures be duplicated?

Does your background and experience qualify you to operate all phases of the operation?

Do you have a complete understanding of the real costs necessary to develop, open and operate the business?

Franchise ownership can be profitable, but only if franchisors conduct themselves ethically and honestly, strictly comply with the disclosure laws and truly concern themselves with the long-term profitability of the individual franchisee; and, if prospective franchisees take the time to fully and realistically evaluate the franchise, the market for the goods or services and their suitability to operate the business.

Warren Hummer is a Grapevine attorney whose practice is concentrated on representing franchisors and franchisees. Hummer can be reached at: (817) 488-1488.

Online at: http://www.fwbusinesspress.com/display.php?id=7860

Questions & Comments FortWorthBusinessPress.com. Last updated on 03-May-2007.
Copyright © 2008 by Fort Worth Business Press.