7 basic considerations before entering a franchise relationship

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The basic idea behind the franchise relationship is that past success of a franchise concept presents a unique opportunity for an entrepreneur to lower start-up risk while at the same time hedge in favor of long-term business successes. In a properly considered and structured franchise relationship, a hard working relative novice can successfully acquire and successfully run a business.

Below is a list of common issues and concerns that should be considered before entering into a franchise relationship. Questions or tasks to consider are:

1. **Carefully read and review the franchise disclosure document:** A potential franchisee will be given a unique opportunity to review the financial and legal aspects of the prospective business. These opportunities are contained in the franchise disclosure document (FDD). Study the FDD! The FDD provides an immerse amount of information both in terms of what is said and what isn't said. For instance, if the FDD and related documents are easily read and understood, it may be fair to assume that the franchisor will be straight forward and transparent. The documents also give great insight into the true start-up costs of the franchise and anticipated profits from running a franchise. It provides names of other persons to speak to about the franchise system. Finally, professional review of the FDD at the onset of the franchise relationship can save future heartache and thousands of dollars.

2. **Is the day-to-day operator of the franchise driven and creative?** While a franchise opportunity generally involves a proven concept, return on investment and long-term success require drive and creativity. Careful consideration and thought should be given to whether the operator is a "9 to 5" person or an all hours, self-starter, whatever it takes kind of person. We suggest only the latter should strongly consider a franchise opportunity.

3. **What is the primary product being sold?** Remember when everyone rented a video? While it's impossible to predict technology, changes in society, or fads, it's important to consider those changes when making a franchise offering or an investment.

4. **Will this work from a business perspective?** Suppose I invest $200,000 of my savings into a new franchise venture. In addition, in order to run this venture, I quit my full time, $75,000 per year job. How much money will the new franchise business need to throw off for me to break even from where I am now? In a very simplified answer, assuming a 5 percent annual rate of return on the $200,000 (or $10,000 per year) invested, your break-even return number is $85,000 (the $75,000 of salary given up, plus the return on the $200,000). A careful review of the financial aspects of the FDD should afford you the opportunity to make an educated determination as to the short term and long-term prospects of return on investment and financial success.

5. **This is a long term commitment!** Franchise agreements (and the related agreements like leases) generally have terms that last for between 10 and 20 years. Frankly, it's a long period of time. Therefore, it's important to understand the ramifications surrounding the extended duration. Typical considerations include:
   - Will I be required to contribute additional capital in the future?
   - Can I sell?
   - Can I pass the business to be family members?
   - What happens if I get divorced?
   - What if I want to close?

   The answers to these questions are generally contained in the FDD.

6. **I know one store doesn't throw off quite enough money but I'll open more and be all set.** While this sounds great, the fact of the matter is that with established brands or saturated markets it's hard to find enough suitable locations to fulfill the developmental requirements. In addition, opening more stores takes more capital. You must consider availability of that additional capita. Finally, you should consider what would happen if the second location wasn't as successful as the first.

7. **I'll just use the franchise to learn the ropes and then open up my own copy-cat store.** Almost every franchise agreement contains a non-compete clause. Rest assured the franchisor will do what is necessary enforce that non-compete. If this is your intention, don't sign a franchise agreement, and open your own store. Sure, there's a learning curve, however it costs much less to do it this way than the lawyers will cost later.

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