



**Serving Monmouth County, New Jersey
and surrounding areas**

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Basic Information about Purchasing and Operating a Franchised Business

The comments included here are directed toward the unique opportunities offered by franchising. Please bear in mind, however, that the basic operating principles of starting any business also apply to the person considering a franchised business. Only if the preliminary groundwork shows promise should you consider moving ahead with any type of business venture. A well thought out business plan is always a good way to help uncover future problems and unexpected expenses.

An excellent franchising information resource available on the Internet is the International Franchise Association web site at www.franchise.org. At this web site you will also find links to many national franchise associations and government offices as well as a resource center and an E-mail address where questions can be submitted to people with expert franchising knowledge.

What is franchising?

Franchising is a mutually beneficial relationship that exists between the franchisor and the franchisee for distributing products or services. It is a legal and commercial agreement between the owner of a trademark, service mark, trade name, or advertising symbol and another individual or group seeking the right to use that identification in a business. The franchise is a contract that governs the method for conducting business between the two parties. In the simplest form, a franchisor owns the right to a name or trademark and sells that right to a franchisee. In the more complex but familiar form "business format franchising," a broader and ongoing relationship exists between the two parties. Business format franchises usually provide a full range of services including, site selection, specialized equipment, marketing assistance, product supply, personnel training and even financing. Keep in mind that with franchising you own the assets of your company but are licensed to operate someone else's business.

What are the benefits of franchising?

Franchising provides easy access to an established product as well as a proven method of marketing that can reduce many of the risks associated with opening a business. It provides entrepreneurs with an affordable means of accelerating expansion and allows them to achieve their goals more quickly than they might otherwise with far less risk. Keep in mind though that

in exchange for the security, training, and marketing power of the franchise trademark, you must be willing to give up some of your independence. As a franchise owner, you must comply with the various controls and procedures established by the franchisor and use these to chart the course of your business.

What is the Federal Trade Commission Rule?

A federal regulation requires every franchisor to prepare an extensive disclosure document called the Uniform Franchise Offering Circular (UFOC) and to give a copy to a prospective franchise purchaser ten days before he or she buys a franchise. Within the disclosure document are 20 different categories of information about the franchise including required fees, basic investment, bankruptcy and litigation history of the company, how long the franchise will be in effect, a financial statement of the franchisor and earnings claims if the company makes them. You must be provided with a separate contract with all blanks or negotiated parts completed, except for the signatures, at least five days before a contract is signed or any money changes hands. This is known as the five day rule. An attorney, who understands franchising, trademark laws and the Federal Trade Commission Franchise Rule, should be engaged to review this material. Generally there is very little negotiation over terms but an attorney can point out the sometimes very subtle but important rights and obligations you are agreeing to and ensure that all your concerns are treated in the agreement.

What are some things to understand completely before buying a franchise?

- The type of experience required in the franchised business.
- A complete description of the business and how its organization functions.
- The hours and personal commitment required to operate the business.
- The track record of the franchisor and the business experience of the company officers and directors.
- How other franchisees of the company are doing and how they feel about their investment in the business.
- What are the basic costs of continuing to operate the business, both fixed and variable, such as utilities, insurance, and taxes?
- Which products or services must be purchased from the franchisor, how much they will cost and how do the costs compare with other suppliers?
- What are the terms and conditions covering renewal rights, reselling the franchise and completely terminating the franchise relationship? How many franchises have been terminated in recent years?
- The current financial condition of the franchisor and its system.
- What restrictions apply to competition with new and with existing franchisees?

How much is it going to cost to get into and operate the business?

- Initial franchise or license fee.
- Training costs including tuition, room and board and transportation.
- On-site start-up aid and promotion charges.
- Advertising contribution usually based on percentage of sales and payable weekly or monthly.
- Centralized bookkeeping, accounting and/or data processing services.
- Charge for premises, equipment, supplies and opening inventory.
- How and when sales royalties are reported and paid.
- Does the royalty payment entitle you to services to be provided by the franchisor? If so what ongoing services are you to receive?
- Cost of updated operating and training manuals and merchandising services.

How can I be sure the information provided in the disclosure is truthful and accurate?

Even though inaccuracy and misrepresentation carry civil and sometimes severe criminal penalties, there is no way to be absolutely sure the information is correct. With the FTC disclosure document, however, fraud and deception are less likely because the franchisor has prepared his statement and has answered a variety of very important questions which are very useful in judging the offer. The assistance of a lawyer and accountant to evaluate the information is highly recommended at this time.

Would I make a successful franchisee?

To be successful as a franchisee you should be suited to that industry, suited to the particular franchise company selected, and suited to the franchise system generally. You must ask yourself several important questions and ask family and friends if they see you in the same light as your answers. Am I suited to the industry physically and by experience, education, learning capacity, temperament and financial ability? What type of work appeals to me -- for example, do I enjoy working with food, mechanical things, people, real estate, etc.? Am I prepared to work hard over long hours and take financial risk? How would I react to controls and authority? Can I readily accept guidance and direction? How do I personally feel about the company's products or services and the company's image?

How can I be sure I won't lose money?

Although most franchise owners are satisfied, successful business people, some do suffer financial loss. Be very wary of any company which guarantees profit or certain success. Any earnings claim not included in or attached to and official disclosure document is suspect -- and

probably illegal. Investigation of all earnings claims made by a franchisor is especially important to your franchising future.

What is the business you are considering all about?

- Would the business be successful apart from the benefits offered by a franchise?
- Does the product meet a local demand? Is there a proven market now and is it growing, mature or declining?
- What is the competition now and what is the likelihood of new competition in the foreseeable future?
- If the product requires servicing, who bears the responsibilities covered by warranties and guarantees, the franchisee, the franchisor or neither? If neither, are service facilities available?
- What reputation does the product enjoy?
- How do you feel about the franchisor's advertising and marketing of the product or service?

How much sales revenue is needed to support the anticipated expenses and expected profit?

This can only be determined by doing a business plan. You must be able to show a direct correlation between your best guess as to income and the estimated expenses. It gets down to a reality check on how many sales can you really produce within the framework of the labor hours available and the capability of any equipment required to do the job.

Legal questions to be considered before signing a contract.

- If the franchisee is a corporation, will a personal guarantee be required, and if so, what obligations are covered?
- If the franchisee executes the contract as an individual, does he or she have the right to assign the franchise to a corporation he or she owns?
- What restrictions are there on other activities of the franchisee, the relatives of the franchisee and their family members (such as ownership, employment, or other participation in businesses that are competitive)?
- Who is responsible for site selection? Is the grant of the franchise contingent upon franchisee being able to obtain and maintain a lease for the selected location?
- Does the franchisee have a right to relocate in the event of condemnation, lease expiration, or poor business results, or is relocation a matter of the franchisor's then current policy?
- Is some type of territorial exclusivity included in the contract or critical to the business? If so, what is the exact nature of any exclusivity or protection granted? Is it contingent upon conditions, such as achieving certain performance goals?

- Under what conditions might the franchisee not be permitted to renew -- e.g., loss of the lease for the premises, failure to achieve minimum performance levels, franchisor's determination not to have a unit at the franchisee's location?
- What are the provisions and circumstances under which the franchisee is permitted to terminate the contract?
- Under what circumstances can the franchisor terminate the contract?
- What will happen to the franchisee's lease for the premises of his business, and to the assets of the business upon termination?
- What are the franchisee's rights if the franchisor's business fails?