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When you buy a franchise, you may be able to sell goods and services that have instant name recognition, and get training and support that can help you succeed. But purchasing a franchise is like any other investment: there's no guarantee of success.

The Federal Trade Commission, the nation's consumer protection agency, has prepared this Guide to help you decide if a franchise is right for you. It suggests ways to shop for a franchise opportunity and highlights key questions you need to ask before you invest. The Guide also explains how to use the disclosure document that franchisors must give you — under the FTC's Franchise Rule — so you can investigate and evaluate a franchise opportunity.

The Franchise Business Model

A franchise enables you, the investor or franchisee, to operate a business. You pay a franchise fee and you get a format or system developed by the company (franchisor), the right to use the franchisor's name for a specific number of years and assistance. For example, the franchisor may provide you with help in finding a location for your outlet; initial training and an operating manual; and advice on management, marketing or personnel. The franchisor may provide support through periodic newsletters, a toll-free telephone number, a website or scheduled workshops or seminars.

Owning a franchise comes with defined costs, franchisor controls and contractual obligations.

Costs

In exchange for the right to use the franchisor's name and benefit from the franchisor's assistance, you will pay some or all of the following:

Initial Franchise Fee and Other Expenses

Your initial franchise fee will typically range from tens of thousands of dollars to several hundred thousand dollars and may be non-refundable. You may face significant costs to rent, build and equip an outlet and to buy initial inventory. You also may have to pay for operating licenses and insurance and a "grand opening" fee to the franchisor to promote your new outlet.

Continuing Royalty Payments

You may have to pay the franchisor royalties based on a percentage of your weekly or monthly gross income. Typically, you must pay royalties for the right to use the franchisor's name, even if you are losing money. You may have to pay royalties for the duration of your franchise agreement even if the franchisor doesn't provide the services it promised and even if you decide to terminate your franchisee agreement early.

Advertising Fees

You also may have to contribute to an advertising fund. Some portion of the advertising fees may be allocated to national advertising or to attract new franchise owners, rather than to promote your outlet.

Franchisor Controls

To ensure uniformity, franchisors usually control how franchisees conduct business. These controls may significantly restrict your ability to exercise your own business judgment. A franchisor may control:

Site Approval

Many franchisors retain the right to approve sites for their outlets, and may not approve a site you select. Some franchisors conduct extensive site studies as part of the approval process and a site they approve may be more likely to attract customers.

Design or Appearance Standards

Franchisors may impose design or appearance standards to ensure a uniform look among their outlets. Some franchisors require periodic renovations or design changes; complying with these requirements may increase your costs.

Restrictions on Goods and Services You Sell

Franchisors may restrict the goods and services you sell. For example, if you own a restaurant franchise, you may not be able to make any changes to your menu. If you own an automobile transmission repair franchise, you may not be able to perform other types of automotive work, like brake or electrical system repairs.

Restrictions on Method of Operation

Franchisors may require that you operate in a particular way. They may dictate hours; pre-approve signs, employee uniforms and advertisements; or demand that you use certain accounting or bookkeeping procedures. In some cases, a franchise advertising cooperative may require you to sell some goods or services at specific discounted prices, which may affect your profits. Or, the franchisor may require that you buy supplies only from an approved supplier, even if you can buy similar goods elsewhere for less.

Restrictions on Sales Area

A franchisor may limit your business to a specific location or sales territory. If you have an “exclusive” or “protected” territory, it may prevent the franchisor and other franchisees from opening competing outlets or serving customers in your territory, but it may not protect you from all competition by the franchisor. For example, the franchisor may have the right to offer the same goods or services in your sales area through its own website, catalogs, other retailers or competing outlets of a different company-owned franchise.

Contractual Obligations

Franchise contracts last only for the number of years stated in the contract. You can lose the right to your franchise if you don’t comply with the contract. Also, keep in mind that you may not have a right to renew the contract unless the franchisor gives you that right.

Terminations

A franchisor can end your franchise agreement for a variety of reasons, including your failure to pay royalties or abide by performance standards and sales restrictions. Many franchise contracts will give you a chance to “cure” an occasional failure to comply (like making one late payment) but keep the right to terminate your franchise for other failures. If your franchise is terminated, you’re likely to lose your entire investment.

Renewals

Franchise agreements may run for as long as 20 years. Renewals are not automatic. At the end of the contract term, the franchisor may decline to renew or m(ontracSLAT2iEts,esf y don)6.1sor may h end of

Is a Franchise Right for You?

Franchise Exposition

Attending a franchise exposition allows you to see and compare a variety of franchise possibilities at one time. Before you attend, research the kind of franchise that may best suit your budget, experience and goals. When you attend, visit several franchise exhibitors who deal with the type of industry that appeals to you. Ask questions, including:

- How many franchised outlets are there? Where are they?
- What is the initial franchise fee? What are the additional start-up costs?
- Are there continuing royalty payments? How much are they?
- What management, technical and other support does the franchisor offer?
- What controls does the franchisor impose?
- How long has the franchisor been in business?

Exhibitors may offer you incentives to attend a promotional meeting to discuss the franchise in detail. These meetings can be another source of information and give you a chance to raise questions, but they may also expose you to high-pressure sales tactics. Be prepared to walk away from any franchise opportunity — and promotion — that does not fit your needs.

Franchise Broker

Franchise brokers may call themselves “business coaches,” “advisors,” “referral sources” or “sales consultants.” They often advertise on the internet and in business magazines, offering to help you select among various franchise options. Typically, a broker reviews the amount of money you have to invest and then directs you to opportunities that match your interests and resources. A broker also may help you finish applications and the paperwork to complete the sale. Brokers often work for franchisors, and are paid only if a sale is made.

Before you decide to use a broker, consider whether you need a broker’s services or could get enough information by shopping online or reading trade magazines. If you go with a broker, be sure to always review any application or paperwork completed by a broker on your behandfylu gogo wr499ualTextFEFF002EtFskn

The franchisor may give you a copy of its FDD on paper, via email, through a web page or on a disc. The cover of the FDD must provide information about the available formats. Make sure you have a copy of the FDD in a format that is convenient for you, and keep a copy for reference.

Read each of the 23 numbered "Items" in the FDD. Don't be shy about asking for explanations, clarifications and answers to your questions before you invest. Here are some, but not all, of the key sections of the FDD:

Franchisor's Background (FDD Item 1)

Item 1 tells you how long the franchisor has been in business and its likely competition. It also lets you know if there any legal requirements unique to the franchised business, like a requirement that you get a special license or permit. This will help you understand the costs and risks you will take on if you purchase and operate the franchise.

Business Background (FDD Item 2)

Item 2 identifies the executives of the franchise system and describes their experience. Pay attention to their general business backgrounds, their experience in managing a franchise system and how long they've been with the franchisor.

Litigation History (FDD Item 3)

Item 3 lists important information about prior litigation, including whether the franchisor or any of its executive officers have been convicted of felonies, or are subject to any state or federal injunctions relating to the franchise or to a Federal, State, or Canadian franchise, securities, antitrust, trade regulation, or trade practice law. In addition, this item will tell you whether the franchisor or any of its executives have been held liable in, or settled, civil actions alleging franchise-law violations, fraud, or deceptive or unfair trade practices. If there have been many claims against the franchisor, it may mean the franchisor has not performed according to its agreements. Or it could show that franchisees are dissatisfied with its performance.

Item 3 also should say whether the franchisor has sued any of its franchisees during the last year. That disclosure may indicate common types of problems in the franchise system. For example, if a franchisor sued franchisees for failing to pay royalties, it could be because franchisees weren't successful, and

- real estate and leasehold improvements
- required equipment, such as a computer system or a security system
- training
- business insurance
- compliance with local ordinances, such as zoning, waste removal, and fire and other safety codes
- employee salaries

You'll need to investigate other initial and ongoing costs that aren't described in Items 5-7, such as the cost of accounting and legal help.

It may take several months to start your business, and it may take more than a year to break even. Some franchises never break even. Estimate your operating expenses for the first year and your personal living expenses for up to two years. Compare your cost estimates for the franchise with what other franchisees in this system and competing systems have paid. An accountant can help you evaluate this information. You may be able to do better with another franchisor.

Supplier, Territory and Customer Restrictions (FDD Items 8 and 12)

These items tell you whether the franchisor limits:

- suppliers from whom you may purchase goods
- the goods or services you may oer for sale
- where and to whom you can sell goods or services
- your use of the internet to sell goods or services to customers within and outside your territory
- the right of the franchisor (or other franchisees) to use the internet to solicit customers or to sell in your territory

These kinds of restrictions may limit your ability to exercise your own business judgment in operating your outlet. If the franchisor does not limit the territory where each franchisee can sell, the franchisor and other franchisees may compete with you for the same customers by establishing their own outlets or selling through the internet, catalogs or telemar97 0 0 11 76.5cTEpan/<ActualText<FEFF002E>BDC (.)TjEMC (Some /Spa

2. The franchisor may add to the information in Item 19. For example, the franchisor may provide information about possible performance at a particular location or under particular circumstances.

For tips on how to evaluate this information, see Evaluating Potential Earnings.

Franchisee and Franchise System Information (FDD Item 20)

Item 20 provides charts showing growth and owner turnover in the franchisor's system. If the charts show more than a few franchised outlets in your area have closed, transferred to new owners, or transferred to the franchisor, it could be due to problems with the franchisor's support or because franchises aren't profitable.

Current and Former Franchisees

Look for the required disclosure of contact information for current franchisees and franchisees who have left the system during the franchisor's last fiscal year. Talking to these people may be the most reliable way to verify the franchisor's claims. Visit or phone as many of them as possible to chat about their experiences. Some current franchisees may be reluctant to talk to you if they're having problems. If that's the case, try contacting others on the list.

Some franchisors may give you a separate reference list of franchisees to contact. To ensure you get the full picture, you may want to contact a number of franchisees listed in the disclosure document and some on the separate list.

Talk to several franchisees who have been in business just over one year. They're in the best position to tell you:

- their total investment
- whether they were able to open their outlet in a reasonable time
- whether they were satisfied with the franchisor's training, opening assistance and advertising
- whether the franchisor provided ongoing help and assistance
- whether they have been able to break even

It's also a good idea to talk to several franchisees who have been in business for five years. Ask:

- how long it took them to break even, earn a reasonable income and recoup their investment
- whether the franchisor is providing the services and assistance it promised and fulfilling its contractual obligations
- what problems, if any, they are having with the franchisor
- whether they would invest in another outlet
- whether they're satisfied with the advertising program
- whether they are satisfied with the cost, delivery and quality of goods or services they must buy from the franchisor, its a□liates or sole approved suppliers

It's worth tracking down former franchisees (using contact information from Item 20), although some of them may have signed confidentiality agreements that prevent them from talking with you. Prior owners can tell you:

- the problems they had with their outlet
- whether they broke even or made a profit
- when and for how long they operated the outlet
- their business background
- why they left the franchise system

Is the Earnings Claim Typical for a Franchise in this System?

Suppose a franchisor claims that franchisees in its system earned $50,000 last year. The claim may be deceptive if it doesn't represent the typical earnings of franchisees. The FDD should tell you how many franchises the franchisor has, how many it surveyed to get that figure, and the number and percentage of franchisees who reported earnings at the level claimed.

Average Income

If a franchisor claims that its franchisees earn an average income of $75,000 a year, that tells you very little about how individual franchises performed. Using an average figure may make a franchise system look more successful than it really is, because the high incomes of just a few very successful franchises can inflate the average for all franchisees.

Gross Sales

Some franchisors provide figures for their franchisees' gross sales. These figures don't really tell about the franchisees' actual costs or profits. An outlet with high gross sales on paper might be losing money because of high overhead, rent and other expenses.

Net Profits

Franchisors often don't have data about their franchisees' net profits. If you get profit information, ask if en36./Span3

Additional Sources of Information

Accountants and Lawyers

In addition to reading the franchisor's FDD — including any updates — and speaking with current and former franchisees, consider talking to an accountant and a lawyer. An accountant can help you understand the franchisor's financial statements, develop a business plan, assess any earnings projections and the assumptions they're based on, and help you pick a franchise system that is best suited to your investment resources and your goals.

A lawyer can help you understand your obligations under the franchise contract. These contracts usually are long and complex. A problem that comes up after you have signed the contract may be very expensive to fix — if it can be fixed at all. Choose a lawyer who is experienced in franchise matters, and rely on your lawyer or accountant for a recommendation about whether to buy a particular franchise.

Banks and Other Financial Institutions

If you need financing to buy a franchise, a bank lender may be able to provide you with a Dun & Bradstreet report or similar financial profile of the franchisor. The bank also might obtain sales and profit information from the franchisor, even if the franchisor won't give you that information. However, some franchisors give banks unrealistic, overstated profit projections so the bank will provide financing to expand the franchise system. Remember that bank approval of a franchise loan doesn't necessarily mean the franchise is a safe or good investment.

Better Business Bureau

Check with the local BBB in the cities where the franchisor has its headquarters and the city where you're thinking of buying a franchise. Ask whether there are complaints on file about the franchisor's products, services or personnel.

Government

Several states have registration or disclosure laws that regulate the sale of franchises. Some states have laws meant to protect franchisees after they buy. The FDD should include information about any such laws in your state. If the information isn't in the FDD, check with your state Attorney General's office, office of consumer affairs or state securities division.

The Franchise Disclosure Document (FDD)

(You can ask for the FDD as soon as the franchisor gets your application and agrees to consider it. And you MUST get it at least 14 days before you're asked to sign a contract or pay money — either to the franchisor or its affiliate.)

Item 1: The Franchisor, and any Parents, Predecessors, and Affiliates.

Item 2: Business Experience.

Item 3: Litigation.

Item 4: Bankruptcy.