

Are you an informed investor? FRANCHISES

When Joe retired, he decided to buy a popular fast food franchise. The salesperson assured Joe that he would soon be making lots of money. But almost a year after signing his franchise agreement, Joe still doesn't have a location for his restaurant. Each time Joe found a location he liked, the franchisor rejected his choice. Frustrated, Joe went back over papers he got before he bought his franchise. Joe noticed that more than half of all franchisees in his system failed to open in their first year, and many never opened at all. Joe also saw that the franchisor could terminate his franchise – and keep his \$30,000 franchise fee – if he doesn't open his restaurant at an approved location within 12 months.

Some people believe that owning a franchise is a safe and easy way to start a successful business. But as Joe – and many others like Joe – learned, buying a franchise can be risky, and there is no guarantee of success, especially in an uncertain economy. If you are thinking of investing in a franchise, you must educate yourself before you buy.

10 Considerations Before Investing in a Franchise:

1. Renewal Conditions. Most franchise agreements are limited to a specific term, usually 5 or 10 years. You may not have an automatic right to renew. Even if you can renew, you may have to satisfy certain conditions, like signing a new agreement with entirely different terms and higher fees, or face losing your business.

2. Legal Counsel. Franchise agreements are drafted by the franchisor's attorney. They almost always give the franchisor every advantage. If you do not use an attorney to advise and assist you before you invest, you place yourself at a serious disadvantage.

3. Get it in Writing. Franchisor salespersons and brokers don't represent your interests. They may promise you many things about a franchise before you buy, but if that promise is not stated in writing in your franchise agreement, it is unenforceable and means nothing.

4. No Easy Way Out. You may not have an easy way to close your franchise business, even if it fails. Some franchisors can actually sue for expected "future royalties" if you terminate your franchise agreement early.

5. Franchisor Control. Most franchise agreements require you to accept the franchisor's system changes, such as menu items, advertising or a whole new decor, no matter how costly or unwise you consider them to be.

6. Dispute Resolution. Many franchise agreements require that you resolve disputes in the state where the franchisor's headquarters is located. It may be expensive and inconvenient for you to travel to assert your rights, even if your claims are valid. Franchisors often require that disputes be "arbitrated," which can further limit your rights and remedies.

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7. Designated Suppliers. Most franchise agreements require that you buy goods or services from suppliers the franchisor designates or approves. You may not be getting the best deal for these goods and services because the supplier may be affiliated with the franchisor or may pay the franchisor a rebate based on your purchases.

8. Contact Franchisees. Every franchisee must receive a franchise disclosure document (FDD) at least 14 days before investing. The FDD contains important information about the franchise, including contact information for current and terminated franchisees. You should contact as many of these individuals as you can before you invest. Determine if a high number of franchisees have closed, transferred or never opened. If experienced franchisees are not happy (or you cannot reach them), be very skeptical.

9. Earnings Disclosures. Most franchisors choose not to disclose earnings of existing franchisees in their FDD, even though this disclosure is allowed. There may be several reasons why a franchisor would not disclose this information, but one reason may be that its franchisees are not profitable.

10. Background Check. 15 states have laws that regulate the sale of franchises. Check to see if your state has a franchise office. Find out if the franchisor is registered, and if it has received any complaints by franchisees. If your state doesn't have a franchise office, check with a state that does, and with the Better Business Bureau, to see if there are franchisee complaints.

NASAA Franchise Resources

Oversight of franchise and business opportunity offerings is an important consumer protection for hundreds of thousands of people who invest in these operations. It requires careful attention by both federal and state authorities.

At the state level, oversight of franchising is grounded in the traditional commitment of grassroots officials to protect consumers whenever possible before they part with their money; and in those cases where money is lost in a fraudulent deal, to marshal the enforcement resources to shut down the violator and seek restitution if possible.

California adopted the first state franchise statute in 1971. Today, several states have statutes that regulate the offering of franchises for sale. These statutes are designed to provide greater protections to prospective franchisees and prevent fraud in the sale of franchise offerings.

You can find information about state franchising offices at the following website: www.nasaa.org/Industry__Regulatory_Resources/Franchise/.

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