

Answers To The 20

Most Frequently Asked Questions About Franchising

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The International Franchise Association (IFA) was established in 1960 to build and maintain a favorable economic and regulatory climate for franchising. It is the only association serving as the voice for franchising in the United States and is a major participant in the international franchise arena. IFA's mission is to enhance and to safeguard the business environment for franchising worldwide. Today, more than 75 industries operate within the franchising format, and IFA's membership and network encompass some 1,000 franchisors, 350 suppliers, and over 7,000 franchisee members.

Unhindered opportunity for all Americans is essential to our economic and political well-being. To retain leadership in bringing new products and services to the marketplace both in the U.S. and abroad, franchise systems continue to provide the widest possible entrepreneurial opportunities for everyone. They also provide expanding opportunities and strong growth possibilities for minorities, women, veterans, and the handicapped. Franchised businesses are rapidly adding jobs to a broad range of industries. In addition, franchise companies are major contributors in the development of management and technical skills which are vital in the creation of an experienced work force, which is so important in building and strengthening both American and foreign economies.

The mutually beneficial relationship that exists between franchisors and franchisees makes franchising unique in the world of business. It provides entrepreneurs with an affordable means of accelerating expansion, achieving development goals more quickly than might otherwise be the case and with far less

risk. Similarly, franchisees have a head start because of the support provided by the franchise system. Franchising is, literally, being in business for yourself but not by yourself. Whether it's accounting and financing, advertising and public relations, personnel management, purchasing or inventory control, franchisors are there to provide "hands on," one-to-one assistance. While franchising does provide opportunities, it does not create miracles. Franchisees combine knowledge and resources with entrepreneurial drive and spirit to form a business relationship unique to franchising. Franchising is a field of expanding economic opportunity in which each and every person can play a part based on talent, initiative, and dedication.

1.

WHAT IS FRANCHISING?

Franchising is a method of distributing products or services. At least two levels of people are involved in a franchise system: (1) the franchisor, who lends his trademark or trade name and a business system; and (2) the franchisee, who pays a royalty and often an initial fee for the right to do business under the franchisor's name and system. Technically, the contract binding the two parties is the "franchise," but that term is often used to mean the actual business that the franchisee operates.

2.

HOW DOES A FRANCHISED CHAIN START?

Imagine a store owned by an individual with a particular concept. If the business is successful, the owner may develop a second or third store and hire employees for the day-to-day operations. At that point, if the entrepreneur still wants to expand but prefers not to operate additional stores himself or herself, he or she may decide to "franchise" the store name and business system to an independent business person known as a franchisee. In return, the entrepreneur may ask for an initial fee and/or a continuing royalty payment based on a percentage of that franchisee's sales. The business is now franchised.

3.

WHEN I VISIT A STORE IN MY AREA, FOR EXAMPLE, A WELL-KNOWN FAST FOOD RESTAURANT, HOW CAN I TELL WHETHER THAT RESTAURANT IS OPERATED BY THE FRANCHISOR OR A FRANCHISEE?

It's difficult to tell just by visiting the restaurant. However, if it is a franchise, there should be some signage in the restaurant which indicates that the restaurant is independently owned and operated. Many companies have stores that are operated by franchisees but also have stores that are company owned and operated. So it's entirely possible that of two stores with the same name, one may be operated by a franchisee and the other operated by the company. In either case, the products, services, and quality should be the same.

4.

HOW WIDESPREAD IS FRANCHISING?

The answer may surprise you. By 2001, there were 767,483 business establishments in all domestic franchise systems (either owned by franchisors and franchisees), which employed almost 10 million people, with direct output close to \$625 billion, and a payroll of \$230 billion. These establishments

account for significant percentage of all establishments in many important lines of business: 56.3% in quick service restaurants, 18.2% in lodging, 14.2% in retail food, and 13.1% in table/full service restaurants.

5.

WHAT IS "BUSINESS FORMAT" FRANCHISING?

In business format franchising, the franchisor prescribes for the franchisee a complete plan, or format, for managing and operating the establishment. The plan provides step-by-step procedures for major aspects of the business and, anticipating most management problems, provides a complete matrix for management decisions confronted by the franchisees. The major advantage of buying a business format franchise is that the "system," the means for distributing goods and or services, has been developed, tested, and associated with the trademark. As a result, rapid expansion of a successful retail concept can occur more quickly than through company-owned expansion.¹

Sales by business format franchisors continued to increase steadily throughout the 1990s and into the 21st century. In 2001, comparing business format franchising to product distribution franchising, business format franchising had about 4.3 times as many establishments, employed 4 times as many workers, generated 2.5 times the payroll, and produced nearly 3 times as much output.

¹ Dave Thomas and Michael Seid, *Franchising for Dummies* 13 (IDG Books Worldwide, Inc. 2000).

6.

WHAT ARE THE MAJOR GROWTH INDUSTRIES IN "BUSINESS FORMAT" FRANCHISING?

As the economy becomes more service and technology oriented, as more women enter the work force, and as a larger percentage of the population grows older, growth areas in franchising are responding to these changes. The industry categories in franchising that are expected to continue to experience rapid growth for the start of the new century are service-related fields such as home repair and remodeling, carpet cleaning, household furnishings, and various other maintenance and cleaning services; business support services including accounting, mail processing, advertising services, package wrapping and shipping, personnel and temporary help services, and printing and copying services; automotive repairs and services such as quick-lube and tune-up; and other areas such as environmental services, hair salons, health aids and services, computers, clothing, children's services, educational products and services, and telecommunications services.

While it is important to consider industry growth before investing in a franchise, it is more important to analyze an individual franchise company's track record, keeping in mind that quick growth does not always spell success. A franchise organization that grows too quickly might not have a service team in place to support all of the units properly. Overall, long range trends indicate a steady, solid growth in business format franchising. Some will fall by the wayside, as is natural with any business, but others may well be the "household name" franchise success stories of tomorrow.

7.

SPECIFICALLY, WHAT KINDS OF BUSINESSES LEND THEMSELVES TO FRANCHISING?

Virtually every business form you can imagine. The International Franchise Association now lists more than 75 different categories to describe its members. Typically, you would think of fast food and restaurants first when thinking of franchising, but franchising covers the spectrum from A to Z – from

advertising/ direct mail to construction to dating services to home inspection to security systems to video sales and rentals. Printing and copying services, maid services, computer services, cleaners, lawn care services, real estate, hotels and motels, and travel agencies are excellent examples of industries that have successfully embraced franchising.

8.

ARE THE "LOOK-ALIKE" CHARACTERISTICS OF FRANCHISES A DISADVANTAGE? DON'T CONSUMERS WANT VARIETY?

Increasingly mobile consumers have come to depend on and appreciate the consistent quality of franchised products and services. Today, no matter where they go, people expect and want the same quality, which is why consumers so often stop at franchised establishments. The ability to easily recognize a franchised store, restaurant or hotel from the outside guarantees there will be no surprises or disappointments on the inside. Quite simply, the public knows what to expect and likes it that way.

9.

WHAT SHOULD I CONSIDER BEFORE BUYING A FRANCHISE?

Among the points which IFA recommends for investigation are:

- a. the type of experience required in the franchised business;
- b. a complete understanding of the business;
- c. the hours and personal commitment necessary to run the business;
- d. who the franchisor is, what its track record has been, and the business experience of its officers and directors;
- e. how other franchisees in the same system are doing;
- f. how much it's going to cost to get into the franchise;
- g. how much you're going to pay for the continuing right to operate the business;
- h. if there are any products or services you must buy from the franchisor and how and by whom they are supplied;
- i. the terms and conditions under which the franchise relationship can be terminated or renewed, and how many franchisees have left the system during the past few years;
- j. the financial condition of the franchisor and its system.

Both the Federal Trade Commission (@ www.ftc.gov) and IFA (@ www.franchise.org) have many helpful publications and resources. Equally important, IFA recommends that you engage an attorney to examine the contract. It is important to work with an attorney who understands franchising, especially the antitrust laws, the trademark laws, the Federal Trade Commission Franchise Rule, and applicable state laws. It is also recommended that you ask a competent accountant to examine your anticipated expenses, your financing needs, and your prospects for achieving your desired level of profitability before you sign any agreement.

10.

WHAT IS THE FEDERAL TRADE COMMISSION FRANCHISE RULE?

It is a federal regulation which requires franchisors to prepare an extensive disclosure document and to give a copy to any prospective franchise purchaser before he or she buys a franchise. The disclosure document typically used to comply with the Rule is called a Uniform Franchise Offering Circular, or UFOC. Within the UFOC are many different categories of information about the franchise, including some of the information described in the response to Question 9 above. 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, earnings claims (if the company makes them)... all are presented in this disclosure document. IFA recommends that both your attorney and your accountant review the UFOC and your franchise agreement. For further information from the FTC, or to order a free publication from the FTC entitled Consumer Guide to Buying a Franchise, call (202) 326-2222. This Guide can also be downloaded at <http://www.franchise.org/content.asp?contentid=615&PageId=13>

11.

HOW CAN I BE SURE THAT THE INFORMATION PROVIDED IN THE DISCLOSURE DOCUMENT 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 disclosure document makes fraud and deception less likely. However, because the franchisor has -- under penalty of law -- answered in written (or electronic) form a variety of very important questions you can use to judge the offer, IFA recommends that you carefully consider the information provided and evaluate the materials, including the history and reputation of the company and its officers, with the assistance of your lawyer and accountant. Also, be absolutely sure you talk to a substantial number of others who have already obtained franchises from the company you're considering, and ask them to verify any information you question. Learn if they are "satisfied customers" of the franchisor.

12.

ARE THERE ANY OTHER LAWS WHICH PROTECT ME?

Fourteen states require franchise companies to file or register their franchise offerings with a state agency: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin. These states, plus Oregon, also have disclosure regulations similar to those of the Federal Trade Commission. By means of so-called "business opportunity laws," certain other states regulate the offer and sale of a "business opportunity" which may include the offering of a franchise under the state's definition of a "business opportunity."

13.

IF I WANT TO BUY A FRANCHISE, WHAT SHOULD I DO TO GET STARTED?

The first thing to do is to identify companies offering franchises. IFA's Franchise Opportunities Guide gives a comprehensive list of franchise companies in more than 75 kinds of businesses. The Guide, which costs \$25.00 (including shipping and handling), is available by mailing a request and check or money order to IFA Publications, P.O. Box 1020, Sewickley, PA 15143. Orders may also be placed by calling 1-800-543-1038, or visiting IFA's online bookstore at www.franchise.org, where you can find other relevant sources to assist in your decision to buy a franchise. The Guide is also available online at the IFA website -- www.franchise.org.

You should contact the companies directly, and "shop wisely." "Shopping wisely" requires that you determine how much you can afford to invest and where to obtain financing. Careful investigation prior to purchasing a franchise also necessitates understanding the UFOC. You need to examine what the franchise relationship entails. For instance, you need to inquire into the training and support provided, assistance in finding and developing a location, and the sources of inventory and supplies. You should research the companies' growth and prospects for future growth. You should also seek advice from professionals and business people you respect. By shopping wisely, you can make an informed decision on whether to purchase the franchise.

14.

WHAT KIND OF INVESTMENT IS NECESSARY TO BUY A FRANCHISE?

Investment requirements differ tremendously. It all depends on the industry and the type of business. Total start up costs can range from \$20,000 or less, to over \$1,000,000, depending on the franchise selected, and whether it is necessary to own or lease real estate to operate the business. The initial franchise fee for most franchisors varies between \$10,000 and \$30,000. Seventy percent of franchisors charge an initial franchise fee of \$40,000 or less. The average investment, excluding real estate costs, is between \$350,000- \$400,000. You must discuss the initial fees and opening costs with individual companies, although IFA's Franchise Opportunities Guide can supply general information.

15.

WOULD I MAKE A SUCCESSFUL FRANCHISEE?

A successful franchisee should be suited to the industry of which he or she is a part, suited to the particular franchise company, and suited to the franchise system generally. Important questions to ask yourself include: Am I suited to the industry physically and by experience, education, learning capacity, temperament and financial ability? What type of work is most appealing to me? For example, do I enjoy working with food, mechanical things, people, real estate, books and recordings, sporting goods, etc.? Am I prepared to work hard and take financial risks? Do my advisors, family, and friends think I am adaptable and trainable? How do I react to controls? Am I a loner—resenting authority and restraints, or can I accept guidance and direction happily? If I prefer to act as a passive investor in the franchise, will the company accept this? How do I personally feel about the company's image and products and services? The right answers to these types of questions help determine your potential success as a franchisee.

16.

HOW DO YOU EXPLAIN THE SUCCESS RATE FOR FRANCHISED BUSINESSES?

“Success” is a subjective term. Studies that claim high success rates of a franchise business compared to independent businesses should be taken with a “grain of salt”. There are so many variables – the type of business, the location, the general business conditions, and experience and capabilities of the business owners and operations – that it would be difficult to make such comparisons. While the franchisor provides the franchisee with a “turnkey” business operating system, the success of the business ultimately depends on the operator.

The Small Business Administration says most businesses fail from lack of two things -- management skills and adequate capitalization. To insure against these risks, you should be sure that you have adequate capital to operate the business and meet your other financial needs. With a franchised business, your franchisor should be eager to help you overcome problems. Your hard work and the franchisor's expertise constitute a strong team.

17.

HOW CAN I BE SURE I WON'T LOSE MONEY?

No one can be 100% sure. That's why you must be particularly wary of any company which "guarantees" profit or certain success. If you hear a claim about a company that sounds too good to be true, it probably

is. Investigation of all earnings claims made by a franchisor is especially important. But, regardless of earnings claims, you must recognize that your success can come only through hard work. Success or failure ultimately depends on you.

18.

WHAT ARE SOME OF THE DRAWBACKS OF OWNING A FRANCHISE?

In exchange for the security, training, and marketing power of the franchise trademark, you must be able and willing to give up some of your independence. If you are a person who likes to make most decisions on your own or to chart the course of your business alone, a franchise may not be right for you. As a franchise owner, you must comply with the various controls and procedures established by the franchisor. Then, too, all successful businesses require a lot of dedication and plain, hard work. You must be prepared to make that commitment.

19.

WHY SHOULD I BE CONCERNED WHETHER A COMPANY IS A MEMBER OF THE INTERNATIONAL FRANCHISE ASSOCIATION?

Companies that belong to IFA must meet certain membership requirements. They must have a satisfactory financial condition and comply with all applicable franchise laws. In addition, all members must agree to abide by the Code of Ethics. IFA members are kept abreast of every change in franchising laws. IFA provides continuing educational programs for members on how to conduct their businesses. IFA offers programs like a Franchise Sales and Disclosure Law Compliance Training Program, an Ombudsman Program, and an Investor Awareness and Education Program. IFA members receive the latest information about topics such as improving relationships with franchisees, use of technology, public relations, marketing, advertising, field operations, networking, and procedures that a company with an eye to the future must know and implement to compete in the marketplace. IFA members are committed to the future... to learning... to succeeding.

20.

ARE THERE ANY CURRENT TRENDS IN FRANCHISING?

Among the most important trends in franchising today are the internationalization of franchising, the emergence of women and minorities in franchising, and the increased use of technology. All of these have profound and positive effects on franchising and make it an even more dynamic method of doing business today.

International Franchising

- Franchised businesses continue to grow in all corners of the world. Domestic franchisors in many countries are increasingly establishing franchises across borders. More than 400 U.S. franchise systems operate internationally. International franchising has been successful because consumers around the world recognize famous brands as symbols of quality, consistency, service, and value.
- If you are considering the purchase of a franchise, you may want to not limit the scope of your search to franchisors in your home country. Increasingly, franchisors are seeking franchisees internationally, and a foreign-based franchisor may provide you with the franchised opportunity which you are seeking.

- In many cases, foreign-based franchisors offer individual franchises to operate a single unit. They also often offer development rights to operate multiple units and “master franchise” rights. The latter is, essentially, an opportunity to be the “franchisor” for the foreign-based concept in your country or a portion of your country.
- Of course, international franchising presents some different challenges than domestic franchising. For example, if goods will come from overseas, you may need to be aware of various duties, tariffs, and transportation requirements. You also need to consider language and cultural differences. For instance, if you are a franchisee in a different country from the franchisor’s home office, the franchisor’s system may need to be modified for use in your country.

Minorities and Women in Franchising

- Increasing numbers of minorities and women are discovering that franchising can be a good opportunity for everybody. While franchising is not a panacea, it provides a means for mitigating the traditional obstacles that otherwise competent and capable small investors, particularly women and minorities, face: lack of business experience and capital. Franchisors provide managerial training and assistance on an on-going basis and, in some cases, arrange for property leases, provide equipment financing and sale-leaseback programs, and assist franchisees in obtaining financing.
- As a result of a strong economy, women are increasingly in leadership positions in franchising whether through establishing new companies, becoming single and multi-unit franchisees, or having high-level positions at corporate headquarters.
- According to the Center for Women’s Business Research, as of 2004, there are an estimated 10.6 million privately-held, 50% or more women-owned firms in the U.S., accounting for nearly half (47.7%) of all privately-held firms in the country. These firms employ 19.1 million people, and generate \$2.46 trillion in sales.
- As the population of minorities in the U.S. population continues to rise, minority franchising in cities is expected to rise.
- IFA’s Minorities in Franchising Committee and the IFA Educational Foundation’s Diversity Institute provides research, education, and outreach programs to expand the opportunities for minorities in franchising.
- IFA’s Women’s Franchise Committee (WFC) is dedicated to inspiring and encouraging women in franchising by creating a network of business professionals dedicated to strengthening the success of women in franchising. The WFC has created a number of programs and resources in order to achieve this goal, ranging from “how to” guides and conferences to local networking chapters.

Technology and Franchising

There are several trends related to the use of technology in franchising today. First, many franchisors use the internet to communicate with franchise owners and suppliers through secure extranets in order to share critical information, facilitate discussion among the franchise network, post operations manuals and updates, disseminate news about ad campaigns, engage in supply chain management, and gather sales reports automatically and without the need for more labor-intensive data entry. Second, franchisors use the internet to advertise their network to customers. Third, some franchisors use the internet to engage in business-to-consumer (B2C) e-commerce, often with the involvement of franchisees. Fourth, many prospective franchisees glean information and make contact with franchisors using the internet. Some franchisors now report that they get more sales leads from the internet than from any other source. Fifth, some franchisors have started providing disclosures to prospective franchisees by electronic means. Sixth, and finally, franchisors make extensive use of technology in offering their services directly to consumers -- such as networks of businesses that offer website design and web hosting. The prospects for, and reality of, involving technology in franchising make this a very exciting time to own a franchised business.

FOR MORE INFORMATION CONTACT:
INTERNATIONAL FRANCHISE ASSOCIATION
1350 New York Avenue, N.W., Suite 900
Washington, DC 20005-4709
Telephone: (202) 628-8000
Fax: (202) 628-0812
www.franchise.org

NOTE: Unless otherwise stated, the sources for facts in this booklet are from Economic Impact of Franchised Business: A Study for the International Franchise Association Educational Foundation, by PriceWaterhouseCoopers for IFA Educational Foundation, 2004; and The Profile of Franchising (Volume III): Statistical Profile of the 1998 Uniform Franchise Circular (UFC) data, prepared by FRANDATA Corporation for IFA Educational Foundation, February 2000. Both of these publications are currently available from the IFA Educational Foundation. You can also download them for free from www.franchise.org/20questions

This booklet was updated by Bret Lowell and Tao Xu of DLA Piper Rudnick Gray Cary US LLP.

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