

Unbiased Financial Information Provided by Financial Wisdom.

Mistake to Avoid

Not Understanding the Pros and Cons of Franchises

Owning and running a business through a franchise arrangement has become a popular way for many individuals to fulfill their dreams of being entrepreneurs. Types of businesses available in franchise form include everything from popular restaurants to cleaning services and retail stores to auto service centers.

When you buy a franchise, you are often able to sell goods and services that already have name recognition. You often can get a "roadmap" for how the business should be started and operated. However, as with all businesses, there are risks and no guarantees of success.

Be sure to investigate the franchise carefully. You will probably want to have a qualified attorney review the franchise agreement. Make sure you understand all the terms. When considering a franchise opportunity, there are many factors to take into consideration and here are a few.

Costs

In return for the right to use the franchiser's name and get its assistance, there are usually upfront and ongoing payments to the franchiser and costs of starting and operating the business.

Your initial franchise fee may be non-refundable and can be significant. Usually the more recognized the product, the higher the fee. You will also incur startup costs for a location, equipment, inventory, working capital and other things like licenses and insurance.

You will probably also be required to pay ongoing royalty fees. Consider them to be fees for the right to use the franchiser's name in your business. These fees are usually based on revenue and can be owed even if your business does not show a profit. Usually the franchiser is to provide ongoing support, but the royalty fees will probably be due regardless of the level of support you actually receive.

The third type of usual franchise cost is some form of advertising fee. Generally, the franchiser will have some ongoing advertising or promotional activities. Since you are expected to benefit from those activities, you will be expected to participate in their costs.

Controls

To ensure standardization, franchisers will impose some controls on the operation of your business. These can include site approval, design and appearance of your location and types of products offered. There may even be restrictions on how you run the business on a day-to-day basis. One of the other items to watch for is any geographic restriction that may be part of the agreement.

Terminations and Renewals

Your franchise agreement will usually include language covering how, why and when either party may end the agreement. Make sure you understand your rights and those of the franchiser.

Other items to consider

Your investment. How much will be needed and how much can you afford to lose?

Your abilities. Do you have the right combination of technical skills, management abilities and psychological make-up to run a business?

Your goals. What level of income do you want and how much time and effort are you willing to spend.

Type of franchise. Do a complete investigation of the business you are considering. This includes a "due diligence" investigation. Evaluate the demand, competition, support you will receive and the financial dynamics of the opportunity.

Talk to other franchisees. In most franchise arrangements, there is a level of tension between the franchiser and the franchisee. By talking to other franchisees, you can get an understanding of how well or poorly other franchisees are doing.

Be Careful

The history of franchising is full of successes and failures. There are many opportunities that sound too good to be true, and often they are. The federal government and many states have laws covering franchises. You can talk to them or visit their web sites to learn more. The Better Business Bureau, your accountant and your attorney may also be able to offer insights that are important.

Another concept to be wary of is "multi-level marketing programs." These typically involve you recruiting others and getting a royalty on their sales. Make sure it is not a "Ponzi" scheme where the activities may be illegal and ultimately the financial dynamics don't work.

The entrepreneurial spirit is alive and well in many people. If you have that spirit and the drive, a franchise may provide the map to your future financial success. But, be careful.