



# FRANCHISE COMPANY INVESTIGATION PROCEDURE

## **Before you Begin**

You've carefully evaluated yourself and built an individual model that can be used to determine if a franchise opportunity has the components you want. You know what you need to find in a business to match your preferences and desires. You have a picture of what the future will be like for you as a business owner. Now you just need a process to investigate individual franchise companies and determine if they fit perfectly into your plans.

## **Process of Mutual Elimination**

The first thing you need to keep in mind in your investigation is that it is a process of mutual elimination for both you and the franchisor. You might find exactly the franchise you're looking for on the first try but that is highly unlikely, unless you are using a consultant like us to narrow the search for you. You also understand that it is unlikely that any one person contacting the franchisor will turn out to be a great match for them. Therefore you are both trying to determine if the fit seems right from the beginning of the investigation.

Each step in the investigation will require more time and effort on both your parts and provide greater detail until you reach the point where you each have sufficient information to make an informed business decision about whether this is a match that is ideal for both parties. If either party comes to the realization that this is not the right match, they simply inform the other party and move on.

## **Step 1 – General Information**

The franchisor will begin by providing you with overview information on the company (typically a brochure and video package). They will then ask you to provide them with additional information (by filling out a questionnaire) to determine if you have the general characteristics that they are looking for. Assuming that each party is still interested based on this information exchange; you will proceed to the next steps.

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## Step 2 - The Franchise Disclosure Document

This document, commonly referred to as the FDD, is the F. T. C. mandated disclosure document that gives you a wealth of information about the franchisor. The form and composition of the document is standard with any franchisor and must include information on a variety of topics of interest to you. The major subject areas include:

1. The history of the franchise and its officers and directors.
2. A complete description of the business to be franchised.
3. All costs and fees that you will be subject to under the agreement.
4. All obligations of either party to the other during the term of the agreement and thereafter.
5. Any relevant litigation history of the company or its officers.
6. Any business failures, ownership transfers, franchise agreement terminations or other potentially adverse information relating to the success rate of the existing units in the system.
7. Audited financial statements for the previous three years for the franchise company.
8. A list of the existing franchisees.
9. A complete copy of the actual franchise agreement document is usually attached to the FDD but may be provided under separate cover at the option of the franchisor.

A few franchisors also include a financial performance representation (commonly referred to as an earnings claim) in the FDD document. Though they are not required to do so, this can be a real time saver for you if it is included. Even if it is included in the FDD, it is still imperative that you discuss this subject with franchisees during your fact-finding calls and visits.

You will carefully review the FDD document and note any questions or issues that the material raises for further discussion with the franchisor. You may also choose to involve outside advisors to review material you are not familiar with.

## Step 3 - Franchisee Calls and Visits

The most valuable source of information on any franchise system is the existing franchisees. You need to plan on calling and, when possible, visiting a number of the existing franchisees during your investigation. It sounds almost trite but whatever you find the prevailing attitude of the existing franchisees on any issue to be, it would almost certainly be your attitude on the issue as well if you decide to become a franchisee. Visit with a sufficient number of the existing franchisees to ensure you have a sense of the prevailing attitudes of the group.

Though you want to find the overwhelming majority of franchisees to be happy and supportive of the franchisor, it is important to try to find an unhappy franchisee during your investigation. When you do, not only listen to the complaints but also try to determine what makes this franchisee different from the rest. If you find you identify with the positive ones and feel the negative franchisee is not at all like you, then you should be fine. If you find that you are more like the person who is unhappy however, this is probably not the right franchise for you.

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The following list covers the principal areas you want to investigate during these calls:

1. Training Programs – You need to determine how well the initial training programs and support prepared the franchisees for opening and running their business.
2. Opening Support – How easily did the franchisor make the process of getting the first unit open and operating? Was there assistance in site selection, lease negotiation, construction and design assistance, financing assistance, permits or any other factors unique to getting this business up and operating?
3. Ongoing Support – You want to know how effective the ongoing support services of the franchisor are in terms of helping franchisees deal with the problems that come up in the running of their business.
4. Marketing Programs – Most franchisors collect marketing dollars from every franchisee into a pool that is spent to promote the brand. You need to know whether the franchisees are happy and supportive of the way this process is handled. Note: this is typically the area you will find the most complaining about in any franchise you look at.
5. Purchasing Power – Does the franchisor use the collective buying power of the total system to get discounts on supplies and inventory beyond what an independent operator could achieve? This factor is one of the biggest advantages of joining a well run franchise system and will offset much of the fee cost associated with being a franchisee with an effective franchisor.
6. Franchisor/Franchisee Relations – Determine what the franchisees feel about the franchisor in general. Is the franchisor supportive, caring, focused on their success, responsive, effective, organized, and trustworthy? Make sure you have a good feeling about the values of the organization and that they are consistent with your values.
7. Investment – The FDD will give you a wide range for the investment required in the business. Use the franchisee discussions to narrow that down to a reasonable and conservative estimate of how much capital you will need to be successful in this franchise.
8. Earnings – It is critical that you have a strong sense of just where the average unit is in terms of earnings. You should know the answers to the following questions: How much money does the typical unit make given a specified length of time in business? How soon does a typical unit start making money after opening? What is the range of answers for these questions? If you are simply not able to determine these answers to your satisfaction in your research, do not settle! Tell the franchisor of the problem and that you cannot proceed unless you have these answers.

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It is always a good idea to bring up the subject of earnings as the last point in your franchisee visits. Most people are reluctant to discuss their income with strangers and you will find the franchisees are more willing to cover this subject after you have spent some time visiting with them. At that point they know you're not a competitor trying to get information but rather a serious prospective franchisee who will need the information to proceed. They were all in your position at some point in the past.

#### **Step 4 – Review the System Documentation**

A strong franchise company will have documented their systems, operations and marketing programs in a concise and easy to use format for the reference of franchisees. Make sure that such documentation exists. The franchisor will probably not give you a copy of their actual manuals but they can certainly provide you with the table of contents or index of every support manual they have. This will enable you to confirm that the documentation exists and the scope of coverage of all major business factors.

#### **Step 5 – Meet the Franchisor**

At some point in the process of investigation, you will want to have personal meetings with key personnel of the franchise company. This might be possible in your local market or you may need to travel to the headquarters of the franchisor. Many franchisors facilitate this need by holding what are referred to as “discovery days.” These are structured events where you can go to a specified location and know that all of the key people from the franchisor will be available.

Be sure to get to know those people you will be working most closely with in the building of your business. We would expect the President of the company to be an impressive person but that's not who will be answering your call when you have a problem. Find out who will be providing the operational support and training directly to you and form an opinion about their competence. Make sure that any remaining questions or issues you may have are addressed at this meeting.

#### **Step 6 – Make a Decision**

If you have been diligent, the entire process outlined above should have taken about two to four weeks to complete. You have now finished your investigation and have all the information you need to determine if this franchise is right for you. It either is or it isn't, and you'll know which it is. In either case, it is time to make a decision and move on. Use the model you developed for yourself to evaluate what you wanted in a business. Don't settle. If this company has everything you wanted, do it. If it doesn't, eliminate it and go to the next one.

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