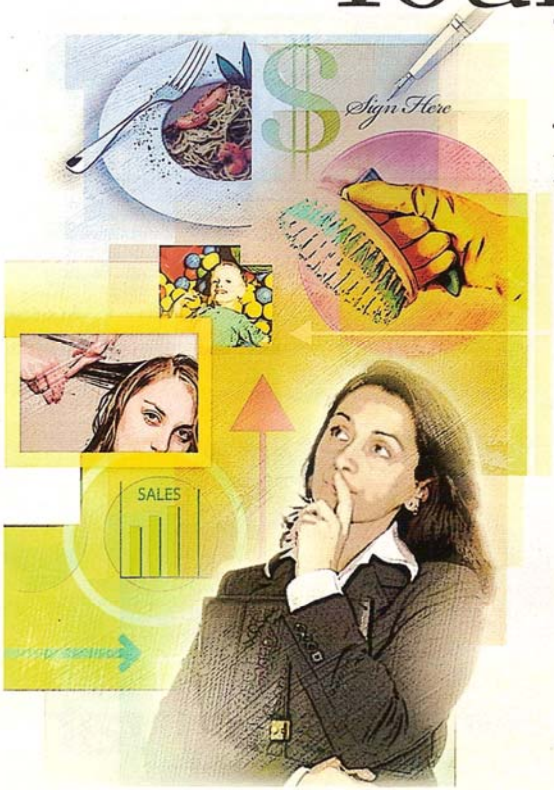
# So You Want Your Own Business?

## Buying a franchise is one way to fulfill your dream—but beware of the possible traps




For as long as she can remember, Carii Liberto, 31, of Kansasville, Wisconsin, has dreamed of running her own business. What held her back? She lacked a concept for a hot new product or service–and she doubted her ability to start a company from scratch.

But in 2005 Liberto, then a sales representative, found the answer to her entrepreneurial aspirations: Dinner by Design, a fast-growing meal-assembly franchisor that lets time-starved customers assemble pre-chopped, measured and seasoned ingredients as entrées that can be frozen and then heated and served later. After two visits to her local Dinner by Design–Liberto loved the cuisine and the convenience–she decided to buy a food-prep franchise of some kind and recruited her mother, Barb Groth, a retired dietitian and sales executive, as her business partner.

From there the duo began an eight-month process of researching meal-assembly corporations; talking to Dinner by Design franchise owners and their competitors; completing reams of paperwork; enlisting a commercial real-estate broker to help them find a location and negotiate a lease; and applying for a bank loan to help fund start-up costs. In 2006 they signed a 10-year contract with Dinner by Design–and paid a $35,000 franchise fee for the right to open a branch in New Berlin, a suburb of Milwaukee. They spent about $131,000 to build the facility and buy equipment and over the next eight months they acquired two more locations in southeastern Wisconsin for an additional $200,000, bringing their total outlay to slightly more than $366,000.

"We're making slow, steady progress, and we're meeting our own goals," says Groth, 57. "Running a business is harder than we imagined, but it's also more fun and rewarding. And doing it as a franchise is easier than starting a brand-new company. We didn't have the expertise to develop the menus, test the entrées or gain partnerships with other major companies–not to mention gather all the marketing tips we've picked up from conferences for franchisees."

Liberto and Groth are among the growing number of women who are turning to franchising as a way to work CONTINUED

ILLUSTRATION: ROY SCOTT

for themselves and escape the limits of corporate life but also enjoy the benefits franchising affords: brand recognition that attracts customers right away; start-up training; ongoing support services from the franchise company; and a proven business plan to execute.

Of course, as many discover, franchising isn't without risks. If the parent corporation goes out of business, you could, too. Or if it's acquired by another company–a common occurrence–the new owner may require you to make sweeping changes to convert to its brand. "The franchisee's bottom line may go south or may dramatically improve depending on who is doing the buying," says John Matthews, president and CEO of Gray Cat Enterprises, in North Barrington, Illinois, a consulting firm for the franchise industry.

## It's possible to earn a six-figure income as a franchise owner, but not likely

Nor is buying a franchise a get-rich-quick scheme–or much of a get-rich-slow plan, either. Like any new business venture, a franchise must be nurtured before it delivers on the initial investment, and while it's possible to earn a six-figure income as a franchise owner, it's not likely, especially if you operate just one outlet. Liberto and Groth didn't turn a profit until their first Dinner by Design had been open one year. They're also working harder than they did in the corporate world–12-hour days during the week and half days on weekends–and while Liberto earns $35,000 a year, Groth is forgoing a salary until their three locations are financially secure (by the end of this year, they expect).

Before you invest your life's savings to open a franchise, experts advise you to weigh the pros and cons, then proceed with caution. "Even if you're purchasing an established franchise, do your homework," warns Susan P. Kezios, president of the American Franchisee Association, a Chicago-based trade association of franchise owners. Here are some factors to consider before signing on:

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**Start-Up Costs**

Buying a franchise isn't cheap. The price varies substantially and depends on the type of business: It takes an estimated $655,000 to $1,255,000 to invest in a McDonald's, yet only an estimated $11,800 to $522,800 to invest in a Century 21 Real Estate company. Franchisors also set minimum net worth requirements for prospective franchisees to ensure that they've got the cash flow to keep the business afloat in the inevitable early lean period.

Most franchise owners use a combination of personal savings and loans from family, friends, banks or the U.S. Small Business Administration to fund start-up costs. Some franchisors offer financing, but their rates tend to be higher, according to Joe Mathews, owner of Franchise Performance Group, a consulting firm in Litchfield, Connecticut, so always comparison shop for the best rates.

**Potential Returns**

It can be tough to calculate how much money you can earn as a franchise owner. As a general rule, Mathews recommends that you use this formula to project earnings after a ramp-up period of a year or two: Take your investment cost and multiply it by 40 to 50 percent. For example, a $200,000 investment in an industry-leading franchise should result in eventual annual owner earnings of $80,000 to $100,000. Also, be aware that the average resale value of a franchise is 2.5 times what the owner earns. "So if you open a franchise for $250,000 and you make $75,000 a year, your business may be worth under $200,000 should you decide to sell," Mathews says.

It may sound counterintuitive to think about selling a business you haven't yet bought, but consider it part of your due diligence. Like it or not, most franchise agreements are a 10- to 20-year commitment. If you want or need to sell, you can; however, the franchisor must approve the new buyer on the basis of its financial criteria, and there is a transfer fee usually factored into the initial sales price, around 15 to 40 percent of the franchise fee.

**Franchise Agreements and Obligations**

Franchisees are expected to execute the franchisor's business plan, implement uniform systems and follow the rules in the operating manual–not add products or services at their whim, and not change the color of the menu or the logo on printed materials. To find out exactly what you'd be getting into, request the franchisor's Uniform Franchise Offering Circular (UFOC)–a legal document that spells out CONTINUED

**Franchisors can, and do, require you to make changes—on your own dime**

the obligations of the franchisor and franchisee and the terms that will govern the relationship for the length of the contract.

The UFOC covers 23 key areas, including the upfront franchise fee (midrange is $20,000 to $40,000); the annual royalties franchisors charge their franchisees (between 5 and 10 percent of the franchisees' gross sales); the amount franchisees must contribute annually to the corporate advertising budget (ranging from one-half percent to 5 percent of gross sales); and the annual amount that franchisees pay to the local, regional or national advertising budget. For example, Liberto and Groth pay 1 percent of their sales to Dinner by Design's national advertising fund and another 2 percent to the co-op advertising in their area. In return, they've received advertising support from Dinner by Design, upgrades to their Web site, and seasonal promotions with nationally recognized companies; through their co-op, they've purchased TV advertising and commercials on two Milwaukee radio stations.

Review the UFOCs of several franchisors in your chosen industry and compare their terms to see which one is the most favorable and least restrictive. Here are some sticky areas that you should evaluate carefully, according to Mathews:

- **Are franchisees required to buy supplies exclusively from the franchisor or another specific source?** The franchisor may insist that you buy from certain suppliers, or may itself be the sole supplier for the products and services it sells, so it may mark up the price to cover its own costs.
- **Is the franchisee's territory truly exclusive–or does the franchisor reserve the right to open outlets within those limits?** Many retail and restaurant franchisors do not offer an exclusive territory. In fact, says Mathews, franchisors such as Quiznos have gained a reputation for cannibalizing successful franchisees' businesses by allowing too many locations to open in close proximity to one another.
- **How many changes can the franchisor make over the life of the franchise agreement?** "You're agreeing to comply with the franchise corporation's procedures as they may change from time to time, and they do," Kezios warns. "If the franchisor decides tonight that tomorrow morning the menu board will be larger or smaller or in some way different, the costs to make the changes are yours, not its."

After you've submitted your application to the franchisor, a recruiter will call to give you the hard sell. Resist pressure tactics. "Often these are salespeople, and their job is to sell franchises–not evaluate whether you're the right person to run one," Mathews cautions. It's essential to talk to current franchisees, who can explain their working relationship with the franchisor and discuss financial information that franchisors aren't legally required to disclose in the UFOC–and usually don't. While the franchisor will refer you to satisfied and successful franchisees, it's also wise to seek out some on your own so that you'll hear the unvarnished truth. Among the questions to ask franchisees:

- **Did the franchisor's training adequately prepare you to run the business?**
- **Does the franchisor's support, such as educational seminars and technical assistance, make a difference?**
- **Has the franchisor imposed changes you had to pay for?**
- **When did you start making money?**
- **Knowing what you know now, would you still buy the franchise?**

Experts also provide valuable guidance. Hire an accountant to help you understand the franchisor's financial picture, assess your risk and set realistic goals. Contact the Better Business Bureau in the city where the franchisor has its headquarters to find out whether consumers have complained about its products or services; check with your state attorney general's office for details about the rights of franchise owners.

Finally, hire an experienced franchisee attorney to review the complex UFOC and franchise contract. (For a list of lawyers, visit the American Franchisee Association at *www.franchisee.org* and click on "legal resources." Or visit the International Franchise Association at *www.franchise.org*, search for "attorney" and click on "supplier.") Not only can an attorney help you understand your obligations under the contract, but she may be able to negotiate better terms for you. "The franchisor's salesperson may not offer to change the current deal, but an experienced franchisee attorney can help you negotiate a better one," Kezios says. "Newer and smaller franchisors often are more open to changing the terms."