



FRANCHISE DUE DILIGENCE STEPS

As Excerpted from “The Franchise MBA – Mastering the Four Steps”

“How to get from Point A to Point Z”

Get Ready – Know Thyself

You’ve taken careful stock of who you and what you want to achieve with business ownership. Having built a franchise model that articulates your goals you can now use this to see if a franchise business has the components that are important to you. This should be able to help you visualize exactly what your future and life will be like if you own a business. The next step is to have a process to investigate various franchise systems and understand if they will match your goals.

Get Set – Do You Like These People?

It is important to keep in mind in your investigation is that it is a process of mutual elimination for both you and the franchisor. You may find the franchise you’re looking for on the first try but that is highly unlikely, unless you are using a consultant 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. The role of a consultant in this regard is important because they are uniquely qualified to understand the landscape of franchising as well as who the right fit is. The franchisors value this service as it saves them time in their development goals. Therefore you are both trying to determine if the fit seems right from the beginning of the investigation.

As you continue to learn more about each other, 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 Overview

The franchisor will begin by providing you with overview information on the company (typically with an email, a call or a package in the mail). 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.

Step 2 - The Franchise Disclosure Document

You will receive a 300 +/- page document shortly after your initial call with the franchisor. 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 – Talking and Visiting with Franchisees

One of the reasons franchising has been so successful is that you can speak and visit with existing franchise owners. 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. You will find that whatever 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. Make sure you put in the time to speak with as many franchisees as possible 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 have a balanced understanding of what the downsides of the business are as well. Speaking with unhappy franchisees during your investigation will give you important insights as well. When you do, listen not only 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.

The points below are some of the areas that are important to understand as you conduct your due diligence.

1. Training – how will the franchisor onboard you and get you up to speed on the systems. Imagine this like going back to school. Do you feel you are going to an elite academy? Are you going to learn what is required for opening and running your business?
2. Opening Your Business - How much support and of what quality is the initial support? Does the franchisor help you in every aspect of the opening process from site selection, lease negotiation, construction guidance, financing, permits or any of the other factors required to get the business up and running?
3. Continuing Support – Once the business is up and running, how good is the franchisor in helping you maximize your revenues and profit?
4. Marketing & Advertising – The power of franchising is in its ability to pool resources to project an image larger than any single franchisee can. Does the franchise you are looking at do this effectively? Are the franchisees happy with the support they are getting? Remember – oftentimes, this is an area that franchisees feel the franchisor could be doing more for them in!
5. Buyer & Purchasing Power – By pooling resources from all the franchise owners, the franchise system should be able to achieve pricing on supplies, necessary products or marketing mediums greater than what you can achieve on your own. This is a key consideration in joining a franchise and you should be able to quantify the savings you will enjoy by being part of a network across the entire spectrum of business inputs.
6. Franchisor / Franchisee Relationship – what do the franchisees you are talking with think about the franchisor? Is it a healthy relationship? Does the franchisor care about the franchisees and support them in a way that is mutually beneficial? Are they organized? Are they trustworthy? Does the relationship make you feel energized to be a part of the team?
7. Costs - What are the costs to get the business up and running as well as down the road to make further investments into marketing and infrastructure? The Franchise Disclosure Document will outline all of these costs. Are you comfortable with the investment?
8. Potential Revenue & Profit – what can you make?!?! What are you learning from your conversations with franchise owners? What is the average unit revenue and net profit? Think about how to quantify these questions. You'll find most franchisees were once in a very similar position to you and are willing to share with you metrics such as the length of time to break even, speed to generating revenue and profit. Make the franchisor an active partner in this aspect if you are not able to understand the financials of the franchise. While the franchisor cannot make “forward looking” earnings claims, they can share information they disclose in their FDD. While most franchise owners are understandably reticent in sharing detailed financial information, by being an active listener and showing positive intent, you'll find they will remember what it was like when they were trying to get the answers to the same questions you now have.

Step 4– Systems & Process Review

A solid franchise system is a collection of ‘standard operating protocols’ that have been tested and vetted over a wide range of franchisees. Read through these and make sure you understand them thoroughly. Are they clear and concise? Do they cover areas that you understand to be

important? Do the franchisees you talk with attest to the value of the systems? If the franchisor won't give you their "manual" they should at least be able to give you a good overview and the FDD typically has a description of the training program categories similar to an index in a book.

Step 5 – Meet the Team!

Imagine getting married without meeting your spouse. Joining a franchise system is an exercise in business and relational partnership. You will want to meet the home office and spend time with everyone from the CEO to the support team who will work with you in the field. While the CEO of the company is likely to be a charismatic and engaging individual, the rest of the team is equally important. This is the team that is going to support you from start up to the various stages of growth in your business and you should feel a high level of comfort in their professionalism and ability to help you. Get to know these people fully, ask every question you have and ask yourself if you can work with them.

Step 6 – Go / No Go (Decision Time!)

Typically, this is a process that takes between 40 to 60 hours from start to finish. If you have taken the time to understand the business, the people and the industry potential, you should be at a place where you know if this is what you want to. If you're not feeling it – that is an answer for a NO GO decision. You will, of course feel fear if you're not sure. This is a big decision and big decisions are not easy. However, if you have done a thorough job and articulated your goals well through your business model then you should be in a position to evaluate if this is the right move. Don't settle for second best. If the company doesn't have the criteria important to you, terminate the investigation, write down what you learned about what you liked and disliked and use that to search for the another business. If the company has the ability to propel you forward and help you attain your goals – go for it! Pursue your passion. The things you have always wanted to do are within your abilities.