

Entrepreneurs Need To Research Franchises Before Signing An Agreement

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Written by Sandi S. Alswager

Opening a franchise can be a good way for entrepreneurs to launch small businesses without having to start from scratch. In a franchise, the franchisor allows the franchisee the right to sell or distribute a service or product under the franchisor's system. In return, the franchisee pays a fee called a royalty to the franchisor. The primary advantage of franchising is the franchisee is immediately able to compete with larger companies by utilizing the goodwill, quality standards and experience of the franchisor.

There are several types of franchises. Brand-name franchises allow franchisees to market products or services under a brand name in order to take advantage of the franchisor's name recognition. Affiliate franchises are groups of similar businesses that join for the purpose of marketing their services. Product-distribution franchises usually operate under a license from the franchisor, which allows marketing of the franchisor's products and services in specific areas. Business-format franchises are the most common and fastest growing.

The Federal Trade Commission first adopted regulations covering franchises in 1978 and since then about 25 states have adopted some type of regulations. These rules usually require registration by the franchisor prior to sale. They also address the parties' relationship under the franchise agreement, particularly regarding term renewal and extension.

Most regulations also require that certain disclosures be made by the franchisor to the franchisee, but these disclosure laws rarely focus on the specific details of the deal. Therefore, entrepreneurs should review the franchise agreement carefully, and retain experienced legal counsel from the beginning.

Operating a franchise isn't for everyone. Some franchisors are control-oriented and will monitor and regulate virtually every aspect of the business. If entrepreneurs are not interested in having the franchisor looking over their shoulder, the franchising may not be ideal for them.

It's also important to be aware of scams that can lure uninformed entrepreneurs into losing their money. The best way to find out about franchising opportunities is at the library. Another way is to talk with people who currently own franchises. Look in the business section of financial and business newspapers and periodicals; many franchisors and owners advertise for buyers in these publications. Franchise trade shows are held in several cities, but entrepreneurs should beware of these. Many of the franchisors at the shows are small, disorganized operations so research them thoroughly before applying.

When making an agreement with a franchiser, it's important to remember that each is different. Don't be afraid to ask the franchiser to explain why a particular term is fair or necessary; the agreement is negotiable even though it comes on a standard form. Entrepreneurs can seek experienced legal counsel to help negotiate a fair deal or they can walk away if they can't reach a fair agreement with the franchiser.

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SOURCE: Marilyn Schlake, program coordinator, Center For Applied Rural Innovation, Nebraska EDGE program, NU/IANR; NX Level Guide, 2000