

A Consumer's Guide to Buying a Franchise

Contents

The Franchise Business Model	1
Costs	
Franchisor Controls	
Contractual Obligations	
Is a Franchise Right for You?	3
Your Investment	
Your Abilities	
Your Goals	
Finding the Right Opportunity	3
Local Outlets	
Franchise Exposition	
Franchise Broker	
Selecting a Franchise	5
Demand	
Competition	
Your Ability to Operate the Business	
Name Recognition	
Complaints About the Franchise	
Training and Support Services	
Franchisor's Experience	
Growth	
The Franchise Disclosure Document	6
Franchisor's Background (FDD Item 1)	
Business Background (FDD Item 2)	
Litigation History (FDD Item 3)	
Bankruptcy (FDD Item 4)	
Initial and Ongoing Costs (FDD Items 5-7)	
Supplier, Territory and Customer Restrictions (FDD Items 8 and 12)	
Franchisor's Advertising and Training (FDD Item 11)	
Renewal, Termination, Transfer and Dispute Resolution (FDD Item 17)	
Financial Performance Representations (FDD Item 19)	
Franchisee and Franchise System Information (FDD Item 20)	
Financial Statements (FDD Item 21)	
Evaluating Potential Earnings	11
Is the Earnings Claim Typical for a Franchise in this System?	
Average Income	
Gross Sales	
Net Profits	
Geographic Relevance	
Franchisees' Backgrounds	
Reliance on Earnings Claims	
Before You Sign the Franchise Agreement	12
Additional Sources of Information	
Opportunity to Comment	
The Franchise Disclosure Document (FDD)	14

When you buy a franchise, you may be able to sell goods and services that have instant name recognition, and get training and support that can help you succeed. But purchasing a franchise is like any other investment: there's no guarantee of success.

The Federal Trade Commission, the nation's consumer protection agency, has prepared this Guide to help you decide if a franchise is right for you. It suggests ways to shop for a franchise opportunity and highlights key questions you need to ask before you invest. The Guide also explains how to use the disclosure document that franchisors must give you — under the FTC's Franchise Rule — so you can investigate and evaluate a franchise opportunity.

The Franchise Business Model

A franchise enables you, the investor or franchisee, to operate a business. You pay a franchise fee and you get a format or system developed by the company (franchisor), the right to use the franchisor's name for a specific number of years and assistance. For example, the franchisor may provide you with help in finding a location for your outlet; initial training and an operating manual; and advice on management, marketing or personnel. The franchisor may provide support through periodic newsletters, a toll-free telephone number, a website or scheduled workshops or seminars.

Owning a franchise comes with defined costs, franchisor controls and contractual obligations.

Costs

In exchange for the right to use the franchisor's name and benefit from the franchisor's assistance, you will pay some or all of the following:

Initial Franchise Fee and Other Expenses

Your initial franchise fee will typically range from tens of thousands of dollars to several hundred thousand dollars and may be non-refundable. You may face significant costs to rent, build and equip an outlet and to buy initial inventory. You also may have to pay for operating licenses and insurance and a "grand opening" fee to the franchisor to promote your new outlet.

Continuing Royalty Payments

You may have to pay the franchisor royalties based on a percentage of your weekly or monthly gross income. Typically, you must pay royalties for the right to use the franchisor's name, even if you are losing money. You may have to pay royalties for the duration of your franchise agreement even if the franchisor doesn't provide the services it promised and even if you decide to terminate your franchisee agreement early.

Advertising Fees

You also may have to contribute to an advertising fund. Some portion of the advertising fees may be allocated to national advertising or to attract new franchise owners, rather than to promote your outlet.

Franchisor Controls

To ensure uniformity, franchisors usually control how franchisees conduct business. These controls may significantly restrict your ability to exercise your own business judgment. A franchisor may control:

Site Approval

Many franchisors retain the right to approve sites for their outlets, and may not approve a site you select. Some franchisors conduct extensive site studies as part of the approval process and a site they approve may be more likely to attract customers.

Design or Appearance Standards

Franchisors may impose design or appearance standards to ensure a uniform look among their outlets. Some franchisors require periodic renovations or design changes; complying with these requirements may increase your costs.

Restrictions on Goods and Services You Sell

Franchisors may restrict the goods and services you sell. For example, if you own a restaurant franchise, you may not be able to make any changes to your menu. If you own an automobile transmission repair franchise, you may not be able to perform other types of automotive work, like brake or electrical system repairs.

Restrictions on Method of Operation

Franchisors may require that you operate in a particular way. They may dictate hours; pre-approve signs, employee uniforms and advertisements; or demand that you use certain accounting or bookkeeping procedures. In some cases, a franchise advertising cooperative may require you to sell some goods or services at specific discounted prices, which may affect your profits. Or, the franchisor may require that you buy supplies only from an approved supplier, even if you can buy similar goods elsewhere for less.

Restrictions on Sales Area

A franchisor may limit your business to a specific location or sales territory. If you have an “exclusive” or “protected” territory, it may prevent the franchisor and other franchisees from opening competing outlets or serving customers in your territory, but it may not protect you from all competition by the franchisor. For example, the franchisor may have the right to offer the same goods or services in your sales area through its own website, catalogs, other retailers or competing outlets of a different company-owned franchise.

Contractual Obligations

Franchise contracts last only for the number of years stated in the contract. You can lose the right to your franchise if you don't comply with the contract. Also, keep in mind that you may not have a right to renew the contract unless the franchisor gives you that right.

Terminations

A franchisor can end your franchise agreement for a variety of reasons, including your failure to pay royalties or abide by performance standards and sales restrictions. Many franchise contracts will give you a chance to “cure” an occasional failure to comply (like making one late payment) but keep the right to terminate your franchise for other failures. If your franchise is terminated, you're likely to lose your entire investment.

Renewals

Franchise agreements may run for as long as 20 years. Renewals are not automatic. At the end of the contract term, the franchisor may decline to renew or may offer a renewal that doesn't have the same terms and conditions as your original contract. For example, the franchisor may raise the royalty payments, impose new design standards and sales restrictions, or reduce your territory. Any of these changes may result in higher costs, reduced profits or more competition from company-owned outlets or other franchisees.

Is a Franchise Right for You?

Before you invest in a particular franchise system, think about how much money you have to invest, your abilities and your goals. Be brutally honest.

Your Investment

- How much money do you have to invest?
- How much money can you afford to lose?
- Are you purchasing the franchise alone or with partners?
- Do you need financing? Where will you get it? What's your credit rating and credit score?
- Do you have savings or additional income to live on until your franchise opens and, you hope, becomes profitable?

Your Abilities

- Does the franchise require technical experience or special training or education — for example, auto repair, home and office decorating or tax preparation?
- What special skills can you bring to this business?
- What experience do you have as a business owner or manager?

Your Goals

- What are your reasons for buying a particular franchise?
- Do you need a specific minimum annual income?
- Do you want to work in a particular field?
- Are you interested in retail sales or performing a service?
- How many hours can you work? How many are you willing to work?
- Do you intend to operate the business yourself or hire a manager?
- Will franchise ownership be your main source of income or a supplement to your current income?
- Are you in this for the long term?
- Would you like to own several outlets?
- Are you willing to let the franchisor be your boss?

Finding the Right Opportunity

There are many ways other than franchisors' websites to find information about franchise opportunities, including visiting local franchised outlets, attending franchise expositions and working with franchise brokers. You can find a lot of information online, in books, or trade magazines about different franchise opportunities. These resources may be particularly helpful if you don't know the type of business you want, or if you want to learn more about which franchises are available in the type of business that interests you.

Local Outlets

It's always a good idea to visit franchised outlets in your area and talk to the owners about their experience with particular franchisors.

Franchise Exposition

Attending a franchise exposition allows you to see and compare a variety of franchise possibilities at one time. Before you attend, research the kind of franchise that may best suit your budget, experience and goals. When you attend, visit several franchise exhibitors who deal with the type of industry that appeals to you. Ask questions, including:

- How many franchised outlets are there? Where are they?
- What is the initial franchise fee? What are the additional start-up costs?
- Are there continuing royalty payments? How much are they?
- What management, technical and other support does the franchisor offer?
- What controls does the franchisor impose?
- How long has the franchisor been in business?

Exhibitors may offer you incentives to attend a promotional meeting to discuss the franchise in detail. These meetings can be another source of information and give you a chance to raise questions, but they may also expose you to high-pressure sales tactics. Be prepared to walk away from any franchise opportunity — and promotion — that does not fit your needs.

Franchise Broker

Franchise brokers may call themselves “business coaches,” “advisors,” “referral sources” or “sales consultants.” They often advertise on the internet and in business magazines, offering to help you select among various franchise options. Typically, a broker reviews the amount of money you have to invest and then directs you to opportunities that match your interests and resources. A broker also may help you finish applications and the paperwork to complete the sale. Brokers often work for franchisors, and are paid only if a sale is made.

Before you decide to use a broker, consider whether you need a broker’s services or could get enough information by shopping online or reading trade magazines. If you go with a broker, be sure to always review any application or paperwork completed by a broker on your behalf. Ask questions and get answers if any of the information in the application or paperwork differs from the information included in the Franchise Disclosure Document (FDD).

What choices does the broker offer?

Some franchise brokers may claim to be able to match you with “the perfect opportunity” because they represent a wide range of business sellers. That may be true — or not.

Ask how many franchisors the broker represents. A broker who represents only a few franchisors will give you limited suggestions.

How does the broker select franchises?

Some franchise brokers may claim they will suggest only those franchises that meet certain standards. You may think this means that your risk is limited because the broker weeds out poor investments. In fact, some brokers represent any franchisor willing to pay them a commission for a sale. A broker who does that might direct you to a franchisor that is failing or doesn’t have a strong history.

Ask how the broker selects franchisors to represent. Ask to see the selection criteria and how many franchisors the broker has recently turned down.

How is the broker paid?

Some brokers earn a flat fee regardless of the price of the franchise they sell. Others earn a commission based on the cost of the franchise. These brokers may steer you toward a more costly franchise to increase their commission.

Ask who pays the broker and how the payment is calculated. Find out whether the broker earns a commission based on the cost of the franchise. If he or she does, consider whether the broker is suggesting a higher priced franchise in order to earn a larger commission.

Are the broker's earnings claims reliable?

To convince you to buy a particular franchise, a broker may talk about how much money you can make. These claims may not be true or can be misleading. For example, the figures may be based on earnings in an area where there is high demand for the franchisor's goods or services. Or the claim may be based on outdated industry data. In some instances, earnings claims may use gross sales figures, but when you consider likely expenses, you may find that actual earnings will be far less. Because earnings representations may be misleading, franchisors and their sales representatives aren't allowed to make claims about sales, income or profits unless the claims are included in the franchise disclosures the franchisor must give you.

If the broker says you can make a certain amount of money, compare that to what the Franchise Disclosure Document says. It's what the franchisor or franchise seller has to give you. If those numbers are different, you should consider walking away from the deal.

The required franchise disclosures will list the names and contact information for the franchisor's current and former franchisees. Talk to them, rather than relying on information from the broker alone. Ask about their experience with the franchisor.

Selecting a Franchise

Purchasing a franchise is like any other investment: it comes with risk. When you consider a particular franchise, think about demand for the products or services it offers, whether competitors offer similar products or services, the level of support you will receive and the franchisor's reputation.

Demand

Is there a demand for the franchisor's products or services in your community? Is it seasonal or evergreen? Could you be dealing with a fad? Does the product or service generate repeat business? Is the franchisor's name so well known that it will bring in customers, or will you have to create a market for the franchise?

Competition

What's the level of competition — nationally, regionally and locally? How many franchised and company-owned outlets are in your area? Does the franchise sell products or services that are easily available online or through a catalog? How many competing companies, including competing franchises, sell similar products or services at a similar price? Are those companies well established or widely recognized in your community?

Your Ability to Operate the Business

Sometimes, franchise systems fail. What will happen to your business if the franchisor closes up shop? Will you need the franchisor's ongoing training, advertising or other help to remain in business? Will you have access to the same suppliers? Could you conduct the business alone if you have to cut costs or lay anyone off?

Name Recognition

Buying a franchise gives you the right to associate with the franchisor's name or brand. An established franchise with a well-known name — and good reputation — is more likely to draw customers than

a relatively new or unknown franchise. If you invest in a franchise, you'll be responsible for creating customer demand for its goods or services in your area.

Consider:

- how long the franchisor has been in business
- name and brand recognition for the franchisor and its products or services
- whether the franchisor has a reputation for quality products or services

You'll want to find out from the required disclosure document whether the franchisor has a federally registered trademark. If it doesn't, a company using the same mark in your area could force you to change the name or mark of your outlet at your expense.

Complaints About the Franchise

It's also a good idea to check whether consumers or franchisees have filed complaints against the franchise or franchisor with state franchise regulators, Better Business Bureaus (BBBs) or local consumer protection agencies in your state or the franchisor's home state. Read more about how to check out a franchise in "Additional Sources of Information" at the end of this Guide.

Training and Support Services

What training and continuing support does the franchisor provide? Does the training measure up to the training provided by other franchisors in the same type of business and for workers in that field? Can you compete with others who have more formal training? What backgrounds do the current franchise owners have? Is your education, experience or training similar? What do current franchise owners say about the quality and usefulness of the training they received?

Franchisor's Experience

Many franchisors that operate well-established companies have years of experience selling goods or services and managing a franchise system. Some franchisors started by operating their own business. There's no guarantee, however, that a successful entrepreneur can successfully manage a franchise system. Find out how long the franchisor has managed a franchise system. Does the franchisor have enough expertise to make you feel comfortable? If the franchisor has little experience managing a chain of franchises, take promises about guidance, training and other support with the proverbial grain of salt.

Growth

A growing franchise system increases the franchisor's name and brand recognition and may enable you to attract customers. But growth alone doesn't ensure that franchisees will be successful. In fact, a franchisor that grows too quickly may not be able to support its franchisees with the services it promises them. Investigate the franchisor's financial assets and resources. Are they sufficient to support you and all the other new outlets the franchisor plans to open?

The Franchise Disclosure Document

Before you invest in any franchise, get a copy of the franchisor's Franchise Disclosure Document (FDD). The FDD requires franchise sellers to disclose 23 items of information about the franchise. Under the Franchise Rule enforced by the FTC, you must receive the document at least 14 days before you are asked to sign any contract or pay any money to the franchisor or an affiliate of the franchisor. You have the right to ask for — and get — a copy of the FDD once the franchisor has received your application and agreed to consider it. Indeed, you may want to get a copy of the franchisor's FDD before you spend any money to investigate the franchise offering.

The franchisor may give you a copy of its FDD on paper, via email, through a web page or on a disc. The cover of the FDD must provide information about the available formats. Make sure you have a copy of the FDD in a format that is convenient for you, and keep a copy for reference.

Read each of the 23 numbered “Items” in the FDD. Don’t be shy about asking for explanations, clarifications and answers to your questions before you invest. Here are some, but not all, of the key sections of the FDD:

Franchisor’s Background (FDD Item 1)

Item 1 tells you how long the franchisor has been in business and its likely competition. It also lets you know if there are any legal requirements unique to the franchised business, like a requirement that you get a special license or permit. This will help you understand the costs and risks you will take on if you purchase and operate the franchise.

Business Background (FDD Item 2)

Item 2 identifies the executives of the franchise system and describes their experience. Pay attention to their general business backgrounds, their experience in managing a franchise system and how long they’ve been with the franchisor.

Litigation History (FDD Item 3)

Item 3 lists important information about prior litigation, including whether the franchisor or any of its executive officers have been convicted of felonies, or are subject to any state or federal injunctions relating to the franchise or to a Federal, State, or Canadian franchise, securities, antitrust, trade regulation, or trade practice law. In addition, this item will tell you whether the franchisor or any of its executives have been held liable in, or settled, civil actions alleging franchise-law violations, fraud, or deceptive or unfair trade practices. If there have been many claims against the franchisor, it may mean the franchisor has not performed according to its agreements. Or it could show that franchisees are dissatisfied with its performance.

Item 3 also should say whether the franchisor has sued any of its franchisees during the last year. That disclosure may indicate common types of problems in the franchise system. For example, if a franchisor sued franchisees for failing to pay royalties, it could be because franchisees weren’t successful, and weren’t willing or able to make their royalty payments.

Bankruptcy (FDD Item 4)

Item 4 discloses whether the franchisor or its predecessor, affiliates or any of its executives have been involved in a recent bankruptcy. If the franchisor or its predecessor or affiliate has declared bankruptcy, carefully review the franchisor’s financial statements in Item 21 of the FDD to see if the franchisor is financially capable of delivering the support services it promises. Consider having an accountant review the required financial statements too.

Initial and Ongoing Costs (FDD Items 5-7)

These items describe some of the costs involved in starting and operating a franchise, including deposits or franchise fees that may be non-refundable, and costs for initial inventory, signs, equipment, leases or rentals. It also explains ongoing costs, like royalties and advertising fees. In addition, ask or find out about:

- grand opening or other initial business promotions
- business and operating licenses
- product or service supply costs

- real estate and leasehold improvements
- required equipment, such as a computer system or a security system
- training
- business insurance
- compliance with local ordinances, such as zoning, waste removal, and fire and other safety codes
- employee salaries

You'll need to investigate other initial and ongoing costs that aren't described in Items 5-7, such as the cost of accounting and legal help.

It may take several months to start your business, and it may take more than a year to break even. Some franchises never break even. Estimate your operating expenses for the first year and your personal living expenses for up to two years. Compare your cost estimates for the franchise with what other franchisees in this system and competing systems have paid. An accountant can help you evaluate this information. You may be able to do better with another franchisor.

Supplier, Territory and Customer Restrictions (FDD Items 8 and 12)

These items tell you whether the franchisor limits:

- suppliers from whom you may purchase goods
- the goods or services you may offer for sale
- where and to whom you can sell goods or services
- your use of the internet to sell goods or services to customers within and outside your territory
- the right of the franchisor (or other franchisees) to use the internet to solicit customers or to sell in your territory

These kinds of restrictions may limit your ability to exercise your own business judgment in operating your outlet. If the franchisor does not limit the territory where each franchisee can sell, the franchisor and other franchisees may compete with you for the same customers by establishing their own outlets or selling through the internet, catalogs or telemarketing.

Franchisor's Advertising and Training (FDD Item 11)

The FDD includes important summaries of the franchise system's advertising programs and the initial and ongoing training the franchisor will provide. Talk to the franchisor and current franchisees to get answers to your questions.

Advertising

Franchisees are often required to contribute a percentage of their sales to one or more national, regional or local advertising funds. Ask the franchisor what advertising it has done and what is being planned.

Ask whether franchisees have any control over how advertising dollars are spent, and if all franchisees and company outlets contribute equally to the advertising funds. Find out if the franchisor gets a commission or rebate when it places ads. If there is a rebate, who benefits — you or the franchisor?

See what percentage of the fund is spent on:

- administrative costs
- national advertising
- advertising in your area
- selling more franchises
- other expenses

Read Item 11 to learn whether franchisees need the franchisor's consent to develop and buy their own advertising. If they buy their own advertising, do they get a rebate or discount on their advertising contribution?

Training

New franchisees typically count on the franchisor to provide all the business and operational training needed to run a successful franchise. The training you need depends on your business experience and knowledge of the franchisor's goods and services. Check Item 11 for information about:

- the trainers and their qualifications
- who is eligible for training
- the cost of training new employees and who pays
- the length of training sessions
- the amount of time spent on technical training, business management training and marketing
- whether the franchisor offers ongoing training and at what cost
- whether support staff are available for trouble-shooting in your area and how many franchisees they are responsible for
- whether on-site individual assistance is available and at what cost

Be sure to talk with recent franchisees about the quality of training the franchisor provides. If — after you read the information in Item 11 and talk with franchisees — you still aren't sure you'll get the training you need, ask the franchisor if you can review the training materials. If the franchisor won't provide them, even if you volunteer to sign a confidentiality agreement, consider a different franchise opportunity.

Renewal, Termination, Transfer and Dispute Resolution (FDD Item 17)

Item 17 covers important topics. First, it states whether you can renew your franchise at the end of the term, and, if you can renew:

- what you must do to qualify for renewal
- whether fees and other contract terms may change

Item 17 also explains what your obligations would be to the franchisor after termination. For example, after termination, restrictions in the contract typically will stop you from operating a business that would compete with your prior franchise, if the new business is within a specified distance of your prior outlet. The restrictions may also prevent you from operating a new business within a specified distance of any other outlets of the franchise. The restrictions may last as long as three years.

Additionally, Item 17 describes what you must do to get the franchisor's approval if you want to sell your franchise. Lastly, it states whether you have the right to go to court if you have a dispute with the franchisor, or must use arbitration instead.

Financial Performance Representations (FDD Item 19)

Item 19 contains claims the franchisor chooses to make about the sales or earnings of its franchises for which there is a reasonable factual basis. The Franchise Rule doesn't require a franchisor to provide sales or earnings information, but many do.

Any claims the franchisor makes about sales, income or profits must be in Item 19. No other spoken or written financial performance claim may be made if it doesn't appear in Item 19. There are two exceptions to this:

1. The franchisor may provide the actual records of an existing outlet you're thinking of buying.

2. The franchisor may add to the information in Item 19. For example, the franchisor may provide information about possible performance at a particular location or under particular circumstances.

For tips on how to evaluate this information, see Evaluating Potential Earnings.

Franchisee and Franchise System Information (FDD Item 20)

Item 20 provides charts showing growth and owner turnover in the franchisor's system. If the charts show more than a few franchised outlets in your area have closed, transferred to new owners, or transferred to the franchisor, it could be due to problems with the franchisor's support or because franchises aren't profitable.

Current and Former Franchisees

Look for the required disclosure of contact information for current franchisees and franchisees who have left the system during the franchisor's last fiscal year. Talking to these people may be the most reliable way to verify the franchisor's claims. Visit or phone as many of them as possible to chat about their experiences. Some current franchisees may be reluctant to talk to you if they're having problems. If that's the case, try contacting others on the list.

Some franchisors may give you a separate reference list of franchisees to contact. To ensure you get the full picture, you may want to contact a number of franchisees listed in the disclosure document and some on the separate list.

Talk to several franchisees who have been in business just over one year. They're in the best position to tell you:

- their total investment
- whether they were able to open their outlet in a reasonable time
- whether they were satisfied with the franchisor's training, opening assistance and advertising
- whether the franchisor provided ongoing help and assistance
- whether they have been able to break even

It's also a good idea to talk to several franchisees who have been in business for five years. Ask:

- how long it took them to break even, earn a reasonable income and recoup their investment
- whether the franchisor is providing the services and assistance it promised and fulfilling its contractual obligations
- what problems, if any, they are having with the franchisor
- whether they would invest in another outlet
- whether they're satisfied with the advertising program
- whether they are satisfied with the cost, delivery and quality of goods or services they must buy from the franchisor, its affiliates or sole approved suppliers

It's worth tracking down former franchisees (using contact information from Item 20), although some of them may have signed confidentiality agreements that prevent them from talking with you. Prior owners can tell you:

- the problems they had with their outlet
- whether they broke even or made a profit
- when and for how long they operated the outlet
- their business background
- why they left the franchise system

Some franchisors may buy back failed outlets and list them as company-owned outlets. If you're thinking about buying an existing outlet that the franchisor acquired from a prior franchisee, ask to see the financials showing the outlet's actual operating results. The franchisor must tell you who owned and operated the outlet for the last five years. If a franchise has had several owners in a short time, perhaps the location isn't profitable or the franchisor hasn't supported that outlet as promised. Contact as many of the previous owners as possible to learn about their experience operating the outlet that failed.

Franchisee Associations

Associations of a franchisor's franchisees are an important source of information. Franchisors are required to list in the FDD the associations they sponsor or endorse and independent associations that ask to be listed. An association, whether it's sponsored, endorsed or independent, can provide information about the relationship between the franchisor and its franchisees. You may want to ask members of a franchisee association about:

- the kinds of system problems or issues they discuss
- system problems they successfully resolved
- any problems franchisees face in the operation of their outlets
- any problems franchisees have with the franchisor

Financial Statements (FDD Item 21)

Item 21 provides the franchisor's three most recent audited annual financial statements. If you know how to read financial statements, this information will give you a good understanding of the franchisor's financial health. If you don't, it's a good idea to hire an accountant to review the statements and explain them to you. Investing in a financially unstable franchisor is a significant risk; the franchisor may go out of business or into bankruptcy after you have invested your money. An accountant can help you understand whether the franchisor:

- has steady growth
- has a growth plan
- makes more of its income from royalty payments from successful existing franchisees or from the sale of franchises
- devotes sufficient funds to support its franchise system

Evaluating Potential Earnings

You may want to know how much money you can make if you invest in a particular franchise. A franchisor isn't required to disclose information about potential income or sales. If it does, the law requires it to have a reasonable basis for the claim when it's made and to include the claim in Item 19 of the Franchise Disclosure Document (FDD). If a franchisor makes a claim that has a reasonable basis, the FDD also must disclose:

- the source and limitations of data that support the claim
- any important assumptions on which the claim is based

Be sure to ask the franchisor for written substantiation that supports the claim. The franchisor is required to provide substantiation if you ask. An accountant can help you determine whether the claims are reasonable, and if they apply to how you plan to operate your business. When you review earnings claims, consider:

Is the Earnings Claim Typical for a Franchise in this System?

Suppose a franchisor claims that franchisees in its system earned \$50,000 last year. The claim may be deceptive if it doesn't represent the typical earnings of franchisees. The FDD should tell you how many franchises the franchisor has, how many it surveyed to get that figure, and the number and percentage of franchisees who reported earnings at the level claimed.

Average Income

If a franchisor claims that its franchisees earn an average income of \$75,000 a year, that tells you very little about how individual franchises performed. Using an average figure may make a franchise system look more successful than it really is, because the high incomes of just a few very successful franchises can inflate the average for all franchisees.

Gross Sales

Some franchisors provide figures for their franchisees' gross sales. These figures don't really tell about the franchisees' actual costs or profits. An outlet with high gross sales on paper might be losing money because of high overhead, rent and other expenses.

Net Profits

Franchisors often don't have data about their franchisees' net profits. If you get profit information, ask if it's based on information from company-owned outlets. Company-owned outlets often have lower costs because they can buy equipment, inventory and other items in larger quantities at lower prices or may own, rather than lease, their property.

Geographic Relevance

Earnings may vary with geography. If a franchisor provides franchisee sales or income figures, ask if any of the supporting data came from franchisees in your area. The FDD should state whether there are geographic differences between the franchisees whose earnings are reported and your likely location.

Franchisees' Backgrounds

Keep in mind that franchisees have different skill sets and educational backgrounds. The success of some franchisees doesn't guarantee success for all.

Reliance on Earnings Claims

Franchisors may ask you to sign a statement — sometimes presented as a written interview or questionnaire — that asks whether you received any earnings or financial performance representations during the course of buying a franchise. If they told or gave you any information about how much your franchise may earn, report it fully on the questionnaire or other statement. If you don't, you may be waiving any right to contest the earnings representations that were made to you and that you used to make your decision to buy. And remember, if you got such representations, and those representations are not included in the FDD, that is a red flag and you should consider walking away.

Before You Sign the Franchise Agreement

The franchisor's disclosures may change between the time you receive the Franchise Disclosure Document (FDD) and the time you sign the franchise agreement. For example, the franchisor may have updated its FDD each calendar quarter and must update the FDD after its fiscal year ends. You have the right to ask for a copy of any updated information before you sign the franchise agreement. An updated FDD may reveal new lawsuits were filed by or against the franchisor, changes in the franchisor's management or training teams, more current financial performance data or other useful information.

Additional Sources of Information

Accountants and Lawyers

In addition to reading the franchisor's FDD — including any updates — and speaking with current and former franchisees, consider talking to an accountant and a lawyer. An accountant can help you understand the franchisor's financial statements, develop a business plan, assess any earnings projections and the assumptions they're based on, and help you pick a franchise system that is best suited to your investment resources and your goals.

A lawyer can help you understand your obligations under the franchise contract. These contracts usually are long and complex. A problem that comes up after you have signed the contract may be very expensive to fix — if it can be fixed at all. Choose a lawyer who is experienced in franchise matters, and rely on your lawyer or accountant for a recommendation about whether to buy a particular franchise.

Banks and Other Financial Institutions

If you need financing to buy a franchise, a bank lender may be able to provide you with a Dun & Bradstreet report or similar financial profile of the franchisor. The bank also might obtain sales and profit information from the franchisor, even if the franchisor won't give you that information. However, some franchisors give banks unrealistic, overstated profit projections so the bank will provide financing to expand the franchise system. Remember that bank approval of a franchise loan doesn't necessarily mean the franchise is a safe or good investment.

Better Business Bureau

Check with the local BBB in the cities where the franchisor has its headquarters and the city where you're thinking of buying a franchise. Ask whether there are complaints on file about the franchisor's products, services or personnel.

Government

Several states have registration or disclosure laws that regulate the sale of franchises. Some states have laws meant to protect franchisees after they buy. The FDD should include information about any such laws in your state. If the information isn't in the FDD, check with your state Attorney General's office, office of consumer affairs or state securities division.

The Franchise Disclosure Document (FDD)

(You can ask for the FDD as soon as the franchisor gets your application and agrees to consider it. And you **MUST** get it at least 14 days before you're asked to sign a contract or pay money — either to the franchisor or its affiliate.)

Item 1: The Franchisor, and any Parents, Predecessors, and Affiliates.

Item 2: Business Experience.

Item 3: Litigation.

Item 4: Bankruptcy.

Item 5: Initial Fees.

Item 6: Other Fees.

Item 7: Estimated Initial Investment.

Item 8: Restrictions on Sources of Products and Services.

Item 9: Franchisee's Obligations.

Item 10: Financing.

Item 11: Franchisor's Assistance, Advertising, Computer Systems, and Training.

Item 12: Territory.

Item 13: Trademarks.

Item 14: Patents, Copyrights, and Proprietary Information.

Item 15: Obligation to Participate in the Actual Operation of the Franchise Business.

Item 16: Restrictions on What the Franchisee May Sell.

Item 17: Renewal, Termination, Transfer, and Dispute Resolution.

Item 18: Public Figures.

Item 19: Financial Performance Representations.

Item 20: Outlets and Franchisee Information.

Item 21: Financial Statements.

Item 22: Contracts.

Item 23: Receipts.

About the FTC

The FTC works for the consumer to prevent fraudulent, deceptive, and unfair practices in the marketplace. The Business Center gives you and your business tools to understand and comply with the law. Regardless of the size of your organization or the industry you're in, knowing — and fulfilling — your compliance responsibilities is smart, sound business. Visit the Business Center at business.ftc.gov.

Opportunity to Comment

The National Small Business Ombudsman and 10 Regional Fairness Boards collect comments from small businesses about federal compliance and enforcement activities. Each year, the Ombudsman evaluates the conduct of these activities and rates each agency's responsiveness to small businesses. Small businesses can comment to the Ombudsman without fear of reprisal. To comment, call toll-free 1-888-REGFAIR (1-888-734-3247) or go to sba.gov/ombudsman.