

## Franchising FAQs

### **Why should I purchase this particular franchise?**

A franchise may need to be looked at from a product or service comparison prospective. While one franchise's product or service may be suitable in a geographic area, another may not be. When evaluating a franchise, close attention needs to be spent evaluating: the strength of the franchiser, the franchiser's long-term goal, the uniqueness of its product or service, the type of consumer response the product or service is achieving, the amount of fees it charges, the type of support it provides: 1) startup 2) operations 3) marketing, and the length of the contract you will be signing.

### **Does the franchise agreement contain a duty of good faith and fair dealing provision?**

A duty of good faith and fair dealing provision allows the franchiser and the franchisee to work together in a good faith manner and puts into place a duty to act honestly with each other and observe standards in fair dealing. This provides a degree of protection from false statements and empty promises.

### **Does the franchise company offer an area of protection (AOP) in writing?**

Exclusive territory means that the franchiser and/or another franchisee will not compete for the same business within the same geographic area; a related issue is encroachment. Is the franchiser limited from placing or licensing another business in unreasonable proximity to an existing franchisee that is engaged in a similar franchise business?

### **What does it cost to get out of the agreement?**

Many franchise agreements require enormous liquidated damages exceeding several hundred thousand dollars if you try to exit the system before the term expires. Try to minimize your damages in the event you have to exit the system.

### **Can I sell my business and allow the franchise to be transferred?**

There may come a time during your franchise that you would like to sell out to another party. Most agreements limit or outright prohibit a transfer of your franchise to another person or company. Request a provision allowing you to transfer your rights under the franchise agreement as long as the interested party is creditworthy and capable of taking over the business.

### **Does your franchise limit or restrict the franchisee from joining a trade franchisee association?**

Some franchise agreements restrict a franchisee from joining an independent trade association formed by other franchisees like you. These associations are created for the purpose of protecting franchisees' interests and rights and allow franchisees to state a unified voice on concerns and issues.

### **Does the franchise company restrict you from competing after the franchisee/franchiser relationship ends?**

Some franchise agreements restrict a franchise owner or his/her business from competing within the same industry upon leaving the system. A franchisee should not agree to any restrictions that are not directly related to the same place and type of business.

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### **Does the franchiser provide accountability for the advertising marketing fund?**

Franchisees within a system frequently pool their money for general advertising and marketing purposes or to handle bookkeeping functions. Some franchisers use these funds at their own discretion, even for purposes not associated with marketing & advertising, without providing a full disclosure of accounting to its franchisee. Requesting audited statements for these fund will disclose where your money is spent.

### **Does the franchise allow a cure period in the event of a default?**

In some franchise systems, when a franchisee fails to comply with system standards the franchiser has the immediate right to terminate the franchisee and demand liquidated damages. However, some franchisers allows the franchisee to cure the default within a period of time (for instance, 30 days) so the franchisee can comply within the required standards. If the default is not cured within the allocated time, the franchisee then may be terminated.

### **Does the franchiser require me to sign a general release upon the end of our relationship?**

Whether it be a voluntary or default termination, many franchisers require a general release agreement to be signed by the franchisee when the relationship ends. While there may be nothing wrong with signing such an agreement, these agreements tend to be one-sided and in the favor of franchisers. They allow the franchiser to be released from any known or unknown obligations and liabilities, yet the franchisee may continue to be responsible for certain obligations and potential liabilities even after the relationship ends. Make sure the release is mutually applicable to both parties.

### **How can I go about investigating a particular franchise that I am interested in?**

- ◆ Request an information packet from the franchiser.
- ◆ Interview owners of current franchises.
- ◆ Research the industry and other franchises in this industry.
- ◆ Seek expert advice to better understand the franchise agreement.
- ◆ Review costs related to getting into this franchise and compare them to the costs of starting a nonfranchised business in this industry.

### **Within the same industry, why does it cost so much more to get into some franchises than it does others?**

- ◆ The more expensive franchises are better known in the marketplace, therefore they can command a higher price (oftentimes you are buying into the value of a well-known name). The less expensive franchises may not have any name recognition and are therefore looking to expand their presence in the market by offering their franchises at a much lower price.
- ◆ The more expensive franchises probably have proven formulas for success, which means your investment risk factor will be lower than it would be for a less proven franchise system.
- ◆ Also, you will find that those more established franchises that have experienced a long history of advertising and promotion of their products have, in turn, created a higher level of demand for their products, which results in a premium price for their franchise.

Taken from <http://www.sba.gov/smallbusinessplanner/start/buyfranchise/index.html>