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Starting a Small Business by Franchising: Five Questions to Ask

Written by [Joanne Cleaver](#) on May 6, 2013 in [Small Business](#) | [No comments](#)

To many small business owners, a franchise sounds like the best of both worlds: You're [starting a small business](#) on your own, but you're not going it alone.

Many business owners have built mini-empires by affiliating with franchisors instead of trying to build a brand from scratch. Franchising is a unique business arrangement, however, and it requires careful vetting.

A franchise typically involves two parties:

- » **The franchisor** who has developed a business model, cultivated a brand, and created a template for running each business in the franchise network.
- » **The individual franchisee** who buys into this model and who agrees to pay royalties to the franchisor for the use of the brand and business template. The franchisee then uses the business template to replicate the franchisor's operation.

Your experience—as a manager at a large company or as a small business owner—may or may not be relevant to a prospective franchise opportunity. The best way to use your business smarts is to research every aspect of a possible franchise opportunity and draw your own conclusions about its potential. The following five questions can help you identify your business goals and assist you in deciding whether you should consider looking at a franchise opportunity as a means to achieve those goals.

1. Does the business concept have real growth potential?

Explore the overall growth potential for the franchise concept based on demographics, market trends, and consumer preferences independent of what the franchisor projects.


- » What is your objective analysis of the unique appeal of the franchise concept?
- » Who is your competition, and how hard will it be to attract customers?
- » Does the franchise brand actually make a difference to the target customer?
- » Does the franchisor offer operational support that will significantly speed your business launch?



You need to consider each of these items with your business advisor or partner and make sure you understand each of them to evaluate any franchise concept.

2. What is the track record of both the franchise and the franchise owner?

You'll want to interview other franchisees within the same system to find out if their businesses are operating as they planned. Consider hiring a lawyer who specializes in franchises to review the contract and any other documentation given to you. You should also [obtain as much information as possible](#)

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about the franchise and its owners to see what, if any, information comes up about issues other people have had or any history of shutting down franchises and leaving franchisees in the lurch. You can get help on both fronts from the American Association of Franchisees and Dealers.

3. What is the financial structure?

By definition, when you buy a franchise, you are buying into a system—not just once but also through regular royalty payments. Often, royalties you pay to the franchisor are computed on gross income of the franchise you have purchased. That means that you pay the franchisor before the landlord, your suppliers, your employees, and yourself.

Often, franchisees are required to use suppliers approved by the franchisor—and often the franchisor owns those suppliers. You might be required to attend conferences or participate in marketing activities with associated expenses on top of the royalty. All of these requirements may become major sources of outgoing cash flow.

4. How will you finance the purchase of the franchise and business start-up?

Some franchises require a large upfront payment. If you decide to move forward with a franchise purchase, you need to know how you will pay for it. Some franchisors may finance your purchase of the franchise business, but in other situations you will have to obtain a loan.

Depending on the amount of money you need to borrow to buy into the franchise, you might have to guarantee the loan you take out for the initial investment. Consider hiring a certified public accountant that is experienced with franchise finance to give you unbiased advice.

The Small Business Administration (SBA) is another excellent source of information and funding for your new business—make sure to review the [SBA's data](#) on franchises, including the default rates of SBA-guaranteed loans. In addition, the [Federal Trade Commission](#) offers a comprehensive consumer guide to buying a franchise.

5. What is your exit plan?

If you become a franchise owner, you will need to know your options for leaving the franchise and moving on, whether you eventually decide to sell your franchise business or simply close it down. You may also want to know how hard would it be to take what you have learned and convert the franchise to a freestanding operation with a similar or related business.

Because franchise agreements can be quite long and detailed, be sure to ask your lawyer and accountant to sketch out scenarios for selling your business and business operation, should this situation arise.

The most important factor when deciding whether to franchise is you. Are you comfortable following someone else's rules and supporting the franchisor's vision? Or does the very idea of having a third party control much of your business make you have second thoughts?

Each franchise system has its own culture. Some are rigid; others invite innovation. Getting to know potential fellow franchisees will clue you in about the culture and help you size up the fit.

Joanne Cleaver doesn't just write about entrepreneurship and finance for national publications and websites. As a longtime freelance writer and editorial project manager, she lives it. Her most recent book is "The Career Lattice" (McGraw Professional, 2012), which shows how lateral moves power career growth.

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