

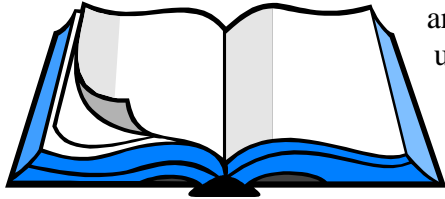
Gauging Financial Performance

Franchise Earnings Claims Reflect Confidence and Success

It's been said that, in life, there are no guarantees, and the only two things we can rely on are death and taxes. Yet we all strive to achieve the greatest chance of success by basing decisions on factual data and reliable information whenever possible. And the bigger the decision, the more important that becomes.

If you were buying a used car, you'd want to have it checked out by a certified mechanic. And few people would buy a house without first having it inspected by a licensed professional. Starting a business should be no different.

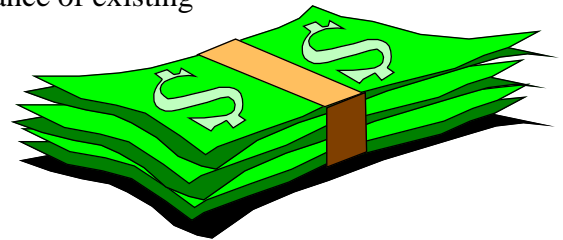
That's why entrepreneurs look to franchising. Franchising offers the greatest chance for success with the least amount of risk through business models that have been time-tested and refined by an existing community of franchisees. Indeed, statistics show that 93% of franchises are still operating and successful after 4 years, while only 27% of independent start-ups survive that long.



In an earlier Franchise Business Journal (Volume 105), we explained the importance of the Franchise Disclosure Document (FDD), a document *every* franchise is mandated by the Federal Trade Commission to make available to prospective franchisees. Since every FDD contains 23 standard items, we've seldom seen one that's less than 100 pages. And while an FDD is not exactly exciting reading, it should be viewed as *required* reading by anyone seriously considering a franchise.

Item 19 in the FDD addresses financial performance, and may answer the question every franchisee candidate wants to ask: "How much money can I make?" It is here that the franchise may state earnings claims based on prior financial performance of existing franchisees.

Two important things to keep in mind. First, most franchises do not publish earnings claims in their FDD, though for those that do, it should be viewed as a positive reflection of the company's confidence and consistency.



Secondly, while franchises are required to present *accurate* financial data, there are no standard guidelines for the *amount* of information or the *format* in which it is presented.

Earnings claims may reflect average financial results for *all* franchisees, or it may only include data for a select community (i.e. franchisees who have been in business for at least 12 months). It

may reflect performance for only the last 12 months or may enable the candidate to review financial trends over multiple years. Many earnings claims also include average cost of goods, cost of sales, sales margins and other useful details – but some do not.



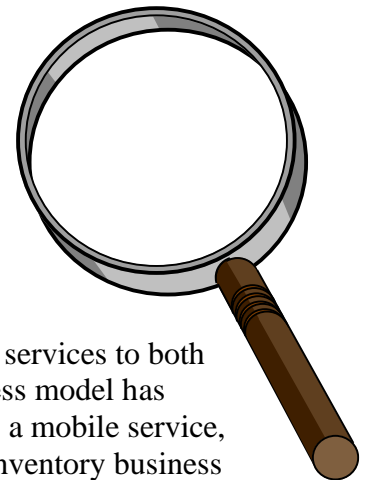
Again, franchises are only required to explain how and from where the data has been formulated, and to ensure its accuracy using generally accepted and approved accounting procedures. So while more information is always better than less, it's important for you as a candidate to understand both the content and context of the information provided.

At Franchise Consultants, Inc., we like to see earnings claims in the belief that they reflect ongoing growth, success, and confidence. Here are a couple of examples of excellent opportunities that do publish detailed earnings claims that we recommend on a regular basis:

Example 1: Retail

This company has a direct-to-consumer business model, providing substantial costs savings to the customer by cutting out the middleman. Their products are built onsite from pre-manufactured components to the customer's specifications. This company provides earnings claims over the previous 36-month period and will match their financial performance against *any* franchise of *any* type.

- ◆ Established: 1958
- ◆ First Franchised: 1986
- ◆ Franchised Units: 75
- ◆ Average per operation annual gross: \$1,600,000 (average between single and multi-unit operations (see earnings claims for details))
- ◆ Average cost of goods: 45%
- ◆ Profit margin (before other non-material costs): 55%
- ◆ Average ticket (transaction): \$575
- ◆ Close ratio: 74%



Example 2: Decorating

This is a home-based business providing window decorating products and services to both consumer and commercial customers. Its aggressive and successful business model has earned them #1 ranking in this \$10BB industry for eight straight years. As a mobile service, this franchise offers relatively low start up costs and a low-overhead, no-inventory business model.

- ◆ Established: 1992
- ◆ 1st Franchised: 1994

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- ◆ Franchised Units: 750
- ◆ Average per territory annual gross: \$348,000
- ◆ Average cost of goods: 49%
- ◆ Profit margin (before other non-material costs): 51%
- ◆ Average ticket (transaction): \$800 – \$1200
- ◆ Close ratio: 75%

In conclusion, though publishing earnings claims is always a positive factor, the lack of earnings claims should not be viewed as a negative. Many excellent franchises do not do so for a variety of reasons.

If a franchise does not explicitly state earnings claims, then Item 20 in their FDD provides an alternative means to gauge financial performance. It is here that the franchise lists current and former franchisees. And unlike personal or professional references one might include in a resume, the franchise is required to list *all* franchisees, not just the best ones. Even if the franchise *has* published earnings claims, you'll want to contact as many of these people as possible to inquire about their individual financial success.

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We are an affiliate of the world's largest franchise network with more than 25 years experience helping entrepreneurs like you find and own their own businesses.

Contact us at 603-888-8881 or rnk@wwsp.com.