

This tipsheet is intended to provide general information and is not a substitute for legal advice.

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Franchising is a popular way to go into business for yourself. It may give you the best of both worlds - the freedom of owning and running a business as well as the support of working with an established company. Many franchisors (sellers of franchises) provide training and ongoing help and advice.

But, like any business, franchising has risks and drawbacks you should be aware of. This tipsheet will help you decide whether owning a franchise will live up to your expectations. Then, it will give you guidelines on how to choose your franchise investment. It will also tell you about the way the sale of franchises is regulated in Alberta. With careful investigation and common sense, and by asking the right questions, you should be able to decide whether a franchise investment is the right one for you.

Be aware that the government can't become involved in disputes between franchisees and franchisors. If you have a dispute with a franchisor, speak directly with the company to try and resolve the problem. If the matter is not resolved you may have to get legal advice.

What is a franchise?

A franchise is a business arrangement. The franchisor (seller of a franchise) grants the franchisee (buyer of a franchise) the right to

distribute certain goods or services in a particular way, in a particular location, and for a specified period of time. In return, the franchisee pays the franchisor various fees and royalties. There are several types of franchise arrangements.

A business format franchise is what most people think of when they hear the term "franchise." A franchisee buys the right to market and sell particular products or services. The franchisee buys those rights for a specific time and a defined area by paying the franchisor a franchise fee for the right to use the franchisor's trademarks and marketing plan. In some cases the franchisee buys an entire system - buildings, equipment, supplies, bookkeeping, uniforms, training, and so on. The franchisee can often walk in off the street, turn the key in the lock and start the business. This ready-made set-up is also known as a turnkey operation. Fast-food chains are good examples of this kind of franchise.

Is franchising for you?

To decide if franchising is for you, you will need to take a frank and in-depth look at your personal qualities and circumstances. Think about these carefully. Here are some of the questions you should be asking yourself:

- Are you willing to follow the franchisor's rules and controls? Are you willing to put in long hours of work? Do you have perseverance? Are you a good organizer? Are you self motivated and able to make decisions when required?
- Can you raise the necessary funds? Are you prepared to risk a large part of what you own to borrow the money you need?

- Do you have the experience, education, learning capacity, and interest needed for a particular franchise? For example, if your interest is in food, should you be considering a car repair shop? Are you prepared to make a commitment for the whole term of a franchise agreement, which could be up to 20 years?
- Are you in good health? Do you qualify for private disability insurance?
- Is your family supportive? Will they be willing to put up with your long hours away from home?
- Will they help out in a pinch?

If the answers to most of these questions are positive, you are probably suited to operating a franchise. The next step is to choose the right operation for you. You need to be really clear in your own mind about your personal and business goals. The following profiles are typical of some of the people who become interested in franchising. You can see how circumstances and lifestyles affect the choice of franchise.

Lee is in his early twenties. He has just graduated from college and is having a hard time finding a job in a tight market. He has no business experience, but is eager to learn. He has a small inheritance to use as start-up financing. He'll probably be looking for a franchise with a small start-up fee, low capital investment, and the potential for long-term growth. He may do best with an organization that has an extensive training program to make up for his lack of business experience.

Marie is in her mid-thirties. After many years working for government, she's bored with her middle-management position. She hates the paperwork and the constraints of her job, and is looking forward to working for herself. She's saved and invested well over the years, and has a significant nest egg. Marie has also had some success running various part-time businesses out of her home. Owing to her experience, she may not need the same training support as Lee. Also, she has strong entrepreneurial tendencies. Franchise

agreements require franchisees to conduct their business according to specific standards and procedures. Marie might find that a franchise would force her to work with even more constraints and paperwork than the government job she is escaping. She may well prefer to start a business on her own.

Robert was given a "golden handshake" when his company cut back on staff last year. He's 57 years old. Robert is looking for a profitable opportunity in which to invest his handshake money and his RRSPs. He expects to take life a little easier from now on. Robert should be aware that many franchisors will expect him to commit his time, as well as his cash, and run the franchise on a full-time basis. Also, he should check the clauses in the franchise agreement that describe his rights to sell or transfer his business. Can he get back his investment if he wishes to retire at the end of the first term?

Once you are sure of what you want, it's time to look for suitable franchise opportunities.

Investigating a franchise

What to look for

Check each franchise opportunity by asking questions to find out about every part of the business. Begin your research by reading the materials provided by the franchisor, and asking questions of the grantor or the salespeople. Don't limit your research to this - you should compare the information you get from many sources.

The *Franchise Act* and regulations stipulate that franchisors must give every prospective franchisee a copy of a disclosure document. Details about disclosure documents are described in the legislation. A disclosure document may answer many of the questions you should ask before investing.

The product or service

- What is the product or service?

- Is it something that you'd buy?
- Will it sell all year round, or will you have little or no income for several months each year?
- Does this product or service look like a fad, or will demand continue?
- Is it priced competitively with others in its class?
- Is it well packaged to promote sales?
- How long has it been on the market in its present form?
- Where is it being sold now?
- How can you be sure that it will sell in your area?
- What assurance do you have that the suppliers will continue to provide the product, and do so
- at a fair and competitive price?
- Does the product or service generate repeat business?
- Are there any government standards for the product or service, and if so, does it meet those standards? Find out from your lawyer whether there are any restrictions on its use or licensing.
- Are the product, special processes or identifying marks protected by patent or trademark? If the product is guaranteed, get a copy of the guarantee and be aware of your responsibilities and obligations as a franchisee. Ask your lawyer to review it and explain it to you.

Review market growth. Ask the franchisor for marketing information. You can also talk to the market research analyst at your stockbroker's about market growth in the industry. Write to the trade magazine that covers the market in question. Research the franchisor and the product or service at your local business library.

Trademark

Does the franchisor own the trademark? Does the franchise system have exclusive distribution rights to the trademarked product, or can the product be sold outside the franchise system, either now or in the future?

The company (franchisor)

You should be looking for a franchisor who has a good record in business over several years, or who can show the ability to build a successful business over the next few years. Go over the franchisor's disclosure document and financial statements with your lawyer and accountant. Find out about its business reputation by asking government departments, suppliers, bankers, the Better Business Bureau, and other agencies. (See Investigating a Franchise: Where to go for help on page 7.)

- Is the franchisor a small company, a national company, or a multinational company?
- Is the company a private or a public one?
- Is it an independently owned company or part of a larger company? You may find financing your franchise business easier if there is a larger company behind your franchisor.
- Who are the directors and managers in the franchisor's company? Do they have experience in this type of business? Have they been with the company long?
- What is the franchisor's company's financial history? Does it show steady growth? Does the company have a growth plan?
- If it plans rapid growth, will it guarantee to continue providing the same level of service to franchisees? Does the franchisor's company make most of its income from the sale of franchises or from continuing royalties? In other words, is it more interested in selling franchises than in the continuing success of the operators?
- How many franchises are there now? Have any of the franchises closed or changed hands? When did this happen, and why? If there have been franchises with financial difficulties, but none recently, what has changed? Can you get a list of their franchisees so you can continue your checking?

Visit or phone current and former franchisees and ask them about their experiences:

- What was the total investment they had to make?
- Were there any hidden or unexpected costs?

- How long was it before they covered operating costs, and received a reasonable salary?
- Are they satisfied with the quality, cost, and delivery of the goods for sale?
- Was their training adequate?
- Did it meet their expectations?
- Did the franchisor live up to the terms of the contract?
- Are there any terms the operators would like changed?
- Would they advise anyone to invest in an outlet with this particular franchisor?
- Is the supplier owned by the franchisor?
- If not, can franchisees buy supplies independently, or must they go through the franchisor?
- Does the franchisee earn rebates based on the amounts purchased?

Expect the franchisor to investigate you thoroughly too. Take care when dealing with a franchisor who's ready to sign you up without checking you out. Your success may be of less interest than your sign-up fee.

Costs (fees, investments, financing)

Don't be fooled by claims such as "Own your own business for only \$3,500!" Most franchises require an investment of at least \$100,000. Think about all the money that you might need. Ask about the cost of the following:

- advertising, both local costs and payments to national funds
- continuing royalties (a percentage of sales or profits, or a fixed charge per unit)
- equipment
- initial deposit or franchise fee (which may not be refundable)
- insurance
- leasehold improvements
- legal and financial advice
- licences
- product or service supply costs
- real estate
- training

Include operating expenses for the first year and your personal living expenses for up to two years. Compare your estimates with what other franchisees paid. Compare the estimated costs of your prospective franchise with those of the competition to see if you can get a better deal with another franchise chain. Consider hiring an accountant to help you evaluate the franchise.

Usually, you will have to pay the franchise fee in cash. The franchisor may have an arrangement with a bank or lending institution, which will lend you some of the start-up costs. You don't have to use the franchisor's bank, so compare loan services at several financial institutions.

Estimates of what a franchise can earn

Ask the franchisor for a written copy of the earnings claim. It may be called a projection of income and expenses, a forecast, or an estimate of costs or cash flow. Franchisors must tell you what economic and market conditions their claims for earnings are based on. They must also identify the key factors that will affect results, such as sales, projections, capital, expenditures, location, break-even sales figures, product mix, seasonal fluctuations, and related profit margins.

- Are other franchisees earning what was projected for them?
- Do they consider your budget realistic?
- Are the franchise and lease terms long enough to let you recover your investment?

Compare the earnings claim with the feasibility study. The conclusions of both should be similar. Ask your accountant to review the claim and advise you.

Feasibility study

- Has a feasibility study been done for your franchise?
- Who's responsible for the study? Find out the researcher's qualifications and experience. Ask for a written copy of the report. Get the following information:
 - traffic counts at various places where you might locate the franchise,

- average income and the number of potential customers in the area, and
- a summary of the situation at existing outlets.
- If you buy a franchise before you agree on a specific site, find out how the site will be selected. Will a feasibility study be done for that site? Who will do it? Who will pay for it?

The feasibility study may show that your franchise would have difficulty succeeding during the term of the franchise and lease agreements. Make sure that the franchisor will refund your deposit if this happens. Get the total costs of the feasibility study and the investment written into the contract. Discuss the contract with your independent, professional accountant and lawyer. Ask other franchisees if they received feasibility studies. If so, how accurate were they? Do they think that the study that you've been given is reasonable and achievable? Based on their experience, is anything missing?

Territory and location

The franchisor may sell you some kind of protected area to operate in. Make sure you ask what area you would be buying, and exactly where the boundaries would be.

- Would you be allowed to open more franchised outlets within that area?
- How long would the area be yours?
- Do you have exclusive rights, or only the right of first refusal? (That is, if the franchisor offers you another outlet within the territory and you turn it down, can the franchisor sell it to someone else?)
- Could you or the franchisor change the size of your territory later?
- Ask what guarantees you have that another franchise won't be opened in your area.
- Who decides the location of the franchise within your area, you or the franchisor?
- What site selection help and evaluation will you have from the franchisor?
- Is the location offered suitable for your needs?

- Do the premises have to meet certain standards set by the franchisor, such as age of building, street frontage, or minimum size?
- Must you lease or buy the property?
- Will you lease from the franchisor or an independent landlord?
- Is the term of the lease as long as that of the franchise agreement?
- If not, can you renew or extend it?
- Could you move the franchise if you wanted to?

Premises

- How tightly does the franchisor control the appearance and layout of the premises?
- Will you have to buy a particular brand of furnishings and equipment? If so, can you choose the distributor who will give you the best price or do you have to buy from a specific source?
- If you have to buy or lease from the franchisor, who is responsible for repairs?
- Are there any warranties?

Operations manual

Before you enter into any franchise contract, ask if there is an operations manual. Read this manual carefully. It will tell you what standards of operation the franchisor expects of the operators. You may have to sign an agreement to keep the contents of the manual confidential.

Training

Find out what training the franchisor will give you.

- Will you learn by hands-on experience at another franchise outlet? If so, how long will you be expected to work?
- Will you be paid?
- Are you the only one to be trained or will any employees be given training too?
- Is there a course?
- How long is the course, and who will pay for it?
- What type of ongoing training, management assistance, and advice will you get if problems arise?

You should get training in the franchisor's products or services, day-to-day business operations, the operating standards you will be required to keep, and employee management. The amount of training you need from the franchisor will depend on your present business knowledge and experience, and on the operating standards you must keep.

Advertising and promotions

Some franchisors have advertising and promotional funds. Franchisees often have to contribute to these funds based on a percentage of their sales. Franchisors and franchisees sometimes disagree over the way these funds are used. The disclosure document and franchise agreement should specify who controls the funds, and who decides how and when the money will be spent. Ask what direct benefits a franchisee can expect to receive.

- Do franchisees have a say in spending this money?
- Will the full amount collected be spent for advertising?
- How much will be spent in your trading area?
- Will the advertising be national, regional, or local?
- Will it focus on selling more franchises or promoting your business?
- Will stores owned by the franchisor itself contribute to the advertising fund on the same basis that you do?
- Do you need the franchisor's consent to advertise independently?
- Must you take part in other advertising or promotional campaigns?

The local advertising and publicity program in support of your franchise should be an extension of the national program. Programs may include radio announcements, TV commercials, direct-mail brochures or novelties, samples, publicity releases, and photographs. Opening your business is news. Does the franchisor provide plans for a grand opening, including advertising, media coverage, and so on? Ask to see a sample promotions kit.

Franchise law in Alberta

Alberta franchise legislation removes all requirements to file documents or register with a government agency. This allows franchisors easier access to the Alberta market at a reduced cost.

Prospective franchisees must be given a franchise disclosure document. The disclosure document must contain copies of all franchise agreements, financial statements, and all material facts, including those material facts relating to the matters set out in Schedule 1 to the Regulation.

Franchisors will be permitted to use disclosure documents acceptable under franchise legislation in jurisdictions outside Alberta, such as the Uniform Franchise Offering Circular and the Federal Trade Commission documents, if these disclosure documents include, by way of an addendum or "wrap around" document, any information necessary to meet the requirements of a disclosure document under the new legislation.

Financial statements must continue to be prepared in accordance with generally accepted accounting principles, however, the minimum standards of review and reporting have been reduced from those of audit to those of review engagement. The Exemption Regulation, however, exempts certain franchisors from the requirement to include financial statements in their disclosure documents.

The disclosure document must include a certificate certifying that the disclosure document contains no misrepresentation.

The legislation imposes on each party to a franchise agreement a duty of fair dealing in its performance and enforcement.

The legislation gives the franchisee a private right of action for damages against the franchisor and every person who signed the disclosure document. If the franchisee did not receive the franchise disclosure document within

the time limits set out in the legislation, the franchisee has the right to rescind all franchise agreements.

You can order a copy of the *Franchises Act* and regulations from the Public Affairs Bureau, Publication Services. (See Need more information? on page 8.)

Investigating a franchise: Where to go for help

The franchisor

After reviewing the disclosure documents and if you need references, contact the franchisor. The franchisor should also be able to give you the names of financial institutions and suppliers willing to act as references. This is especially important if the company is a private one.

Other franchisees

The disclosure document should include the names and addresses of existing franchisees. Most franchisors will have no objection to you contacting their franchisees. If there are objections, you might wonder if the franchisor has been entirely frank with you. Be reasonable about taking up franchisees' time. They are running a business, and their time is valuable. Call ahead and make appointments.

Lawyers and accountants

Contracts are usually long and complex. A contract problem that arises *after* you have signed on the dotted line could be impossible or very expensive to fix. Money spent on specialized legal advice at this stage may prevent losses or surprises later on. Choose a lawyer who is up to date on the legal aspects of franchising, and has some experience in this area.

A qualified accountant will be able to alert you to any problems disclosed in the franchisors' financial statements. The accountant should also advise you on the financial projections and the assumptions they are based on.

Banks and other financial institutions

These may provide an unbiased view of the franchise opportunities you are considering.

Your banker should be able to get you Dun and Bradstreet reports on the franchisor.

Better Business Bureaus and trade associations (contact information at the end of the tipsheet)

Check with the local Better Business Bureau (BBB) and with the BBBs in cities where the franchisors' head offices are located. Ask if any consumers have complained about the companies' products, services, or personnel. What are the companies' reputations within the trade associations - the Canadian Franchise Association, the Franchisee Association of Alberta, and the International Franchise Association?

The Business Link (contact information at the end of the tipsheet)

This joint initiative by three levels of government provides information to help new and developing small to medium businesses. It is an excellent source of information and referral including information about government assistance.

Check the agreement before you sign

After careful consideration, you've made your choice. You've applied for a franchise operation and been accepted. Sometimes you can negotiate with the franchisor to get better terms in the franchise agreement. Then it's time to sign the agreement, or contract, between you and the franchisor.

Before you sign the agreement, read it carefully clause by clause with your lawyer and be sure you understand every part. This can't be emphasized too greatly. The agreement sets out the conditions of your franchise arrangement. Once you sign the agreement you must honour it. If you don't understand any part, go back to the franchisor for a written explanation, or ask your lawyer to make it clear to you. The franchisor should give you enough time to study the agreement and consult with your lawyer and other advisors before signing.

The agreement should specify your rights and responsibilities and those of the franchisor. It should cover every verbal or written promise that the franchisor has made. If there are particular aspects of the business that specially appealed to you, make sure they are included.

There are some items you should check particularly:

Relationships with other agreements

Look at the way this agreement tallies with any other agreements you may have to make with the franchisor. For example, suppose you must lease the business premises from the franchisor. Your franchise agreement is for ten years, but your lease is only for three years. If the franchisor refuses to renew your lease, your franchise agreement will in effect also be terminated after three years.

Renewal

The term of your agreement and the notice needed to cancel the agreement should be stated. The term may be negotiable, but it should be long enough for you to recover your capital investment based on your information.

The agreement should specify the conditions under which it will be renewed. If the franchisor has the right to refuse to renew the agreement for particular reasons, those reasons should be spelled out. What would it cost you to renew? Make sure you don't work to build a successful business, then find the franchisor refuses to renew when your agreement runs out, and you have no right to sell.

Cancellation

Check what the agreement says about the rights of either side to cancel. Usually, the franchisor is allowed to end the agreement if the franchisee doesn't live up to some part of it.

Do you think the provisions in your agreement are fair? Suppose the franchisor considers that you haven't lived up to a part of the agreement. Will you be given notice of the problem, and enough time to correct it, before the agreement is cancelled? Can you cancel the agreement,

and under what conditions? What will you have to do? Will there be any penalties?

Transfer or sale of the franchise

Can you sell the franchise? Does the franchisor get the first opportunity to buy? If so, who would decide how much the business was worth? Will there be an independent appraisal or valuation? Who owns the goodwill of the franchise, you or the franchisor? What if you die or become disabled? Can a family member take over?

Can you get out of your agreement, once it is signed?

Under the *Franchises Act*, the disclosure document provided by the franchisor must be received by the franchisee 14 days before the franchisee signs any agreement relating to the franchise or pays the franchisor. If that is not done, the franchisee may rescind all the franchise agreements by giving notice of cancellation within 60 days after receiving the disclosure document or within two years after the franchise has been granted, whichever occurs first.

You may also have the right to cancel the agreement under civil or contract law. Remember, trying to cancel a legal agreement is expensive and takes a lot of time. You will almost certainly need a lawyer. Investigating a franchisor thoroughly *before* you sign an agreement could save you a lot of grief later. The time and money you spend choosing exactly the right franchise are some of the best investments you can make.

Need more information?

Before you commit to investing in a franchise, you might want to take a course on the subject. Call your local university or community college to find out what's available.

Canadian Franchise Association

1-800-665-4232

www.cfa.ca

- a resource for franchisors and franchisees
- sells publications and a Membership Directory

Franchisee Association of Alberta

John Zlotoff
194 Highland Way
Sherwood Park AB T8A 5V5
Phone: (780) 467-0930

International Franchise Association (IFA)

Suite 900 1350 New York Avenue NW
Washington DC 20005
USA
(202) 6228-8000
www.franchise.org

Canadian Business Franchise

Published 6 times a year in Victoria B.C.
(205) 383-8855
www.cgb.ca

The Franchise Annual Handbook

Published annually in St. Catherines Ontario
(905) 688-2665
www.infonews.com

Alberta Government Services

Administers the *Franchises Act* and regulations
Edmonton: (780) 422-1588
Toll free in Alberta: 1-877-427-4088

The Business Link

An excellent source of information and referral
including information about government
assistance

1-800-272-9675
<http://cbasc.org/alberta>

5th Floor #100
999 8th Street SW
Calgary AB T2R 1J5
Phone: (403) 297-6284

10237 104 Street
Edmonton AB T5J 4A1
Phone: (780) 422-7722

Queen's Printer Bookstore,

Copies of the *Franchises Act*, *Franchises
Regulation (AR 240\95)*, and the *Exemption
Regulation (AR 249\95)* are available here.

Calgary
Main floor, McDougall Centre
455 6th Street SW
Calgary, Alberta T2P 4E8
Phone: (403) 297-6251
Fax: (403) 297-8450
www.gov.ab.ca/qp

Edmonton
10611 98 Avenue
Edmonton, Alberta T5K 2P7
Phone: (780) 427-4952
Fax: (780) 452-0668

To be connected to toll free in Alberta, dial 310-0000 and follow the instructions.

Other organizations**Better Business Bureau**

Calgary and Southern Alberta
350, 7330 Fischer Street SE
Calgary AB T2H 2H8
Phone: (403) 531-8780

Central and Northern Alberta
514, 9707 110 Street
Edmonton AB T5K 2L9
Phone: (780) 482-2341

A current version of this tipsheet and other tipsheets are available at the Alberta Government Services web site at www.gov.ab.ca/gs Most public libraries have Internet access available if you don't have access at home.

If you need more copies of this tipsheet, you have permission to photocopy. Please call our office to make sure you have the most up-to-date version.