The 5 Deadliest Sins A Buyer Can Make

By David Omholt, CFE

As author John Gray is fond of saying, 'Men are from Mars and Women are from Venus'. Likewise, in many franchise systems, it seems as though the Franchisor and its Franchisees are from different planets. However, with the high-performing franchise systems, their stars always seem to be in a line with their franchisee partners. Why is that? I think the answers lay in the effectiveness of the up-front validation process… the mutual validation process.

Although no one can completely error-proof their buying decisions, many commonly-made mistakes can be easily mitigated a priori. And, if not, it can be the beginning of an unhappy, short-lived and financially-underwhelming nuptial period.

In this issue, we highlight the five common Pitfalls a Prospective Buyer Must Avoid:

1. Asking Only the Obvious and Relative Questions

Too many buyers basically ask only 3 questions during their due diligence process:

- How much can I make?
- How much will it cost?
- Where are the best available markets?

Not only are these questions inadequate, they are devoid of context. They almost beg to be answered with a series of rhetorical questions right back at the interrogator: How much do you want to make? Can you follow a system? What are you gifted at or enjoy doing (hint: passion usually leads to profits)? What is your Exit Strategy? Etc., etc.

The point is, a prospective franchisee can make inaccurate inferences, good or bad, from these context-lacking questions, potentially leading to a buying decision based on relative answers.

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Mitigating Actions:

- Prevent misinformation or missed information by following a thorough checklist, such as the AAFD's Road Map to Selecting a Franchise. You can also find great buyer-related resources on the International Franchise Association's website: franchise.org. Download them. Use them.
- Don't neglect some of the "fluffier"-sounding, non-quantitative considerations (e.g., your ability to mesh with the personality/culture of Franchisor's management team and/or the other franchisees). Too many people overlook them and end up getting into a business they don't enjoy (whether it is profitable or not) – which obviously defeats the purpose.
- Get the assistance of an experienced consultant that can point out overlooked and potentially-concerning aspects of the franchise like territory definition or trademark protection (or lack thereof) and weak financial statements, among others. A trained set of eyes will not miss critical points that you might.

2. Not Understanding the 20-60-20 Rule

The bell curve is a reality of life. We have seen it all our lives: in academia, Corporate America, the public sector…wherever you look, you can see this disparate performance distribution across any organization: low performers, average performers and 'star' players.

I think far too often a prospective franchisee gets spooked by low-performing or disgruntled franchisees. You can't expect that everyone in the franchise system just 'mints money' and is a 'happy camper'. I believe one hasn't talked to enough franchisees until they interview those that are performing poorly and/or not making the money they had hoped to by this point of their business lifecycle. At a minimum, they will give you great clues on what not to do in your business! Interestingly, some even have a "victim mentality" where, of course, it was through no fault of their own that they are not making the numbers they had expected. Rarely do they accept any of the blame and you have to temper their negativity (just as you should when talking with the hyper-positive ones).

You are also likely to encounter those franchisees that might perceive you as a potential competitor that would cannibalize their market share and they may intentionally disparage the Franchisor's system in hopes that you do not sign up (even though there is strength in numbers and the franchisor growing and scaling will ultimately help them). Buyer beware!

Mitigating Actions:

- Speak to as many franchisees as possible… new ones fresh out of training, tenured ones, ones near your market or in markets similar to yours, high performers, average performers, low performers, ones with professional backgrounds similar to yours, etc.
- Make sure you ingratiate yourself to the franchisee before barraging them with questions, some of which may be very personal. The first words out of your mouth should not be, "So, how much are you making?"
- Look for franchise systems where the top players are making significantly more than the average performer. The model should not be so constrained that you only get a slight "bump" by being above average.
- Check to see if data providers like Franchise Business Review or FranData carry franchisee reports on the franchises you are investigating. These can be objective, 3rd-party validation sources.

3. Not Narrowing the Search Soon Enough

With some 3000+ active franchises available, you can't look at them all, although it is human nature to want to. I think buyers really dilute their effectiveness by not pruning down to a manageable number early on. They learn only a little about a lot and do not learn enough about any. The risk is a buyer will make a decision without having all the right data points on the franchisor they ultimately select. Or, more likely the case, they burn too much time and eat into their staying power and are forced to retreat back to where they came (and presumably want out of).

You can also get sideways with a franchisor if you don't demonstrate that you are making some progress toward a decision in a reasonable timeframe. Frankly, they are assessing your ability to make decisions and operate at the speed of small business. That is not to say that you should feel pressured or "bum-rushed" into making a decision before you have all the facts.

Mitigating Actions:

- Define your buyer values… things like: your exit strategy, skillsets, weaknesses/'blind spots', preferred clientele, venue, employees, etc.
- As quickly and prudently as possible, pare back the list to a manageable number…say three or four. While this in no way precludes you from looking at others, it gives you a starting point from which to gain forward momentum.
- Create a workplan that leads up to a go/no-go decision. Always anchor-back to this to keep yourself accountable to making progress.

4. Forgetting That It Is a Mutual Assessment

Gone are the days of the fog-the-mirror test and cursory credit checks. Franchisors now have a seasoned and savvy talent pool from which to draw franchisees. And competition for their remaining territories can be fierce and 'darwinistic'. Unfortunately, some buyers have an arrogant, almost entitlement-like posture towards a franchisor.

You need also not forget that the way you treat them is viewed as the way you might treat a customer. Top franchise company executives do not subscribe to the notion that people have one behavior for one group and another for a different group. They believe that people live by a consistent modus operandi, treating every person with respect and courtesy, or they do not.

Mitigating Actions:

- Pay homage to the franchisor. They took the first big (and expensive) risk in developing the franchise system.
- Remember that they are interviewing you just as much as you are interviewing them. After all, it is their brand and they are looking for good stewards (note I did not say robots).
- Treat everyone as you would treat a customer.

5. Being Either Too Analytical or Too Intuitive

Both are equally sinful and equally ineffective. There is no perfect model and it doesn't take an Ivy League MBA to poke holes in a viable model. At the same time, the pure gut feel-based decision makers are a scary breed too.

Mitigating Actions:

- Accept the fact that every business generally has some sort of "wart" on it, or at minimum, some aggravating nuisances you'll have to deal with.
- Be data-driven but don't over-analyze things. Ultimately, draw upon your empirical data, franchisee sound bytes, professional advisors and your experiential base of knowledge to decide the right path forward.
- Engage an attorney that specializes in Franchise and Distribution Law who can represent your interests in the transaction.
- Beware of input from investment advisors who may be worried that their income will potentially decrease if you take funds away from their management to use for opening your own business. It can be a conflict of interest.