

REPORTER'S NOTEBOOK



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Nancy Kaffer

Franchisees have some loan benefits

When you're asking a bank for a business loan, pitching a franchise concept has some advantages over a traditional startup business.

"When we underwrite a franchise, we have the ability to look at the franchise nationally," said Tom Zernick, a vice president and head of U.S. Small Business Administration-backed lending at Flint-based Citizens Republic Bancorp Inc. "There are statistics published on the default rate of franchisees nationally, so when a Jimmy John's (Gourmet Sandwiches) or a Quiznos comes to us, we have a track record of how they perform nationally."

Another plus, Zernick said, is that the franchisor has often prescreened the franchisee's financial eligibility.

"They can require a certain amount of liquidity post-closing," he said. "They want the store to stay open. They can provide advertising, projections ... a franchisor can be a valuable partner when they produce very good industry statistics on a franchise in a particular market."

But a franchise isn't a free pass to a business loan. Prospective franchisees must still meet the same stringent requirements as any business loan applicant.

"When we underwrite, we really look for management experience," he said. "What are the owners bringing to the table? We look at the résumé, look at their background, what skill sets do they have from past employment or a previous job that they'll bring into the new franchise?"

The down payment is also important, Zernick said.

"We're going to want anywhere from 20 to 40 percent down in cash," he said. "We want them to have some skin in the game, because we're not an investment bank."

Prospective franchisees are eligible for SBA-backed loans, he said, noting that a list of franchises preapproved for SBA loans is available online at www.franchiseregistry.com.

Like any would-be business owner, a prospective franchisee must be a viable prospect for the lender, Zernick said.

"We look at post-closing cash, how much working capital do they have, because we often find that the number one reason businesses fail is they went in undercapitalized," he said. "We would not put a borrower in a position where they would be so highly leveraged with no working capital. We like to see a secondary income coming into the household so the income from startup isn't the only way to pay the bills. We like to see collateral, or a guarantor."

For all loan applicants, Zernick said, it's important to be prepared.

"It comes down to having a well-prepared business plan when you come to the bank that documents these kinds of items: What's the cash in going to be, what kind of collateral, what other income is coming in, what kind of management experience do you have, what are you bringing in in terms of résumé?"

FOCUS

FRANCHISING



LOCATION, LOCATION

Bieri Co. president and CEO addresses franchisee real estate needs, **Page 12**



GLENN TRIEST

Michael Ansley, president and CEO of Diversified Restaurant Holdings Inc. in Southfield, has owned franchises for 14 years and now plans to sell franchises of his Bagger Dave's Legendary Burgers and Fries. He said franchising has evolved during his time in the restaurant business.

Working with a net

Franchising offers support to would-be biz owners; more look to get into the act

BY NANCY KAFFER
CRAIN'S DETROIT BUSINESS

Fourteen years ago, Michael Ansley opened his first Buffalo Wild Wings franchise.

Then 25 and a recent graduate from the University of Dayton in Ohio, Ansley had become a fan of the restaurant and thought its formula was one that would pay off.

QUICK TIPS

Guide: Things to consider before becoming a franchisee, **Page 10**
Homework: Study the disclosure document, **Page 11**

Back then, Ansley said, franchising was a more casual arrangement.

Ansley lacked restaurant and business experience; as a franchisee, he

thought he'd get help with both.

So he and a then-partner borrowed the \$25,000 it cost in 1996 to buy a Buffalo Wild Wings franchise and opened shop in Ypsilanti.

"In the early days, it was more of a handshake and here's our document. I had no idea what it said, and luckily it worked out," said Ansley, who advises prospective franchisees to be more aware. "It's really important to understand what you're getting into."

Now Ansley's president and CEO of a \$19-million-a-year company, Southfield-based Diversified Restaurant

Holdings Inc., with 17 Buffalo Wild Wings restaurants, three in the works and a franchise concept of his own: Bagger Dave's Legendary Burgers and Fries. He also has learned lessons on franchising that he

thinks will serve him well as a franchisor.

With no significant job growth in sight, more Michiganders are getting serious about business ownership, and for an increasing number of would-be business owners, that means franchising, said Mark Cory, a franchise placement specialist at Grosse Pointe-based FranNet Detroit.

The franchise industry has evolved, and franchisees and consultants agree that today there are resources to ensure better structure and training.

Cory said interest is further increased because potential business owners see lower

risk, more support and easier access to financing.

"There are more and more people who are at the end of their rope and may have considered making a change and getting into their own business in the past," he said. "Now — because of the long job search, the frustration and limited amount of opportunities out there, especially for people in their 40s or 50s or early 60s — many are getting serious about looking for business ownership."

But franchising isn't for everyone, cautions Bingham Farms-based attorney David Steinberg, who specializes in franchise law.

"You have to be willing to be a follower of sorts," he said. "If you're not the kind of person who can follow rules and regulations in a given format, maybe it's not for (you)."

And it's key for franchisees to choose a franchise that fits their talents, Cory said.

"They should consider their transferrable skills, the things they have learned and been good at from prior employment," he said. "Consider their

"If you're not the kind of person who can follow rules and regulations in a given format, maybe it's not for (you)."

David Steinberg,
franchise law attorney

Focus: Franchising

Support: More consider franchising

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role in the business and what their preferences are in terms of their day-to-day activity.

"Among the topics to consider: hours of work required, people and management skills, sales and marketing ability, and preferences on whether to sell services or products to end users or do B-to-B sales.

And buying a franchise doesn't eliminate all risks.

"People have to be careful, because a franchise is not an insurance policy," Steinberg said. "If things don't go well, it doesn't mean you can sue."

Ansley said in his franchise development, things could have gone horribly awry.

"It was very difficult," he said. "Back then, the franchise structure and training were horrible. The people involved didn't have a lot of experience with franchising, and you were left on your own. I think franchising has evolved tenfold since I got involved."

Ansley said learning on the job gave him the experience he needed to buy a second franchise when his partner bought him out of the Ypsilanti location.

The Bagger Dave's concept that Ansley plans to franchise came with some rules, given his Buffalo Wild Wings restaurants in Michigan and Florida.

"I had to stay away from the sports bar segment and chicken, more or less," he said. "But Buffalo Wild Wings was very, very cooperative. The laws are very protective in that essentially you can't go out and be Buffalo Wild Wings, and why would you want to? I'm still a franchisee."

There are three Bagger Dave's corporate stores, and one is under construction in Brighton. It is approved as a concept for franchising in Michigan, Illinois and Ohio.

Before getting serious about buying into a franchise concept, new or established, prospective owners need to do their homework, Steinberg said.

Each franchisor is required by the **Federal Trade Commission** to produce a Franchise Disclosure Document that should detail the ins and outs of the business.

"Look at the financial statements very carefully," he said. "I know what to look for, but I'm not an accountant. I tell people, please go have an accountant or CPA look at this to make sure you're not buying from a company that's losing money. If the franchising company is not making money, I don't know why you would, either."

Be conservative about costs, Steinberg said.

"Federal law requires franchisors to determine how much working capital (a franchisee) will need for the first three months. ... I find that the range given is too low," he said. "When I review the Franchise Disclosure Document, I tell them to add another 30 percent on top of that figure so there's no surprises."

"Another red flag is not knowing what it's going to cost you to build the store, to build the fran-

A ROADMAP TO WEIGHING FRANCHISE BUSINESS IDEAS

- Expect to pay between 4 percent and 10 percent of gross revenues in royalty fees to a franchisor. But make sure you know what you're getting for your money — a low royalty might mean higher business operating costs.
- Ask how much of the fees you'd pay will be used to directly benefit franchisees in your area.
- Inquire about the franchisor's advertising program. If the franchisor doesn't offer advertising for franchisees, make sure to

budget for those costs.

- What kind of initial training and ongoing support does the franchisor offer? Ask current franchisees what they've experienced.

- Don't just speak to franchisees recommended by the franchisor. Do the homework and interview other franchisees.

- Evaluate the strength of the franchisor financially, but also look at the company's management team.

Where to turn

There are online resources designed to assist would-be franchisees. Among them:

- SBA Small Business Planner, Buying a Franchise www.sba.gov/smallbusinessplanner/start/. Click on "Buy a Franchise."
- www.frandata.com
- www.frannet.com

- www.franchiseregistry.com
- **International Franchise Association**, www.franchise.org
- **The American Franchisee Association**, www.franchisee.org

chise in full before you open. If you don't know exactly what the build-out's going to cost you, how much the lease is going to cost, how much for advertising, you're going to be in trouble."

Different franchisors offer differing levels of advertising support, Steinberg said.

"Advertising is very important, and the franchisee needs to make an inquiry into what kind of advertising the company is going to be doing"

on the franchisee's behalf, he said.

When choosing to purchase a franchise, a prospective business owner should plan to spend upwards of \$50,000, Cory said, and expect to pay 4 percent to 10 percent of gross revenue in royalties to the franchisor. The amount of royalties will likely indicate the level of support a franchisee may expect to receive from the franchisor.

Steinberg said that the potential franchisee should be careful to protect himself or herself financially.

"What we normally do for a franchisee is encourage them to create a subchapter S-corp or an LLC, and never to own anything in their own personal name," he said. "That's just to limit potential exposure to downside risk from liability. If they end up owing money to a vendor or supplier, they want money to be owed by the entity, not by them personally."

However, he said, quite often a franchisor will ask a potential franchisee to sign a personal guarantee.

It can be easier to get a bank loan to purchase a franchise, Cory said, but getting financing isn't a gimme.

"A lot of people are looking at alternative sources, primarily utilization of existing 401(k) or IRA funds," he said. "I've found that

probably the majority of my clients have used those. If done right, it can be done without incurring penalties or taxes by setting up a C-corp, establishing a new 401(k) in the company name,

rolling the existing 401(k) in, and using it to buy stock in the company. It's not like a loan, it's like a little IPO, but private, not public."

Tapping into 401(k) savings is how Kim and Scott Frane recently purchased a **Speedpro Imaging** franchise. The company makes large display graphics.

Kim Frane said Speedpro's franchise support appealed to the couple.

"They have a very good training and mentoring program to help you seek out business, and have production and technical teams to make sure you can get support, make sure you have everything covered from the technical aspect," she said. "That's very much a reason why we went into a franchise. With a franchise, we felt we'd have a much better success rate."

Kim Frane, formerly in mortgage lending, is working to open the shop, while Scott has kept his day job in the automotive industry.

"We're both hard workers. So we thought, we could have our 401(k) in the market and possibly lose it. ... Do we trust another company to make it profitable for us, or do we trust us?" she said.

Frane said the couple decided to buy a business based on the same theory.

"We started thinking that if we put forth the effort working for ourselves the way we did for the companies we're employed with, we would be so much further ahead," she said.

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“With a franchise, we felt we’d have a much better success rate.”



Kim Frane, Speedpro Imaging

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