Franchise Brokers Association

Franchising as an Investment Strategy

A white paper comparing franchise investments with other investment vehicles

Contents

Introduction

Most people hope to have disposable income during their lifetime to invest and ultimately build their wealth. However, when it comes to investing, most people know little about stocks, bonds, and real estate. They may have been exposed to it through discussions with family, observations of the marketplace, or their own investments in 401ks or IRAs.

But do most people realize that one of the best investment options–albeit rarely discussed–is business ownership? The wealthy do! Corporate employees, who often develop an understanding of business and management skills, rarely evaluate whether this investment option is for them. As you will discover in this paper, business ownership may be one of the best options an investor can consider. And, as we will discuss, franchise ownership in particular and working with experienced franchise consultants and brokers is probably the least risky way to evaluate it. Best of all, your evaluation when working with brokers–like FBA brokers–costs you nothing unless you decide to choose a franchise and invest.

The Federal government through its tax policy provides substantial benefits to business owners. However, the principal reasons to consider business ownership are financial. When you invest in a franchise, you technically are partnering with a management team, the franchisor, who has successfully operated a similar business for years and whose interests are totally aligned with yours. They do well when their franchise owners do well.

As you will learn, the potential returns associated with business ownership are multiples of other investment options but what may be the most important is the control factor. Unlike other investments, when you are the owner of the business–you control it. You don't depend on others.

Unlike other investments, when you are the owner of the business you control it.

Your success is largely determined by you.

Here is food for thought. Tom Corley, a financial advisor, tax specialist, and accomplished author completed a 5-year study of millionaires. What he found was that millionaires exhibit certain habits–he wrote all about it. **However, during the same study, he classified the 233 participants into various types of people, and what he found was stunning. When he classified the individuals into different groups, ranging from the employee saver type, the corporate executive, the successful doctor or lawyer, to the entrepreneur, he found that the entrepreneur made their millions 20 years sooner than the employee saver. This arguably suggests that entrepreneurs create wealth much quicker and this paper will hopefully illustrate the reasons why.**

But before we look at the possible benefits of owning a franchised business as an investment, let's consider some of the other alternative investments an investor might own or be considering as an alternative, Take a look at the chart on the next page.

According to Tom Corley's study, he found that the entrepreneur made their millions 20 years sooner than the saver investor.

Investment Vehicle	Growth Potential	Cost to Purchase or Sell	Level of Control	Leverageable Investment	Visibility of Investment Quality Before Purchase
Public Stocks	Varies widely depending on company, industry and the relative benefits of the company's actions relative to the entire market.	Liquid market valuation depends on market conditions.	Moderate control through buying, holding, or selling shares (playing the market). No control over the company or its board.	A marginal loan of up to 50% of value is generally possible but not recommended. Can increase level of holding but market swings and trigger liquidity calls.	Annual reports, review of historical returns, market watcher evaluations.
Investment Real Estate	Varies depending on location, property type, and rental demand.	Requires significant upfront investment (downpayment) and ongoing expenses.	High control over property management, maintenance, and improvements. Introduces collection risks.	Common to leverage against the equity of the real estate. Can substantially increase investment return.	Comparisons, property disclosures, review of historical returns, and inspection reports. Future value is driven by the general market, payment history, and condition of actual property.
Bonds	Relatively limited growth potential unless the instrument held for long periods.	Varies depending on payment rating of issuer and market interest rate conditions.	Limited control over returns (interest only, not general market), but can make decisions regarding types of bonds and duration of holdings.	Very short-term borrowing on Exchange Traded Funds (ETF) Market conditions magnify returns good or bad.	Prospectus and interest market conditions and projections.
Commodities	Varies widely depending on supply and demand dynamics and market conditions. Very speculative.	Varies depending on types of commodities and market conditions. There are public markets.	Limited control over returns but can make decisions regarding types of commodities of holdings. Highly speculative because of market participants, both physical and financial traders.	Possible but not recommended. Much more volatile than stocks, bonds, and real estate.	Range of information and reports through commodity exchanges and industry reports.
Crypto	Varies widely depending on market sentiment and technological developments.	Varies depending on marketing conditions.	Limited control over returns, but can make decisions regarding the timing of purchases, sales, & overall amount held.	Cryptocurrency-collateralized loans are high-interest and subject to margin calls and liquidation.	Is not as heavily regulated as other investment vehicles, cryptocurrencies often have whitepapers or technical papers.

Let's break down this information in greater detail.

Stocks

Growth Potential

The growth potential of public stocks can vary widely depending on the company and industry in question. Most investors evaluate company valuation, both public and private, on its cash flows and the probability of the continuity of those cash flows. Some stocks may experience rapid revenue growth or cost reductions due to factors such as innovation, strong leadership, and favorable market conditions. A company with ever-growing cash flows and strong leadership is thought to be able to weather changing market conditions and fare better than its competitors in the same market.

Cost to Purchase

Stocks can offer reasonable long-term returns, but can also be subject to high volatility and risk. The cost to purchase public company stocks can vary widely depending on the company and market conditions, but most advisors suggest picking a stock that the Stock Investor thinks will perform well and simply investing in it rather than trying to pick the exact time to purchase it. Returns can be influenced by factors such as company performance, economic conditions, and geopolitical events. Stocks can be purchased directly with the assistance of market participants like stock brokers and financial institutions

Level of Control

Investors have very limited control over the performance of a stock portfolio they invest in through their decisions to buy, hold, or sell particular shares. Investors do not have any control or influence over the individual performance of a specific stock or its underlying value. However, external factors such as market conditions, geopolitical events, and company-specific news can also have a significant impact on the performance of a particular stock.

Leverageable Investment

It is generally not recommended for most investors to get a loan on stocks. This type of loan is known as a margin loan, and it allows investors to borrow money, generally up to 50% of the stock's market value from a broker or a lender to purchase stocks, using the purchased stocks as collateral.

While margin loans can provide investors with additional buying power and potentially increase returns, they also come with significant risks. For example, if the margin loan is 20% of the stock's underlying value, in the best case, there will be no problems. However, if the amount of the loan is closer to 50% and the value of the purchased stocks declines, the investor may be required to add additional funds immediately to the account to meet the margin call, or may be required to immediately sell the stocks to repay the loan, potentially resulting in significant, unintended losses.

In addition, margin loans often come with higher interest rates and fees than traditional loans because of the market volatility aspect, increasing the overall cost of borrowing. Therefore, margin loans are typically only suitable for experienced, liquid investors with a high tolerance for risk who can carefully manage their investments and monitor market conditions closely.

Visibility of Investment Quality Before Purchase

Publicly traded companies are required to file quarterly and annual reports and other periodic disclosures with the Securities and Exchange Commission (SEC). These reports must be readily available to the public and provide information about the company's financial performance, operations, and management. Investors can also review analyst reports and financial news to evaluate the potential of a stock investment.

Rental Income Producing Real Estate

Growth Potential

The growth potential of rental real estate investments can depend on factors such as location, property type, and rental demand. Leverage can increase those returns but just like other debt-related strategies it can accentuate losses on the downside in bad market conditions. Over time, real estate values generally trend the overall market increasing in value. However, in some cases, real estate investments may experience rapid revenue growth or loss due to factors such as demand and supply in a particular market. Also, rental, income-producing real estate is subject to collection risks from the tenants, and occupancy laws generally favor the tenant in the areas of nonpayment or dispute. Unlike investments in public stocks or bonds, these investments are illiquid and may require many months to liquidate.

Cost to Purchase

Real estate investments can offer potentially stable returns and appreciation in property value over a reasonably long term but can require significant upfront investment and ongoing expenses such as maintenance, property taxes, insurance, and possibly debt service.

Level of Control

Real Estate Investors have a higher degree of control over the performance of their investments, as they can make decisions regarding property management, maintenance, and improvements that can impact rental income and property value. However, external factors such as economic conditions and changes in rental demand can also impact real estate performance.

Leverageable Investment

Real Estate Investors can leverage their real estate assets with a loan. This type of loan is commonly referred to as a mortgage. A mortgage is a loan specifically designed for purchasing real estate, whether it's a home, a commercial property, or an investment property. Of course, the terms of the loan vary depending on the use of the property, with investment property requiring larger down payments and higher rates. When Real Estate Investors take out a mortgage, they typically use the property they are buying as collateral for the loan.

Visibility of Investment Quality Before Purchase

Before purchasing a property, investors can conduct due diligence by reviewing property disclosures, inspection reports, and other relevant documents. Investors can also evaluate the potential return on investment by analyzing rental rates, vacancy rates, and property appreciation trends.

Bonds

Growth Potential

Bonds do not grow in value. The bond pays interest on the investment but does not grow with time. Bonds are typically more limited than stocks or real estate, as they generally offer a fixed rate of return. However, bonds can still provide steady income and moderate growth over time. Zero coupon bonds do not make interest payments, but pay out a set amount after a defined period, typically 10 years.

Cost to Purchase

The cost of a bond can vary widely depending on the type of bond, the issuer, the creditworthiness of the issuer, and the prevailing interest rates. Bonds are typically issued with a face value, which is the amount the bond will be worth when it matures, and they are typically priced as a percentage of their face value.

For example, if a bond has a face value of $1,000 and is priced at 90%, it would cost $900 to purchase the bond. However, it's important to note that the actual price of a bond can be influenced by several factors, including the coupon rate (the interest rate the bond pays), the maturity date, the creditworthiness of the issuer, and market conditions.

In addition, when purchasing bonds, investors should also be aware of any associated fees or commissions, which can vary depending on the broker or financial institution facilitating the purchase. It's always a good idea to do research and compare prices and fees from multiple sources before making an investment decision

Level of Control

Investors have limited control over the performance of bonds, as their returns are largely determined by interest rates and credit risk. However, investors can make decisions regarding the types of bonds they invest in and the duration of their holdings.

Leverageable Investment

Not advisable. The interest rate on a loan may be higher than the return rate on a bond, especially for high-quality bonds such as those issued by governments or highly rated corporations. This means that borrowing money to invest in bonds may not be an effective strategy, as the interest payments on the loan may eat into the returns generated by the bond investment. Additionally, bonds are generally considered lower risk than many other investments, but they are not risk-free, and investors may face losses if the bond issuer defaults or interest rates rise.

Visibility of Investment Quality Before Purchase

Investors can review a bond's prospectus, which provides information about the bond issuer, the terms of the bond, and the risks associated with the investment. Bond rating agencies such as Moody's and Standard & Poor's also provide ratings on bond issuers, indicating the level of risk associated with the investment.

Commodities

Growth Potential

The growth potential of commodities can vary widely depending on factors such as supply and demand dynamics, geopolitical events, and market conditions. Some commodities may experience rapid price growth due to factors such as limited supply or increased demand, while others may experience slower growth or even decline due to oversupply or weak demand.

Cost to Purchase

Commodities can offer potentially high returns, but can also be subject to high volatility and risk. The cost to purchase commodities can vary depending on the type of commodity and market conditions, and returns can be influenced by factors such as supply and demand dynamics and geopolitical events. The difference between the offer price and the bid price is the cost to buy.

Level of Control

Investors have limited control over the performance of commodities, as their returns are largely determined by supply and demand dynamics and market conditions. However, investors can make decisions regarding the types of commodities they invest in and the duration of their holdings.

Leverageable Investment

Commodities can get loans against them but it is generally not recommended for most investors. Like stocks, investors can use margin loans to borrow money to invest in commodities, using the purchased commodities as collateral.

However, investing in commodities can be highly risky, as their prices can be subject to volatility caused by factors such as changes in supply and demand, geopolitical events, and changes in currency values. Additionally, many commodities are traded on futures exchanges, which means that investors may be required to roll over their contracts or make additional margin payments, increasing the overall cost of the investment.

Furthermore, margin loans for commodities may come with high interest rates, fees, and restrictions, and investors may be required to maintain a minimum account balance or meet certain eligibility requirements.

Therefore, it's important to carefully consider the risks and costs associated with investing in commodities and to consult with a financial professional before taking out a loan to invest in commodities. It's also important to have a well-diversified investment portfolio that aligns with the investment goals and risk tolerance.

Visibility of Investment Quality Before Purchase

Commodity markets are highly regulated, and investors can access a range of information and reports through commodity exchanges, such as the Chicago Mercantile Exchange (CME). Investors can also review market trends, supply and demand factors, and other economic indicators to evaluate the potential of a commodity investment.

Crypto

Growth Potential

TThe growth potential of crypto can be difficult to predict, as it is subject to factors such as market sentiment, regulatory developments, and technological advancements. Crypto has experienced rapid price growth at times in the past, but it is also subject to significant volatility and regulatory risks.

Cost to Purchase

The price of crypto can fluctuate widely based on various factors, including market demand, supply, and overall investor sentiment. Crypto Investors can find the current price on various cryptocurrency exchange platforms or financial news websites that report on the latest market data.

It's worth noting that Bitcoin, like other cryptocurrencies, is known for its volatility, and its price can fluctuate rapidly over short periods. Therefore, investing in bitcoin can be considered a high-risk investment and should be approached with caution. Investors should conduct their research and carefully consider their investment objectives and risk tolerance before investing in Bitcoin or any other cryptocurrency.

Level of Control

Investors have very limited control over the performance of their investments, as the price of crypto is largely determined by market sentiment. However, investors can make decisions regarding the timing of their purchases and sales, as well as the overall amount of crypto they hold.

Leverageable Investment

Crypto loans, also known as crypto-backed loans or cryptocurrency-collateralized loans, have become more common in recent years as the cryptocurrency market has grown. These loans are offered by various online platforms, lending institutions, and decentralized finance (DeFi) projects.

Cryptocurrencies are known for their price volatility, and fluctuations can affect the value of Investors collateral, potentially leading to margin calls or liquidation.

Interest rates for crypto loans can be relatively high compared to traditional loans. The rate Crypto Investors receive depends on various factors, including the platform they choose and the terms of the loan.

Crypto loans can be a useful financial tool, but they come with unique risks and should be used prudently. Before obtaining a crypto-backed loan, it's advisable to consult with financial professionals and understand the specific terms and conditions of the loan agreement.

Visibility of Investment Quality Before Purchase

While not as heavily regulated as other investment vehicles, cryptocurrencies often have whitepapers or technical papers that provide information on the underlying technology, the cryptocurrency's value proposition, and other relevant details. Investors can also review news and analysis from industry experts to evaluate the potential of cryptocurrency investment.

Business Ownership through Franchises

Before looking at the basics of franchise investment and its pros and cons, it's important to consider the fundamental reasons most people make investments in businesses and some of the fundamental elements of this decision. In most cases, investments are made with the disposable income of the individual and are made for the purpose of garnering long-term gains in value as compared to alternative investments that may have a dual purpose like second homes. All of the investments we discuss above can achieve these results. However, it's the amount of long-term gain potential that is likely one of the most significant differences in why people consider business ownership.

A Review of US Business and Background

According to the U.S. Small Business Association (SBA), small businesses of 500 employees or fewer make up 99.9% of all U.S. businesses and 99.7% of firms with paid employees (1). So, while the great dollar value of business today is concentrated in a few large public companies, most employees work for small companies. One may wonder, why are there so many small businesses? Simply because that is where the money is and the opportunity for individuals to control a company. Unfortunately, this financial fact is not readily shared with the general public or in many cases, Prospective Franchise Owners considering their investment options.

When considering that Financial Advisors are fiduciaries to the Investor and would want to share this wealth creation concept with their clients, Investors will find that largely the opposite is true. While surprising, this is because their compensation is directly tied to their existing portfolio of assets. Most of them recognized the fact that investment in a business can be a very strong step in building wealth, however, it may not necessarily be in the short-term interest of their firms to recommend this over more traditional investments.

An exception to this trend was encountered in Denver Nowicz, a financial advisor who articulates unconventional perspectives in his newsletter, "The Modern Family Dynasty," published on LinkedIn. Mr. Nowicz's publication elucidates advanced tax defense and wealth enhancement strategies, particularly appealing to those seeking alternatives to conventional financial advice. Mr. Nowicz's advocacy for business ownership is illustrated in a recent newsletter featuring a chart depicting the prevalence of various investments among affluent individuals.

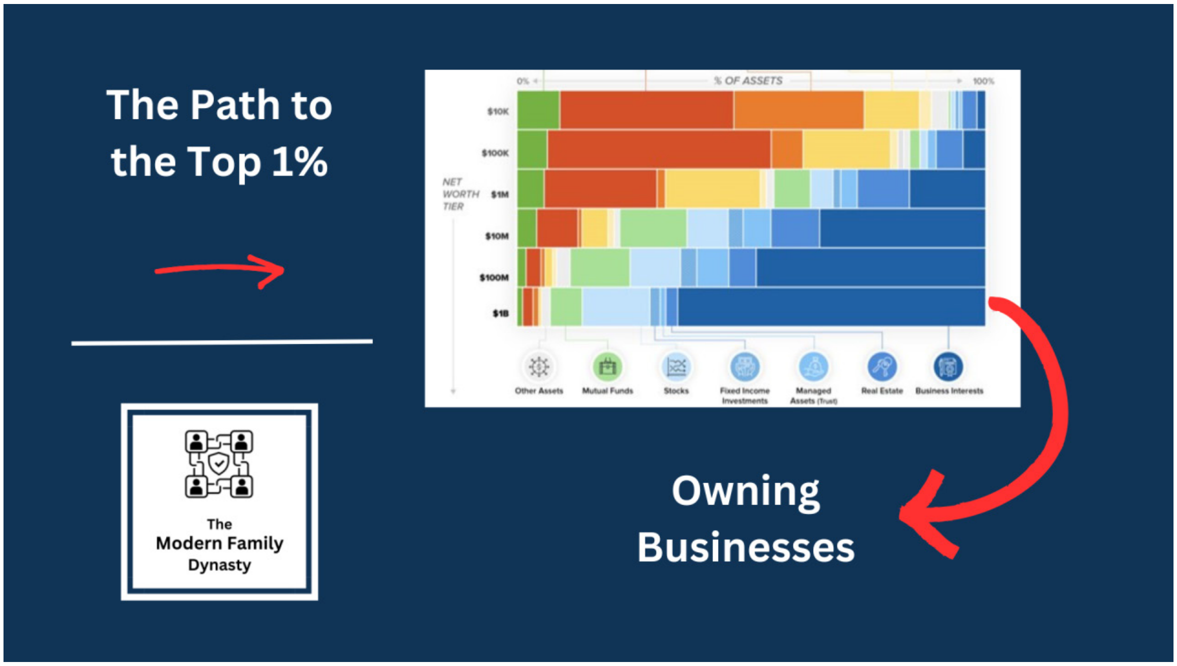
The chart below delineates the proportion of wealth allocated to "business interests or investments in business assets." Notably, at an investment portfolio level of $10,000, business-related investments are negligible, while Investor Owners at the billion-dollar level allocate approximately 70% or more to such endeavors. This empirical evidence underscores the viability of business ownership, especially through franchises, for individuals aspiring to build wealth.

> The billionaire's investment mix has up to 70% or more in business ownership.

It is imperative for individuals interested in building wealth to consider business ownership, particularly through franchises. It’s essential for these key reasons:

1. Good or bad, investing in a franchise is the only investment an Investor Owners can make where they partner with experienced, successful business owners, and the Investor Owners control the local business (near total control);

2. US income tax laws and policies benefit business owners in general and self-employed owners in particular;
3. Rates of returns that can be achieved in a franchise are much higher than stocks and bonds, etc.



The chart shows a strong case that business ownership has definitely worked and is being used to build wealth by some of the wealthiest people in the world. Why then, should a young person consider business ownership and why should they look at franchising?

Building wealth from a young person's point of view, should take into consideration these points of progress throughout their lifetime:

A. Initial Stage (Lifestyle) - Spend less than you make and save.
B. Emergency Fund - College Savings
C. Retirement Savings
D. Taxable Savings Accounts
E. Accumulating asset- Real Estate, Business

Most people recognize that one should focus on making tax-deferred savings like Section 529 College Savings funds and 401k retirement funds. Most understand that there are tax-deferral benefits with these accounts, but most don't understand how significant this tax benefit can be.

Here's an example. If an employee is saving $1,000 a month in 401k savings, the federal and state governments are essentially providing them approximately $3,000 a year in assistance through deferred taxes. Once the money goes into the tax-protected (until withdrawn) account where earnings are not taxed, that can provide another 1.5% in annual returns on their investments. This can add up over a 25-30 year funding lifetime.

Conceptually, an individual should maximize their tax-deferred savings before they begin building savings accounts where earnings are taxed. This especially argues for building retirement accounts because after all, when Investor Owners begin withdrawing these amounts and paying taxes on the withdrawals, they can possibly live entirely on these amounts with little other sources of income to meet their living expenses and growing medical expenses. And if they are counting on the Federal Social Security plan for retirement income, they probably should assume that if it is available, it will provide income just above basic needs. In other words, to count on it as a basic source of retirement may prove costly if the plan fails or is substantially modified to maintain its continuity.

If there is agreement that funding tax-deferred accounts like retirement plans is critical, it's important to know that if a business owner sets up a business and sets up a Self-Employment Pension (SEP) plan, the Investor Owner could possibly contribute and deduct up to $60,000 annually. This is almost 3 times what the employee can fund annually if working for a corporation.

Now for this factor to be significant in Investor Owners's retirement savings, this assumes that the new business makes enough where they have disposable income to fund the plan. But, even if this is not the case in year 1 of the business, it can certainly happen over a few years. And the growth in the retirement fund at this annual funding level could shorten the 25-30-year funding lifetime substantially and accelerate things like investments in second homes or income-producing real estate investments. Again, this is so vital to the person who wants to build wealth. If their retirement is funded early they can either expand their business or venture into other investments that meet other purposes like family assets.

Most young people don't consider this, because they don't believe they can fund a new business. But to give another example of how the Federal tax policy favors business ownership, it actually allows an individual to essentially transfer retirement savings out of an existing plan that they may have (with the company they are working for) to fund a new retirement plan (ROBS which stands for a Rollover Business Start Up) to fund all or part of the new business.

One could argue that there are several great reasons why young people should consider business ownership and specifically buying a franchise. But, probably the greatest reason is because of the rates of return possible. After all, it's where the money is. As an example, most people are either not funding their retirement plans with enough contributions annually or they probably are not realizing enough returns on their investment. After all, while the financial returns of individual stocks and bonds will vary, over the long term, these investments generally earn around 6%. If a Prospective Investor considers compound interest on these investments, retirement accounts will only double twice over a person's 25-year investment period. If a Prospective Investor is contributing more like $60,000 in a SEP that is less of an issue, but if they are investing more like $12,000-$15,000 annually, that can be a big issue. Financial advisors think that most people need at least 10 times their annual cost of living in their retirement accounts when they retire and for most people, this generally just doesn't work at the $12,000-$15,000 a year investment contribution.

Let's also look at the rate of return on a business. As a member of FBA, we have access to many great franchise businesses. Here is an example of the financial opportunity in general. If a franchise costs $200,000 to start, earns top-line revenue of $600,000, and produces a net revenue of 20% in EBIDTA (Earnings before interest, depreciation, taxes and amortization) then the annual return of this business amounts to a 60% rate of return on the $200k investment. This is why wealthy people have so much of their fortune invested in businesses.

These are just the financial considerations of owning a business or investing in a franchise. There are risks associated with this investment just like every other investment. Again, there is a big difference in the fact that with a franchise, the Investor Owner controls the investment. Unlike an investment in stocks or bonds, where the only action an Investor Owner can take if the business falters, is to sell the stock. With a franchise, Investor Owners have near total control and are working with the franchisor/partner to execute strategies to deal with the financial performance of the business. Now, let's look at why prospective Investor Owners should consider franchises and what factors they should explore.

Growth Potential

The growth potential of franchises can depend on factors such as the strength of the brand, the quality of the product or service, and the effectiveness of the franchise model. In many cases, these businesses have been operating for years in different markets, under varying market conditions. They have developed standard operating practices, including possible mitigation techniques such as the use of key performance indicators, measurement systems, business supplier arrangements, etc. that allow the owner to not only measure financial conditions but to perhaps anticipate them before they develop. In some cases, franchises may experience rapid revenue growth due to factors such as high demand and effective marketing, while in other cases, growth may be slower due to competition or other factors. Some franchise businesses are less susceptible to economic factors such as inflation because the demand for their product or service is considered necessary.

Cost to Purchase

As we have discussed, franchises can offer potentially very high rates of returns and the support of an established brand can be critical to the success of an owner. When an owner purchases a franchise they should try to match the brand's strengths and past performance with their individual skills and preferences. But, generally, an owner should be focused mostly on the function of "executing" the business plan and not the creation of the plan. Likewise, the owner should consider how much capital they wish to put at risk. Significant upfront investment and ongoing fees may generate higher returns, but they may also limit the owner's true flexibility and create more stress if the business doesn't develop as expected. Again, think of the franchisor as a partner who has previously demonstrated the success of its business with prior owners and in different markets. They want new owners, but consistency in practices, products, and services can be very important to them. Try to match the cost to purchase with the owner's risk profile and tendency to follow proven practices. This is important for both buyer and seller.

Level of Control

Franchise investors have high control over the performance of their investments, as they can make decisions regarding the operation and management of their franchises within the framework of the franchise agreement. The early review of the franchise purchase opportunity should focus on the disclosures by the franchisor and their existing owners, but a Prospective Investor Owner should pay close attention to the franchise agreement, which is the governing document that outlines the business relationship between the parties. These documents have to be developed to describe how key functions will be handled and the responsibilities of the parties. But, remember they must deal with conditions that hopefully will never be encountered (the bad case scenarios), and in those cases, the contract will favor/protect the franchisor and indirectly other owners. A careful review of this document by an experienced franchise attorney can not be overstressed to Prospective Investor Owners. The new owner may not have had much success in modifying the document, but they should understand how it works and what they are committing to.

Leverageable Investment

Remember the returns can be very high in the case of a successful franchise business. However, when considering business ownership in general, businesses more commonly fail because of undercapitalization. In the example of the franchise returning 60% investment return, there was an assumption of no debt. Of course, one could argue that a business earning returns at that level could obviously afford some debt even in today's economy.

Prospective Investor Owners should develop financial models that forecast cash flows and business performance under varying conditions. It is especially important to stress test these models because the various components of the business are interlinked to cash flows. If revenues begin to drop due to market conditions, operating costs can become more significant causing modifications in the business. However, if the owner cannot infuse more cash and can only adjust variable costs in the business and therefore they have to reduce payroll, advertising, etc. this can further stress the cash flows and the business. This condition is sometimes referred to as a death spiral and an owner must avoid this at any cost and thus may choose to have less debt and fixed related costs than it might otherwise consider. It is very important to understand these dynamics in a Prospective Investor Owners proposed business before engaging with lenders. After all, Prospective Investor Owners will have great success in their discussions with lenders if it is evident that they understand these factors and are focused on the mitigation of these risks.

Many financial institutions, including banks and credit unions, offer franchise financing options to Prospective Franchise Owners. Here are some common methods to secure financing for a franchise:

SBA Loans

The U.S. Small Business Administration (SBA) offers various loan programs to assist small business owners, including those interested in purchasing a franchise. The SBA doesn't directly lend to business owners but provides loan guarantees to approved lenders (commercial banks generally), making it easier for borrowers to qualify for loans with favorable terms. These loans will be made under specific SBA programs with published conditions. The type of franchise business may impact eligibility and a Prospective Investor Owner should ask the franchisor if their business model is eligible.

Conventional Business Loans

Prospective Investor Owners can apply for conventional business loans from banks, credit unions, or other financial institutions. These loans may require collateral and a strong credit history.

Franchisor Financing

Some franchisors offer financing or financial assistance to help their franchise owners get started. This could include reduced franchise fees, equipment financing, or other financial incentives.

Home Equity Loans or Home Refinancing

If Prospective Investor Owners own a home, they may consider using a home equity loan or a home equity line of credit (HELOC) to finance their franchise investment. These loans are secured by the home's equity. The stress testing that we discussed earlier is more important in these types of financing.

Rollover for Business Startups (ROBS)
This option allows Prospective Investor Owners to use funds from their existing retirement accounts, such as 401(k)s or IRAs, to finance their franchise without incurring early withdrawal penalties. It involves setting up a business-specific retirement plan and requires the use of a C-corporation ownership structure.

Personal Loans
In some cases, Prospective Investor Owners may use a personal loan to finance part of their franchise investment. However, personal loans may have higher interest rates and shorter repayment terms than business loans.

SBL- Securities-based loans
Any marketable securities that investors can buy and sell on an exchange so long as it is not on a retirement plan or profit-sharing account. Investors can pledge based on the value of securities and brokerage gives investors a revolving line of credit. There is often no charge to set up and no credit pull. Commonly, the agreement is one document, two pages, and Investor is provided a checkbook. The broker charges the stated interest payment. Investors can borrow from the stock portfolio and the broker will simply add interest to it. However, if the value of the underlying securities trade is below contracted levels this can trigger “margin call” payments to increase the collateral in the account. Loans should be sized with this in mind.

Visibility of Investment Quality Before Purchase
In the United States, franchisors are required by law to provide a Franchise Disclosure Document (FDD) to potential franchise owners before they purchase a franchise. The FDD serves as a critical evaluation tool and source of information for individuals interested in buying a specific franchise. It offers transparency regarding the franchise opportunity, its financial health, legal aspects, and the franchisor's history.

Here's what Prospective Investor Owners can typically find in a Franchise Disclosure Document (FDD):

1. **Franchisor’s Background**
   Information about the franchisor, its history, key executives, and litigation history.

2. **Financial Statements**
   The franchisor's audited financial statements, including balance sheets and income statements.

3. **Franchise Fees**
   Details about initial franchise fees, ongoing royalties, and other fees franchise owners are required to pay.

4. **Investment Costs**
   An itemized list of the estimated initial investment, including real estate costs, equipment, inventory, and other startup expenses. As discussed above, particular care should be taken regarding the working capital needs of the business over time.

5. **Restrictions and Obligations**
   Information about territorial rights, restrictions on products or services, and obligations for both the franchisor and franchise owner.

6. **Training and Support**
   An outline of the training and support programs provided by the franchisor to help franchise owners succeed.

7. **Franchise Owner's Obligations**
   An overview of the responsibilities and obligations of the franchise owner, including advertising and marketing requirements.

8. **Renewal and Termination Terms**
   Details about the terms and conditions for renewing or terminating the franchise agreement.

9. **Financial Performance Representations (Item 19)**
   If the franchisor chooses to provide it, this section may contain historical financial performance information for the franchise locations, such as sales data.

10. **List of Current and Former Franchise Owners**
    Contact information for existing and former franchise owners so that Prospective Investor Owners can speak with them directly about their experiences.

It's worth noting that franchise investments also have one uncommon feature in the evaluation of the investment. That feature is that Prospective Investor Owners can speak with and are encouraged to speak with existing owners in the franchise system who have already purchased the business (commonly referred to as Validation). This is very unusual in the investment space, but extremely important. All other investment types mentioned do not have a structural process for speaking to past purchasers and hearing their experience. Whereas with franchising, the franchise disclosure document includes all past purchasers of the investments with their contact information so they can be reached.

As outlined above, Prospective Investor Owners should develop financial models projecting cash flows and business performance over time. In any such projection, certain assumptions are key and this is where this validation step may be critical. The Prospective Investor Owner should not only understand its model and key assumptions but also the variability in the model associated with key assumptions. When validating information with other owners, the Prospective Investor Owners should try to validate these key assumptions with the experience of other franchise owners.

Summary of Franchise Investments Compared to Other Investment Vehicles

While each investment has opportunities and risks associated with it, franchising is an investment that stands out for key reasons. As we've illustrated, business ownership is a key tactic used by wealthy investors and should be considered by most individuals at some point in their lives. If one accepts that business ownership can offer much higher returns than other investments, the earlier an individual considers investing in a business the better. If one accepts that people should try to accelerate their retirement savings and earn tax-deferred amounts for as long as possible and the compounding of interest works in their favor over long periods of time, the earlier an individual considers investing in a business the better.

The earlier an individual considers investing in a business the better.

While many of the various investments we have discussed in this paper may have a place in an investor's portfolio and there are certainly varying levels of risks and business skills needed to manage them, there is little doubt that wealthy families have always been very active in business ownership. The conclusion inherent in this paper is that business ownership, especially through franchising is something everyone should consider and not just when they have accumulated millions of dollars. If a person has qualifying experience and background in corporate America, for example, and they have been successful in making money for the owners of the corporations they work for, why not at least consider starting their own business and minimize their risks through franchise ownership? Because of compounding interest fundamentals, the sooner one does this evaluation the better. Let us help if we can.

Business ownership, especially through franchises is something everyone should consider.

For more information or a deeper conversation around franchise investment reach out to John Anderson at
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Addendum A

Characteristics and Questions to Look for When Considering a Franchise Investment

- Cash outlay rather than investment outlay
- Options to accelerate the business performance
- Where you may be restricted from that acceleration in a particular franchise
- Length of time to hold investment
- Resale potential (check the multiple that the type of business sells for)
- The expectation of continuity of success for the system
- How experienced is the staff you will work with?
- How streamlined is the operational execution of the business functions?
- Has the brand already publicly adopted the service or product?
- Is there limited to no seasonality?
- Is there a recession-resistant aspect to the franchise business?
- What is the potential ramp-up window to break even?
- What is the quality and consistency of the business's cash flow potential?
- Are there national corporate accounts?
- Are there call centers to support marketing?
- Are the top-line revenues 2 to 3 times the initial cash investment?
- What is the franchise's long-term growth plans? What are the franchise's goals for growth?
- Are the current owners of the system validating and confirming the franchise's delivery of its commitments?

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