

A CONVERSATION WITH



Ed King,
Wayne State
University

Eyeing franchise? Beware of canaries

Ed King, director of small-business services in **Wayne State University's** department of professional and executive development, has a résumé that includes CPA credentials, a gig at **PricewaterhouseCoopers L.L.P.**, the acquisition of an MBA and a stint as a carry. He talked to reporter **Nancy Kaffer** about business opportunities and franchises.

Why do people buy a business or franchise instead of starting one?

People don't have the foggiest idea of how to start their own business ...

WEB EXTRA

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especially first-generation entrepreneurs. They don't know the basics like market research and

getting the bugs out of the system. With a franchise, they've put a red ribbon around it and say: "We've done all the hard work. All you have to do is get in there and run the thing ... and live happily ever after."

So how do you avoid a bum deal? You have to find a business that's suitable to yourself. Everybody is a genius at some things, and they suck at most things. The secret to a successful business is to find out, truly, your passion.

When should you buy a business or franchise? I like buying businesses because they've already got customers, they've already got sales and don't have royalties. That 7 percent (a common royalty for franchisees) will kill you. But not all franchises are bad.

When would you buy a franchise? Make sure they can do something you can't do for yourself. If I wanted to buy a hotel, I would buy a **Holiday Inn**. Why? Because of their worldwide reservation system.

How do you examine a franchise financial track record? A franchisor cannot tell the franchisee what their sales will be. They will put you in contact with their franchisees and you can ask any question you want to, but you have to watch out for canaries.

Canaries? You've got to go out and visit these people. If this guy says he's selling pizzas, go out and look at his truck, talk to his customers. In the business world, they're called canaries and they're paid to lie to you. ... A ten-dollar word for it is "due diligence." You've got to go out there and do your research.

If you know someone in small business or Detroit or Wayne County government **Nancy Kaffer** should interview, call (313) 446-0412 or write nkaffer@crain.com



Small Business

Monthly

2 sides of franchising

Buying

Ready to roll not the same as risk-free

BY NANCY KAFFER
CRAIN'S DETROIT BUSINESS

Layoffs were coming down the pike for Detroit Dan Ryan, then a television producer in New York City. He wasn't sure what to do — but knew it was time to come back to Detroit.

Enter **College Hunks Hauling Junk**.

BEFORE YOU BUY

- Check out existing franchisees and the company's finances. Ensure that the terms of the franchising agreement are equitable.

- Invest in an experienced team of advisers — an accountant, a banker and an attorney.

- Find an opportunity that meshes with your interests.

- Be prepared: Buying a franchise isn't a fast track to guaranteed financing.

The unusually named junk-hauling business had been on Ryan's radar for a number of years. As job prospects in his chosen field dried up, he started to think seriously about buying a **College Hunks** franchise. He recruited childhood friend Patrick Lipa as a partner, and the pair bought a **College Hunks** franchise for \$35,000.

Ryan and Lipa are part of an increasing number of people purchasing franchises, said Steve Maltzman, a prin-

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Dan Ryan (left) and Patrick Lipa bought their **College Hunks Hauling Junk** franchise for \$35,000. Operating from St. Clair Shores, they expect \$100,000 in revenue this year, Ryan said.

Selling



MARK LEWIS/CRAIN'S DETROIT BUSINESS

CEO Wayne Wudyka began franchising his **Certified Restoration Drycleaning Network** business in 2001 and has expanded to 150 locations, with revenue in 2008 of about \$83 million.

Niche, mindset, plan keys to cleaning up

BY NANCY KAFFER
CRAIN'S DETROIT BUSINESS

If you look at **Certified Restoration Drycleaning Network's** corporate-owned, Michigan-based stores, CEO Wayne Wudyka is a small-businessman, reporting a respectable \$8 million in sales for 2008.

Now look at the Berkley-based **Restoration Drycleaning's** franchise network.

Systemwide, the network brought in \$83 million in revenue for 2008, and Wudyka expects to end this year with \$100 million from franchisees.

Wudyka entered the dry cleaning business with little experience in 1992, and, in his words, "stumbled" across a lucrative niche: the insurance restoration industry, or the business of restoring textiles that have been damaged by smoke or water, marketed directly to insurance carriers.

"The textile restoration business really did not exist. We created the category and branded the category in six years," Wudyka said.

Seeing opportunity, Wudyka rolled out a franchise network in 2001. The company sold about 35 franchises the

first year. Today, the network has 150 franchisees and has few markets left to sell.

Retail sales for dry cleaners nationally have been declining, he said. By selling franchises, Wudyka was able to quickly establish a national brand without significant capital investment by building on existing infrastructure and excess capacity. And having a national network gave Wudyka entrée to business relationships with major insurance providers.

"The franchise model allowed us to scale our business fast and define a category," he said. Without franchising, we could not have scaled our business that fast."

Wudyka's network could be a textbook study in successful franchising.

"(A potential franchise) is a company that's looking to grow but is looking to finance the growth with outside capital — that's the capital that's provided by

BEFORE YOU SELL

- Be prepared to give up control.

- Create a franchise agreement that protects your business. A non-compete clause is key.

- Give value to your franchisees — don't just look for profits.

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Small Business Monthly

Selling: Niche, mindset, plan are keys to chains' cleaning up

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franchisees," said Bruce Haffey, a shareholder in Troy-based **Giarmarco Mullins & Horton P.C.** who sits on that law firm's board of directors.

"One of the first steps in the process is to decide whether the business is franchisable. Oftentimes, some of the key elements are recognizable trademarks, or an operating system that provides value to the franchisees."

Typically, Haffey said, the business will have experience with opening additional stores or units and will have developed a process that can be replicated in the franchising.

A potential franchisor needs a team of advisers — generally an attorney, an accountant and a banker, said Steve Maltzman, a principal in financial services firm **The Rehmann Group's** Farmington Hills office. "If you're going to develop your own franchise, there

are a number of legal developments and structural elements that have to go into this."

A franchising agreement, Haffey said, should be protective of the franchisor but reasonable for the franchisee.

He said the agreement should be "respectful of the franchisor in its business judgment and discretion in terms of how the business will be run, how it will evolve over time, what new products it develops — in terms of the contract, all those things would favor the franchisor," he said. "A good franchisor would provide a mechanism to get input from the franchisee. But it is going to control those elements."

Treating franchisees fairly benefits the franchisor, Haffey said.

"Whether it's the agreement or the franchise structure itself, things need to be reasonable and work for the franchisee in order

for it to be successful for the franchisor," he said. "Like not putting stores too close to each other to have encroaching and overlapping territories, and to have some value to provide, whether it's new products, services, training, fair use of advertising funds and money."

While franchisors should expect to receive royalties and other profits from franchisees, onerous fees can create bad feelings, Haffey said.

It's important to treat franchisees as valuable business assets, Wudyka said — and to deliver value to the franchisees, who pay between \$25,000 and \$45,000 for a network franchise, and an average of 7 percent annual royalties.

"They look at us as an asset, not a liability," Wudyka said. "Many franchisors are viewed by the franchise company as a liability, which creates a bad dynamic. Be-

ing an operator, we walk the talk every day."

Wudyka spends a lot of time supporting the company's franchise network, through training sessions, annual regional meetings and a networked computer system.

Ultimately, selling franchises means some loss of control, Maltzman said, adding that one of the first things he'd do with a prospective franchisor is determine whether the business owner is

willing to give up that degree of control.

Some business owners can have difficulty adapting to the necessary shift in priorities, Haffey said.

"One of the first things the franchising company has to realize is, whatever their company was, they're no longer in that business," he said. "They're in the franchise business."

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Buying: Franchising is not risk-free

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principal in financial services firm **The Rehmann Group's** Farmington Hills office.

"It seems as though there is an extreme amount of interest in our area, with people being displaced from their jobs, taking the money and trying to get into the franchising world," he said. "I see a lot of interest from people who want to start a career and don't want to start from scratch."

That's part of what drew Ryan to College Hunks Hauling Junk's concept.

"I wanted to save myself the headache" of starting a business, he said. "With the franchise, you have a system that's already set up for you. And I've seen how this company has grown."

The home-based franchise, located in St. Clair Shores, has little overhead — just its trucks — another factor that Ryan said made the business model attractive.

Since Ryan and Lipa opened last month, Ryan said they've made about \$5,000 in sales and expect to finish the year with about \$100,000 in revenue.

Tampa, Fla.-based College Hunks was founded by a relative of Ryan's, but he knew that familiarity with the company's founder was no substitute for research. So Ryan and Lipa crafted a business plan and consulted an attorney and an accountant. Ryan interviewed existing franchisees and looked at the corporate model.

There's no such thing as too much information, Maltzman said.

"Set the table with as many facts as you can," he said. "Try to get an understanding of what it means from the financial side. Find an attorney who will explain it from the legal end."

The **Federal Trade Commission**-required Franchise Disclosure Document, or FDD, is invaluable in evaluating a business, said Bruce Haffey, a shareholder in Troy-

based **Giarmarco Mullins & Horton P.C.** who sits on that law firm's board of directors.

"The questions you want to ask are, is it a good franchise, and is it a good fit for the franchisee?" he said. "Is there a history of problems between the franchisor and existing franchisees? What kind of track record does it have?"

It can be difficult to make a thorough financial assessment, he said.

"But the franchisee has to do that to make an intelligent investment," he said.

Red flags include a history of litigation or franchisee complaints, bankruptcies and whether the franchisor provides each franchise a protected territory.

Buying a franchise, even with an established track record, isn't necessarily a shortcut to obtaining financing — Ryan said he and Lipa went through five lenders before obtaining a loan.

"The banking community historically looks for a couple of things," Maltzman said. "A game plan, which obviously a franchise will give you, so you're satisfying the lender's need in that respect, but the other end of the equation is always the collateral equation. So depending on what lender you go to, it's still tough to get money."

For a prospective franchisee, it's important to have some knowledge of business principles and practices, he said.

"When you're talking to someone who's trying to get into a business, the No. 1 thing is, do you understand the finances, are you financially savvy, or are you product-driven?" he said. "Do you want to work in a restaurant or do you want to run a restaurant? Will you make a profit? How long before you make a profit? Is there a good return on investment?"

And even a tried and true premise doesn't assure success.

"There is no guarantee," Maltz-

man said. "You drive by a McDonald's and you say, 'Everybody that owns a McDonalds makes it.' Well, that's not true. The difference between success and failure sometimes is luck. Sometimes it's a lack of business acumen. There is no such thing as a sure thing."

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