



## FRANCHISE FACTS & FIGURES

### Financial Transparency Delivers

## Introduction

Buying a franchise is about choosing a business that can make you money.

### It's that simple.

The importance of knowing how much money you can make when you're buying a franchise can't be overstated. Having accurate and detailed sales and expense data makes it easier to understand the benefit of buying a particular franchise, because it enables you to construct a more accurate pro forma income statement and cash flow projection.

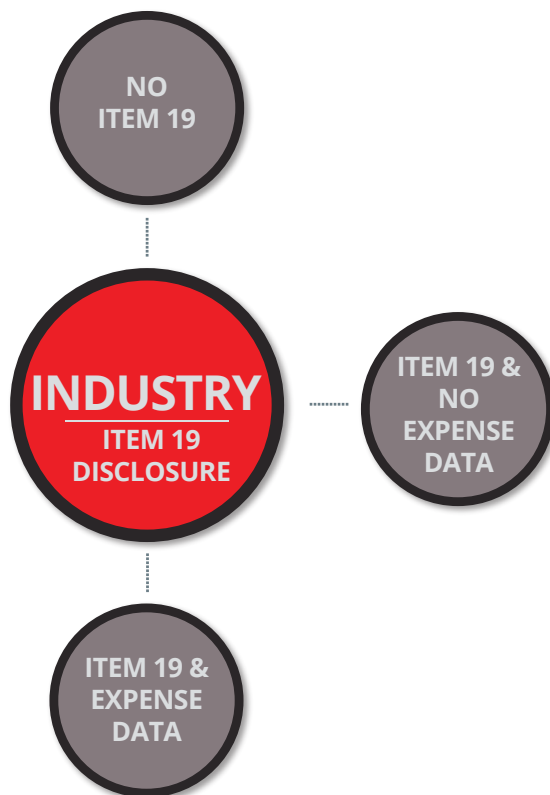
Franchisors aren't required to disclose financial information about their franchisees. This information is referred to as a Financial Performance Representation (FPR), and is done in Item 19 of the Franchise Disclosure Document. Because this information isn't mandatory, some franchise systems don't provide any financial data on their franchisees, which should raise some serious red flags for potential investors. ***After all, if franchisees are making money, why wouldn't the franchisor want to tell you about it?***

In addition, most franchise systems only show you their gross revenue (the amount of sales), but not their expense data (the costs). In reality, it doesn't matter how much gross revenue you make -- it's about what you can put in your pocket at the end of the day after all of your expenses are paid.

As the number of franchisors who provide an FPR has slowly increased over the last ten years, it has become more and more obvious that this disclosure could provide a competitive advantage for selling a franchise. A steady rise in franchisor financial disclosure has led to 54% of franchisors doing an FPR.

When crunching numbers in our database, we found a relationship between a strong FPR and successful franchise systems. The following Facts & Figures reveal the results of our analysis on the growth of 1905 franchise systems over a 6-year period, based on financial transparency within Item 19 disclosure.

We looked at three groups of franchise systems. First, franchise systems without an Item 19. Second, those with an Item 19 but without expense data. Third, those with an Item 19 that also disclosed expense data.



## A Shocking Statistic!

Our proprietary research showed that there were 870 franchise systems, or 45% of our sample franchise group, that didn't provide an FPR. What's interesting is that this group, without an Item 19, shrunk from 135,154 franchise locations in 2010 to 134,348 locations in 2016 – **a decrease of 306 locations or -0.2%.**

So, why would franchisors make the choice to NOT disclose any information? There are very few reasons, but to cautious investors this could be a sign that their franchise system lacks positive results. It could be that their franchisee locations have had weaker financial performance than they want to communicate to potential investors, and their franchise just isn't a good investment.

But, that's not always the case. Other factors could be that the franchise system's legal counsel recommends against putting information out, or that the franchise is successful selling new franchises even without making the FPR available.

If you want to buy a franchise that doesn't provide financial information, you need to spend a lot of time finding out why that information isn't available. One way to do that is to talk to past and present franchisees about their financial success.



The advertisement for Fast Signs features the company logo on the left, which reads 'FAST SIGNS' in red and blue, with the tagline 'More than fast. More than signs.®' below it. To the right is a photograph of a Fast Signs store interior, showing a counter and staff. On the far right is a black box with the text 'MADE THE GRADE 2016' in white, with a red checkmark icon. A green button with the text 'Click Here' is positioned over the bottom right of the store photo.

## Financial Transparency Equals Growth

Franchise systems that provide an FPR have grown by 13.1% since 2010. Our database sample consisted of 652 franchise systems that grew from 136,885 locations to 154,812. This growth of 17,927 locations is opposite the -306 locations of franchises that did not provide an FPR.

Information disclosed by a franchise system can vary significantly. Some common presentations include:

### SYSTEM WIDE GROSS SALES

This is when a franchise system will add the total revenue of all of their franchise locations and determine an average. Here, you need to be careful because averages can be misleading -- one very successful location can make the average look better than all other locations.

### QUARTILE BREAKDOWN

This is when a franchisor takes all of their locations and breaks them up into four sections (called quartiles). An average of each quartile is then provided, which can give you a look into the range of success between locations.

### LOCATIONS OPEN FOR MORE THAN ONE YEAR

This is typically presented to show the revenue of locations that are in business for a minimum of one full year. Here, you should ask yourself two questions. First, are there franchises that didn't stay open for a full year? And second, will you have enough working capital to stay open long enough to be profitable.



**17,927**  
6 YEAR  
GROWTH

**13.1%**  
6 YEAR  
GROWTH %

**NO EXPENSE DATA**

### KEEP IN MIND

Just because a franchisor discloses an FPR doesn't make them perfect. In fact, there are some that have shrunk and closed franchise locations. While having an FPR is a sign of transparency, it's not the only reason you should buy this franchise.

## The Top Of The Mountain For Transparency

Expense data gives you a way to estimate how much money will be left at the end of the year once your royalties, operating costs and other expenses are covered. Is there money left for you?

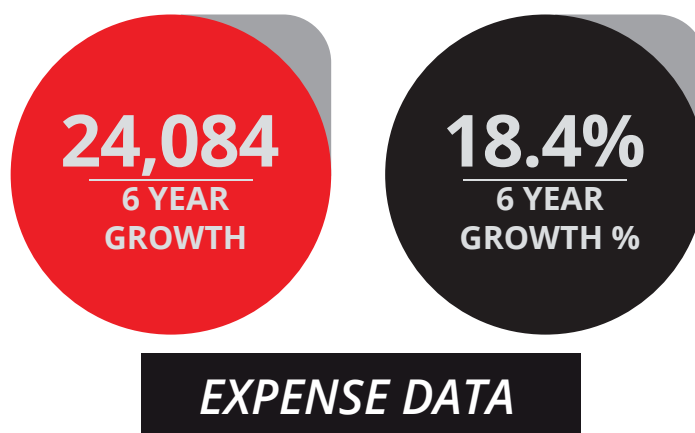
*Franchisors who provide expense data on their franchise locations grew by an amazing 18.4%. The 383 franchise systems grew by 24,084 locations since 2010, from 131,111 to 155,195.*

Franchisors disclose expense data in a number of ways including through Gross Margin, EBIT (Earnings Before Interest and Tax) or EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization). Some will provide percentages of different types of expenses, such as advertising or payroll. Others will provide details of the costs of royalties or food costs.

When you're thinking of buying a franchise, you need to know how much money you can make.

To do this, you need to create a cash-flow projection. This includes revenues and all costs such as operating, lease or debt payments.

Any expense information that's provided by the franchisor is an important piece of that formula; the more real information you can include in that formula, the more real your results will be.



*Without expense data – or without an Item 19 at all – you need to guess (or make up) the numbers.*



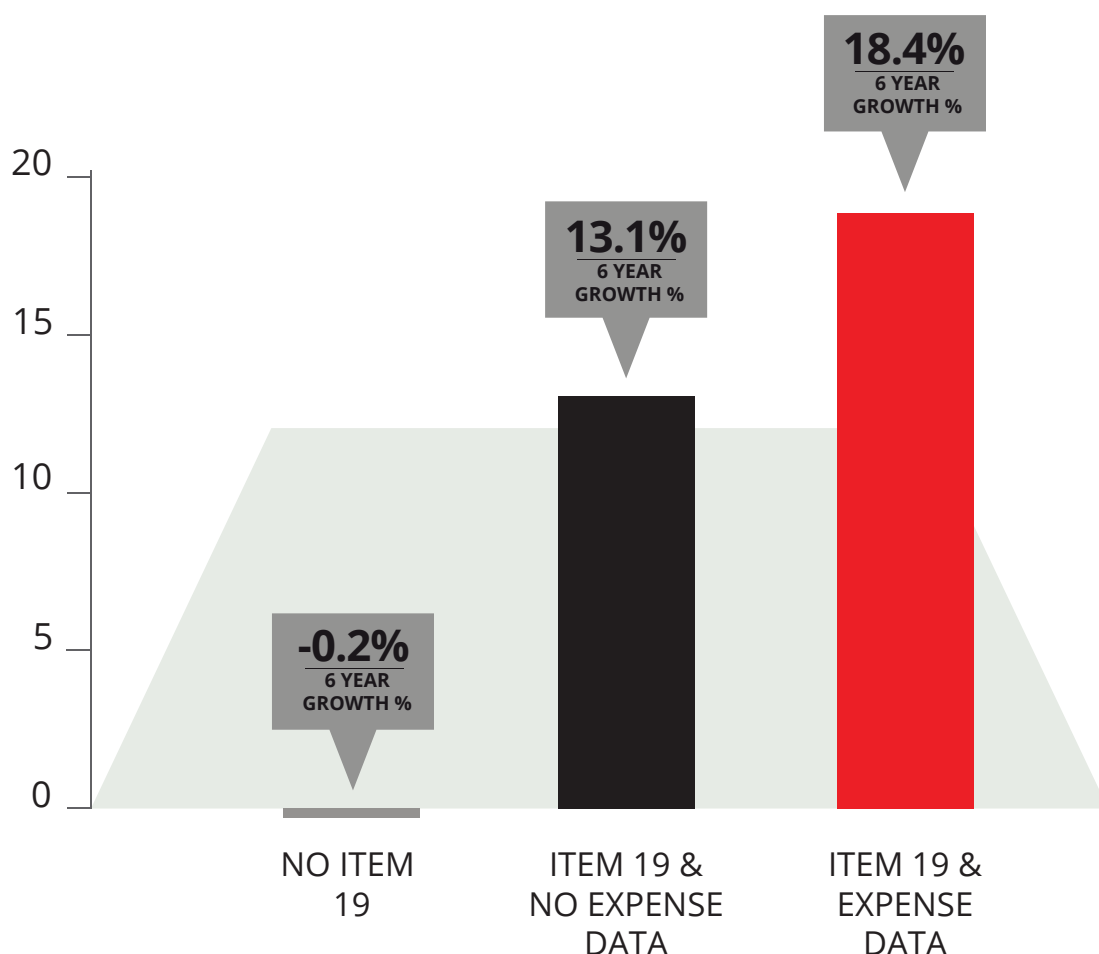
## Conclusions

*What does this mean to you when you're going to buy a franchise?*

Franchise systems that failed to provide financial transparency had negative growth over a 6-year period. On average, franchise systems that provided expense data had the highest growth rates.

A lack of franchisor financial transparency can definitely be a drawback. Not having the information you need means that it will be harder for you to create accurate financial projections, which are vital factors in understanding the risk involved in your potential investment. It also raises questions about why a franchisor would choose not to disclose this information, when they have the option to do so.

Choosing the right franchise to invest in can be hard, but it can also be very rewarding. While financial transparency gives you a bigger picture of what you can expect from a franchise opportunity, it's not a guarantee for success just to have that information. You still need to do a lot of research to find the best franchise to invest in.





## About FranchiseGrade.com

# FRANCHISEGRADECOM

### The Authority on Franchising

FranchiseGrade.com objectively grades over 2,500+ franchise systems for people seeking a franchise opportunity. Our grading is focused on a franchise's investment risk.

As the only company to freely publish research data on franchise opportunities we disclose the grade of every franchise in our Franchise Grade® Find The Best Platform.

A prospective franchisee's money and time is on the line. The integrity of the data we provide is critical, and as the only company to publicly identify healthy and unhealthy franchise investments, FranchiseGrade.com demonstrates it is the Authority on Franchising.

FranchiseGrade.com is the only source of comprehensive information about franchising that is:

- *Totally fact based*
- *Represents objective analysis*
- *Graded for franchise investment risk*
- *Largest database in franchising*

FranchiseGrade.com is the major source of franchise industry data for major media publications such as The Wall Street Journal, Bloomberg, Forbes and a variety of local news outlets.

## Get in touch

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