Chapter 4—Franchises and Buyouts

TRUE/FALSE

1. One of the advantages of buying a franchise is that the purchaser has access to a proven business system.

   ANS: T PTS: 1 REF: p. 109 OBJ: 4-2 TYPE: C
   NAT: Analytic | Value Creation

2. A franchise is typically attractive because it offers training, financial assistance, and operating benefits.

   ANS: T PTS: 1 REF: p. 110 OBJ: 4-2 TYPE: C
   NAT: Analytic | Value Creation

3. A disadvantage of purchasing a franchise is that franchisors seldom provide adequate training programs.

   ANS: F
   Results show that most franchisors provide training.

   PTS: 1 REF: p. 110 OBJ: 4-2 TYPE: C
   NAT: Analytic | Value Creation

4. The unscrupulous actions by franchisors to void contracts of franchisees in order to sell the franchise to someone else and collect an additional fee is called chewing.

   ANS: F
   The term is churning.

   PTS: 1 REF: p. 112 OBJ: 4-2 TYPE: D
   NAT: Analytic | Ethical and Legal

5. A comprehensive listing of franchisors can be found on the website of the *International Franchise Association*.

   ANS: T PTS: 1 REF: p. 116 OBJ: 4-3 TYPE: C
   NAT: Analytic | Dynamics

6. As of 2008, the *Federal Trade Commission'*s Franchise Rule prescribes that franchisors must disclose to prospective franchisees information such as bankruptcies, business experience of the principals, and litigation in which the firm is involved.

   ANS: T PTS: 1 REF: p. 121 OBJ: 4-3 TYPE: D
   NAT: Analytic | Ethical and Legal

7. One benefit of becoming a franchisee is sharing profits with the franchisor.

   ANS: F

A franchisee enjoys benefits such as rights to use the franchisor's nationally advertised trademark or brand name and its tested methods of marketing and management. Profits are not shared with the franchisor but franchise costs such as the initial franchise fee, investment costs, royalty payments and advertising costs are paid for the use of the franchise.

PTS: 1 REF: p. 114 OBJ: 4-2 TYPE: C
NAT: Analytic | Finance

8. The entrepreneur who enters into a franchising agreement does *not* acquire the right to use the franchisor's trademark or brand name.

ANS: F
In reality, one of the greatest benefits an entrepreneur gains by entering a franchise agreement is the right to use the franchisor's trademark and brand name.

PTS: 1 REF: p. 109 OBJ: 4-2 TYPE: C
NAT: Analytic | Ethical and Legal

9. In many cases, a franchisor will receive payments in the form of royalties that are based on a percentage of the franchisee's gross income.

ANS: T PTS: 1 REF: p. 114 OBJ: 4-2 TYPE: C
NAT: Analytic | Finance

10. Franchising is a two-party legal agreement whereby a franchisor is granted the privilege to conduct business as an individual owner according to the methods and terms specified by the franchisee.

ANS: F
The franchisor specifies the methods and terms of conduct and grants business privileges to the franchisee, not the other way around.

PTS: 1 REF: p. 107 OBJ: 4-1 TYPE: D
NAT: Analytic | Ethical and Legal

11. The potential value of any franchise arrangement is defined by the rights outlined in the franchise contract.

ANS: T PTS: 1 REF: p. 107 OBJ: 4-3 TYPE: C
NAT: Analytic | Ethical and Legal

12. *Chick-Fil-A* is an example of a company that uses business format franchising.

ANS: T PTS: 1 REF: p. 107 OBJ: 4-1 TYPE: A
NAT: Reflective Thinking | Value Creation

13. The *Coca-Cola Company* is an example of a product and trade name franchisor.

ANS: T PTS: 1 REF: p. 107 OBJ: 4-1 TYPE: A
NAT: Reflective Thinking | Value Creation

14. A franchising strategy whereby a single franchisee owns more than one unit in a given area is typically referred to as an area developer strategy.

ANS: T PTS: 1 REF: p. 107 OBJ: 4-1 TYPE: D

NAT: Reflective Thinking | Value Creation

15. Business publications such as *Inc., Entrepreneur* and *The Wall Street Journal* are excellent sources of franchise informational advertising.

    ANS: T PTS: 1 REF: p. 115 OBJ: 4-3 TYPE: A
    NAT: Reflective Thinking | Value Creation

16. There is no need to find out more information about a prospective franchise as the franchisor should be the primary source of information.

    ANS: F
    This information will be a primary source but more information should be obtained. The information from the franchisor is being used to promote the franchise.

    PTS: 1 REF: p. 117 OBJ: 4-3 TYPE: C
    NAT: Analytic | Dynamics

17. Existing franchisees are a valuable source of information about franchises.

    ANS: T PTS: 1 REF: p. 118 OBJ: 4-3 TYPE: C
    NAT: Analytic | Dynamics

18. To reduce costs, a franchise consultant can substitute for a licensed attorney experienced in the evaluation of legal documents related to franchising agreements.

    ANS: F
    Franchise consultants are not necessarily attorneys; an experienced franchise attorney should evaluate all legal documents.

    PTS: 1 REF: p. 120 OBJ: 4-3 TYPE: C
    NAT: Analytic | Ethical and Legal

19. One drawback of becoming a franchisor relates to possible new restrictions as a requirement for contract renewal.

    ANS: T PTS: 1 REF: p. 113 OBJ: 4-3 TYPE: C
    NAT: Analytic | Ethical and Legal

20. Because the offering and sale of a franchise are more intensely regulated by state and federal laws than is the establishment of a new business, individuals and/or firms involved in negotiating a franchise arrangement have limited need for legal counsel.

    ANS: F
    Due to the complexity of typical franchise arrangements, prospective franchisees should consult legal counsel before signing such an agreement.

    PTS: 1 REF: p. 121 OBJ: 4-3 TYPE: C
    NAT: Analytic | Ethical and Legal

21. Aside from consulting an attorney, a potential franchisee will probably not need other sources of assistance.

    ANS: F

A prospective franchisee should also consult with a banker, an accountant and others sources of help as is practical.

PTS: 1 REF: p. 121 OBJ: 4-3 TYPE: C
NAT: Analytic | Ethical and Legal

22. *Subway* is the franchisee and the local owner is the franchisor.

ANS: F
It is the reverse.

PTS: 1 REF: p. 107 OBJ: 4-3 TYPE: A
NAT: Reflective Thinking | Value Creation

23. UFOC stands for the United Franchise Offering Circular.

ANS: F
UFOC stands for the Uniform Franchise Offering Circular.

PTS: 1 REF: p. 122 OBJ: 4-1 TYPE: D
NAT: Analytic | Ethical and Legal

24. The UFOC replaced the Franchise Disclosure Document (FDD) in 2008.

ANS: F
The FDD replaced the UFOC.

PTS: 1 REF: p. 122 OBJ: 4-3 TYPE: C
NAT: Analytic | Ethical and Legal

25. Conducting a thorough due diligence should always be accomplished if purchasing an existing corporation or franchise, but is unnecessary if acquiring a sole proprietorship.

ANS: F
Due diligence is needed no matter what corporate format the prospective business has.

PTS: 1 REF: p. 125 OBJ: 4-4 TYPE: C
NAT: Analytic | Finance

26. The buyer of an existing business typically acquires its personnel, inventories, physical facilities, established banking connections, and ongoing relationships with trade suppliers.

ANS: T PTS: 1 REF: p. 123 OBJ: 4-3 TYPE: C
NAT: Analytic | Value Creation

27. The advice of lawyers and accountants, if employed, should be strictly followed.

ANS: F
Since the consequences of a business purchase, good or bad, are borne by the buyer, the prospective new business owner should never let the experts make the final decision.

PTS: 1 REF: p. 126 OBJ: 4-4 TYPE: C
NAT: Analytic | Ethical and Legal

28. Financial statements can mislead a potential purchaser trying to develop an accurate business valuation.

ANS: T PTS: 1 REF: p. 127 OBJ: 4-4 TYPE: C
NAT: Analytic | Finance

29. A firm's financial statements should *not* be adjusted because they conform to generally accepted accounting principles.

ANS: F
Financial statements should be adjusted by a potential buyer so that they reflect realistic values - e.g., property that has recently appreciated in value and receivables that are actually worth less than their stated value.

PTS: 1 REF: p. 127 OBJ: 4-4 TYPE: C
NAT: Analytic | Finance

30. As part of the valuation process, a buyer should scrutinize the seller's balance sheet to see whether asset book values are realistic.

ANS: T PTS: 1 REF: p. 127 OBJ: 4-4 TYPE: C
NAT: Analytic | Finance

31. Valuing a company is an easy task that results in a precise figure.

ANS: F
Valuing a business is neither easy nor exact, even under the best of circumstances.

PTS: 1 REF: p. 128 OBJ: 4-4 TYPE: C
NAT: Analytic | Finance

32. A franchise organization that is registered with the *U.S. Small Business Administration* will greatly speed up loan processing for a franchisee.

ANS: T PTS: 1 REF: p. 111 OBJ: 4-4 TYPE: C
NAT: Analytic | Ethical and Legal

33. Legal commitments of an existing business do *not* need to be evaluated by a prospective buyer.

ANS: F
Although only indirectly related to a firm's future cash flows and financial position, legal considerations can be an important nonquantitative factor in valuing a business.

PTS: 1 REF: p. 128 OBJ: 4-2 TYPE: C
NAT: Analytic | Ethical and Legal

34. Franchising offers both a proven line of business and reduced risk.

ANS: T PTS: 1 REF: p. 106 OBJ: 4-1 TYPE: D
NAT: Analytic | Value Creation

35. The practice of putting one franchise right next to another is referred to as piggyback franchising.

ANS: F

Co-branding involves having two franchise brands under one roof.

PTS: 1 REF: p. 107 OBJ: 4-2 TYPE: D
NAT: Analytic | Value Creation

36. Jill sees an advertisement for a franchise opportunity that matches her interests. Her first step in pursuing the franchise is to look for independent, third-party sources of information to verify that the opportunity is legitimate.

ANS: T PTS: 1 REF: p. 116 OBJ: 4-2 TYPE: A
NAT: Reflective Thinking | Value Creation

37. To control costs when purchasing a business, an attorney at the closing can represent both sides.

ANS: F
An attorney should represent only one side.

PTS: 1 REF: p. 129 OBJ: 4-4 TYPE: C
NAT: Analytic | Ethical and Legal

38. A nondisclosure agreement signed by a prospective buyer shows the seller that the buyer intends to purchase the business.

ANS: F
A nondisclosure agreement is a contract stating the buyer promises the seller that he or she will not reveal confidential information or violate the seller's trust.

PTS: 1 REF: p. 127 OBJ: 4-4 TYPE: D
NAT: Analytic | Ethical and Legal

MULTIPLE CHOICE

1. Which characteristic is *not* considered a positive of franchising?
   a. higher success rates than for alternative methods.
   b. entrepreneurial independence.
   c. financial and training assistance.
   d. operating benefits.

ANS: B PTS: 1 REF: p. 109-110 OBJ: 4-2 TYPE: C
NAT: Analytic | Value Creation

2. A disadvantage of franchising is
   a. reduced risk of failure.
   b. access to a proven system.
   c. restricted sales territories.
   d. immediate economies of scale.

ANS: C PTS: 1 REF: p. 109 OBJ: 4-2 TYPE: C
NAT: Analytic | Value Creation

3. An entrepreneur would choose a franchise over an independent startup most likely because of the
   a. freedom in decision making.
   b. guidance provided for organizational structure.
   c. probability of success.

d. opportunities to meet and share ideas with other executives.

ANS: C PTS: 1 REF: p. 109 OBJ: 4-2 TYPE: C
NAT: Analytic | Value Creation

4. The cost of a franchise may include
   a. royalty payments.
   b. higher operational costs.
   c. a one-time federal franchise tax.
   d. higher labor costs.

ANS: A PTS: 1 REF: p. 114 OBJ: 4-2 TYPE: C
NAT: Analytic | Finance

5. Investment costs related to franchising include all of the following *except*
   a. insurance premiums and legal fees.
   b. inventory and supply costs.
   c. building and equipment costs.
   d. royalty payments.

ANS: D PTS: 1 REF: p. 114 OBJ: 4-2 TYPE: C
NAT: Analytic | Finance

6. Having worked professionally for 10 years, Tom and Kate have decided to start a new franchise. Considering their background, a disadvantage for them becoming franchisees is
   a. the restrictions on business operations.
   b. unlimited company growth.
   c. the expectation to work more than a 40 hour work week.
   d. an increase in entrepreneurial independence.

ANS: A PTS: 1 REF: p. 113 OBJ: 4-2 TYPE: A
NAT: Reflective Thinking | Value Creation

7. Consider this quote: "If you can't follow somebody else, don't buy a franchise." Which characteristic of a franchise does this quote describe?
   a. High success rate
   b. Restrictions on growth
   c. Loss of entrepreneurial independence
   d. Location problems

ANS: C PTS: 1 REF: p. 113 OBJ: 4-2 TYPE: C
NAT: Analytic | Value Creation

8. Which company is credited with being the first franchisor in the United States?
   a. *Ben Franklin Printing*
   b. *Roman Catholic Church*
   c. *Singer Sewing Machine*
   d. a South Carolina printer

ANS: C PTS: 1 REF: p. 105 OBJ: 4-1 TYPE: C
NAT: Analytic | Value Creation

9. An entity or individual granted the right to conduct business according to specified methods and terms of another party is known as a
   a. franchisor.
   b. franchisee.

c. franchise.
d. licensee.

ANS: B PTS: 1 REF: p. 107 OBJ: 4-1 TYPE: D
NAT: Analytic | Ethical and Legal

10. A legal agreement between two parties in a franchise arrangement is referred to as a
a. master license.
b. franchise contract.
c. requirements contract.
d. franchise consent draft.

ANS: B PTS: 1 REF: p. 107 OBJ: 4-1 TYPE: D
NAT: Analytic | Ethical and Legal

11. An entity or individual that grants another party the right to conduct business according to specified methods and terms is known as a
a. franchisor.
b. franchisee.
c. franchise.
d. licenser.

ANS: A PTS: 1 REF: p. 107 OBJ: 4-1 TYPE: D
NAT: Analytic | Ethical and Legal

12. The franchising strategy whereby an individual or firm is granted the legal right to own more than one unit of a franchised business is known as
a. development franchising.
b. multiple-unit ownership.
c. piggyback franchising.
d. aggregate ownership.

ANS: B PTS: 1 REF: p. 107 OBJ: 4-1 TYPE: D
NAT: Analytic | Ethical and Legal

13. Individuals or firms that possess the legal right to open multiple outlets in a given area are referred to as
a. development franchisees.
b. area developers.
c. piggyback franchisees.
d. multiple-unit owners.

ANS: B PTS: 1 REF: p. 107 OBJ: 4-1 TYPE: D
NAT: Analytic | Ethical and Legal

14. The rights conveyed by a franchising agreement are referred to as
a. franchising rights.
b. franchise claims.
c. franchise interests.
d. the franchise.

ANS: D PTS: 1 REF: p. 107 OBJ: 4-1 TYPE: D
NAT: Analytic | Ethical and Legal

15. Products and trade name franchising is best illustrated by the system offered by
a. *Exxon Mobil.*

b. *Mail Boxed Etc.*
c. *Burger King.*
d. *Holiday Inn.*

ANS: A PTS: 1 REF: p. 107 OBJ: 4-1 TYPE: A
NAT: Reflective Thinking | Value Creation

16. Business format franchising is best illustrated by the system offered by
a. *Goodyear Tires.*
b. *Coca-Cola.*
c. *Subway.*
d. *Dr. Pepper.*

ANS: C PTS: 1 REF: p. 107 OBJ: 4-1 TYPE: A
NAT: Reflective Thinking | Value Creation

17. A _____ is an independent firm or individual acting as a sales agent with the responsibility for finding new franchisees within a specified territory.
a. multiple-unit franchisor
b. area developer
c. franchisor representative
d. master licensee

ANS: D PTS: 1 REF: p. 107 OBJ: 4-1 TYPE: D
NAT: Analytic | Ethical and Legal

18. A *Starbucks* franchise located inside a Target store is called _____ franchising.
a. folded
b. internalized
c. cooperative
d. piggyback

ANS: D PTS: 1 REF: p. 107 OBJ: 4-1 TYPE: A
NAT: Reflective Thinking | Value Creation

19. Which source of information is *not* recommended to help a potential franchisee investigate a franchising opportunity?
a. The franchisors themselves
b. The franchisor suppliers
c. Existing and previous franchisees
d. Independent, third-party sources

ANS: B PTS: 1 REF: p. 117 OBJ: 4-3 TYPE: C
NAT: Analytic | Value Creation

20. Which source of franchise information is produced by a federal agency?
a. *Buying a Franchise: A Consumer Guide*
b. Website of *Entrepreneur* magazine
c. *Francorp*
d. Franchise list for the *International Franchise Association*

ANS: A PTS: 1 REF: p. 116 OBJ: 4-3 TYPE: A
NAT: Reflective Thinking | Economic Environments

21. A primary source of information for a potential franchisee should be
a. the franchisor.

b. the franchise suppliers.
c. other parties considering the same franchisor.
d. other franchisors.

ANS: A PTS: 1 REF: p. 116 OBJ: 4-3 TYPE: C
NAT: Analytic | Dynamics

22. Which source would provide the most pertinent information about potential franchisors?
a. Any state funded university
b. Friends and neighbors
c. Advertisements in *Inc.* magazine
d. Internet search

ANS: C PTS: 1 REF: p. 115 OBJ: 4-3 TYPE: C
NAT: Analytic | Value Creation

23. Sarah is considering investing in a nationally known franchise. While the franchise involves an industry she has had an interest in for several years, she has no formal business experience. Which source of information should cause her the least concern?
a. The franchisor
b. The franchise suppliers
c. Other independent business people she knows
d. Information posted on a website

ANS: D PTS: 1 REF: p. 115-116 OBJ: 4-3 TYPE: A
NAT: Reflective Thinking | Value Creation

24. What information is typically *not* found in a disclosure document?
a. The franchisor's involvement in litigation
b. Key features of the franchisor's experience
c. Details of the franchisor's proprietary technology
d. The franchisor's size

ANS: C PTS: 1 REF: p. 118 OBJ: 4-3 TYPE: D
NAT: Analytic | Ethical and Legal

25. Franchise costs include all of the following expenses *except*
a. advertising costs.
b. investment costs.
c. royalty payments.
d. churning costs.

ANS: D PTS: 1 REF: p. 114 OBJ: 4-2 TYPE: C
NAT: Analytic | Finance

26. All of the following restrictions are considered management disadvantages of franchising *except*
a. requiring adherence to the operations manual.
b. requiring site approval and outlet appearance.
c. restricting goods and services offered for sale.
d. restricting advertising and hours of operation.

ANS: A PTS: 1 REF: p. 112 OBJ: 4-2 TYPE: C
NAT: Analytic | Ethical and Legal

27. What question is the least important when developing a franchise from an independent business?
a. Who will develop the operations manual?

b. Is the business replicable?
c. How will growth be financed?
d. What expert assistance will be needed for legal matters?

ANS: A PTS: 1 REF: p. 120 OBJ: 4-3 TYPE: C
NAT: Analytic | Value Creation

28. Benefits of becoming a franchisee include all of the following items *except*
a. reduced risk of failure.
b. detailed operating manual.
c. management training.
d. reduction in control.

ANS: D PTS: 1 REF: p. 109 OBJ: 4-2 TYPE: C
NAT: Analytic | Value Creation

29. In what way is a franchisee's control over the business greatly reduced?
a. Most franchisors are located near the franchisee.
b. The franchisees are technically employees of the franchisor.
c. The franchisee is bound by the terms the franchise contract.
d. The franchisee is completely dependent on the franchisor for funding.

ANS: C PTS: 1 REF: p. 113 OBJ: 4-2 TYPE: C
NAT: Analytic | Ethical and Legal

30. The disclosure statement provided to a prospective franchisee must contain all of the following information *except*
a. franchisor's finances.
b. experience in the market.
c. involvement in litigation.
d. strategic plans for future expansion.

ANS: D PTS: 1 REF: p. 122 OBJ: 4-3 TYPE: C
NAT: Analytic | Ethical and Legal

31. Which of the following reasons for buying a business is also a reason for purchasing a franchise?
a. Reduction of uncertainty
b. Acquiring goodwill
c. Bargain price
d. Quick start

ANS: A PTS: 1 REF: p. 123 OBJ: 4-4 TYPE: C
NAT: Analytic | Ethical and Legal

32. The *Franchise Registry* maintained by the *U.S. Small Business Administration*
a. lists warnings about certain franchise systems.
b. verifies a franchise system's lending eligibility.
c. rates franchise systems according to a four star rating.
d. registers all franchise systems operating in the U.S.

ANS: B PTS: 1 REF: p. 111 OBJ: 4-2 TYPE: D
NAT: Analytic | Ethical and Legal

33. A FDD disclosure includes all of the following information *except*
a. litigation and bankruptcy history.
b. investment requirements.

c. conditions that would affect renewal, termination, or sale of the franchise.
d. franchise qualifications requirements.

ANS: D PTS: 1 REF: p. 118 OBJ: 4-2 TYPE: D
NAT: Analytic | Ethical and Legal

34. Which descriptor is *not* a part of the definition of franchising?
a. Two party legal agreement
b. One party obtains the right to sell a specific product or service
c. Two parties are brought together by a facilitator
d. One party allows another to do business as it specifies to gain certain benefits

ANS: C PTS: 1 REF: p. 106 OBJ: 4-1 TYPE: D
NAT: Analytic | Ethical and Legal

35. In addition to consulting an attorney, the text also suggests the use of all of these professionals in evaluating a franchise *except*
a. an accountant
b. as many sources of help as would be practical
c. a banker
d. an experienced administrator

ANS: D PTS: 1 REF: p. 121 OBJ: 4-3 TYPE: C
NAT: Analytic | Ethical and Legal

36. One of the most important features of the franchise contract is the provision related to
a. the sale or transfer of the franchise to a government entity.
b. changes in management.
c. termination and transfer of the franchise.
d. termination of contracts with suppliers.

ANS: C PTS: 1 REF: p. 122 OBJ: 4-3 TYPE: C
NAT: Analytic | Ethical and Legal

37. The offer and sale of a franchise are regulated by
a. state laws exclusively.
b. federal laws exclusively.
c. both state and federal laws.
d. Federal Trade Commission laws exclusively.

ANS: C PTS: 1 REF: p. 122 OBJ: 4-3 TYPE: C
NAT: Analytic | Ethical and Legal

38. A document called the _____ is the accepted format for satisfying franchise disclosure requirements.
a. Franchise Disclosure Document
b. Franchise Offering Circular
c. Franchise Circular Agreement
d. Uniform Franchise Circular Agreement

ANS: A PTS: 1 REF: p. 122 OBJ: 4-3 TYPE: D
NAT: Analytic | Ethical and Legal

39. Items covered in the new FDD include all of the following *except*
a. litigation.
b. bankruptcy.
c. investment requirements.

d. marketing goals.

ANS: D PTS: 1 REF: p. 122 OBJ: 4-3 TYPE: C
NAT: Analytic | Ethical and Legal

40. Most franchise experts recommend that the FDD be examined carefully by
a. regulators that specialize in such documents.
b. a franchise attorney and an accountant.
c. everyone associated with the potential startup.
d. suppliers that may be used if the startup is successful.

ANS: B PTS: 1 REF: p. 122 OBJ: 4-3 TYPE: C
NAT: Analytic | Ethical and Legal

41. Susan is considering buying the local franchisee of *Pots-R-Us*. The owners would probably state this reason for selling when in actuality the other three reasons may be more likely.
a. desire to locate to a different part of the country
b. unprofitable
c. loss of an exclusive sales franchise
d. lack of growth potential

ANS: A PTS: 1 REF: p. 127 OBJ: 4-4 TYPE: A
NAT: Reflective Thinking | Dynamics

42. Craig Slavin, as the chairman and founder of *Franchise Architects*, felt that
a. a company grows best when it is allowed to form as needed.
b. his training as an architect student helped him get his start in franchising.
c. too many ventures are built from the top down based on the founding entrepreneur.
d. his company's research team showed following the rules was best for performance.

ANS: C PTS: 1 REF: p. 119 OBJ: 4-3 TYPE: C
NAT: Analytic | Value Creation

43. Which consideration does *not* need to be well thought out before deciding to franchise a business?
a. Is the business model replicable?
b. What will be included in the operations manual?
c. How will the growth be financed?
d. What proprietary information will be included in the FDD?

ANS: D PTS: 1 REF: p. 120 OBJ: 4-3 TYPE: C
NAT: Analytic | Value Creation

44. The purchase price of a business is determined by negotiation between
a. lender and seller.
b. seller and broker.
c. buyer and seller.
d. lender and buyer.

ANS: C PTS: 1 REF: p. 129 OBJ: 4-4 TYPE: C
NAT: Analytic | Finance

45. In evaluating the financial health of an existing business that available for purchase, all of the following historical documents must be examined *except*
a. profit and loss statements.
b. seller's personal bank statements.
c. income tax statements.

d. balance sheets.

ANS: B PTS: 1 REF: p. 127 OBJ: 4-4 TYPE: C
NAT: Analytic | Finance

46. Union contracts are among the many _____ factors in valuing a business.
a. nominative
b. nonessential
c. nonquantitative
d. nonqualitative

ANS: C PTS: 1 REF: p. 128 OBJ: 4-4 TYPE: D
NAT: Analytic | Finance

47. Which factor is a non-quantitative factor of valuing a business?
a. Future community development
b. Size of the buildings
c. Number of employees who will stay with the company
d. Employee salaries

ANS: A PTS: 1 REF: p. 128 OBJ: 4-4 TYPE: C
NAT: Analytic | Finance

48. When purchasing a business during closing, which document will *not* be completed?
a. Bill of sale
b. Certifications as to taxing and other governmental regulations
c. Agreements pertaining to future payments and related guarantees to seller
d. FDD

ANS: D PTS: 1 REF: p. 129 OBJ: 4-4 TYPE: C
NAT: Analytic | Ethical and Legal

49. Which technique is *not* valid for valuing a company?
a. Asset-based valuation
b. Cash flow-based valuation
c. Market-comparable valuation
d. Review of recent business sales

ANS: D PTS: 1 REF: p. 128 OBJ: 4-4 TYPE: C
NAT: Analytic | Finance

50. Who will be the least informed when asking questions about a prospective business during due diligence?
a. Bankers
b. Competitors
c. Employees
d. Suppliers

ANS: B PTS: 1 REF: p. 125 OBJ: 4-4 TYPE: C
NAT: Analytic | Dynamics

51. When evaluating the financial data of a 10 year old business that is being considered for purchase, which issue will be of least concern?
a. Understated income in an effort to minimize taxes
b. Unrealistically reduced levels of advertising cost
c. Business expenses related to personal use of vehicles

d. Not having the books for Years 1-5 due to a fire

ANS: D PTS: 1 REF: p. 127 OBJ: 4-4 TYPE: C
NAT: Analytic | Finance

52. A matchmaker
a. is a realtor who deals only with businesses that banks have started foreclosure proceedings.
b. who only represent possible sellers and therefore have no conflict of interests between a possible buyer and seller.
c. is a specialized broker who handles all arrangements for closing a buyout.
d. All of the above statements are true about matchmakers.

ANS: C PTS: 1 REF: p. 124 OBJ: 4-4 TYPE: D
NAT: Analytic | Dynamics

53. Which practice is a competitive concern for franchisees?
a. churning
b. encroachment
c. nondisclosure agreements
d. royalty payments

ANS: B PTS: 1 REF: p. 113 OBJ: 4-2 TYPE: D
NAT: Analytic | Value Creation

ESSAY

1. Discuss 5 negative practices that governmental agencies have with franchisers. What could a potential franchise do to counteract these practices?

ANS:
From Exhibit 4-3, the items listed include:
1. Misleading or exaggerated earnings claims by franchisors.
2. Opportunity behavior by which the franchisor becomes a competitive threat to franchisees.
3. Restrictions on franchisees who desire to liquidate their holdings in favor of alternative investment opportunities.
4. Conflicts of interest, such as when a franchisor forces franchisees to be captive outlets for other suppliers owned by the franchisor.
5. Churning: terminating a successful franchise operation in order to resell it and gain additional franchise fees.
6. Encroachment: locating a new outlet or point of distribution too close to an existing franchisee, causing a material loss of sales.
7. Imposing noncompete clauses on franchisees.
8. One-sided contracts devised by franchisors.
9. The imposition of new restrictions as a requirement of contract renewal.
10. Franchisor intimidation of franchisees who attempt to form franchisee associations, seek alternative sources for products, or make other efforts to create a more level playing field.

To eliminate these issues as a concern, a potential franchise should check that the franchisor is a member of the International Franchise Association and fully investigate the operation before signing any contracts.

PTS: 1 REF: p. 112 OBJ: 4-2 TYPE: C
NAT: Communication | Economic Environments

2. Define the terms franchising, franchisor, and franchisee. Apply to *McDonald'*s or another franchise example.

   ANS:
   - Franchising: a method of distributing products or services defining the privileges and responsibilities of the involved parties. (e.g. the process of ordering, preparing and serving food using *McDonald'*s selected procedures and suppliers)
   - Franchisor: the party who lends the trademark or trade name and a business system (e.g., *McDonald's*).
   - Franchisee: the party who pays a royalty and often an initial fee for the right to do business under the franchisor's name and system. (e.g. *McDonald's* local owner/operator)

   PTS: 1 REF: p. 106-107 OBJ: 4-1 TYPE: A
   NAT: Communication | Value Creation

3. Compare and contrast the functions of a master licensee and area developer.

   ANS:
   A master licensee is a firm or individual that acts as a sales agent (or middleman), taking on the contractual responsibility of finding new franchisees within a specified territory. Sometimes a master licensee will provide support services, such as training and warehousing, which are more traditionally provided by the franchisor.

   An area developer is an individual or firm that obtains the legal right to open several operations in a given area.

   While both the master licensee and area developer would have to thoroughly understand the franchise requirements, these entities would be two separate organizations or persons.

   PTS: 1 REF: p. 107 OBJ: 4-1 TYPE: C
   NAT: Communication | Value Creation

4. What options are available to the aspiring franchisee to assist in the evaluation of a franchising opportunity?

   ANS:
   Basically, three sources of information should be tapped: (1) independent, third-party sources such as a consultant, educational materials, or layperson information, (2) the franchisor information as seen online or in conversations, and (3) existing and previous franchisees.

   PTS: 1 REF: p. 115-119 OBJ: 4-3 TYPE: C
   NAT: Communication | Value Creation

5. List four reasons for buying an existing business. Which one is the most important?

   ANS:
   1. To reduce some of the uncertainties and unknowns that must be faced in starting a business from the ground up
   2. To acquire a business with ongoing operations and established relationships with customers and supplier
   3. To obtain an established business at a price below what it would cost to start a new

business or to buy a franchise
4. To begin a business more quickly than by starting from scratch.

The most important reason will vary based on the prospective buyer's motivation and needs.

PTS: 1 REF: p. 123 OBJ: 4-4 TYPE: C
NAT: Communication | Value Creation

6. Briefly compare and contrast "product and trade name franchising" with "business format franchising."

ANS:
When engaged in "product and trade name franchising" the business mainly gets to use the well known name of the franchisor's product or service and the operation of the company is left up to the franchisee.
With "business format franchising," there maybe a name associated with the product or service, but the main benefit to the franchisee is the complete marketing and management system that is provided by the franchisor.

Both types of franchising will have strict requirements for use.

PTS: 1 REF: p. 95 OBJ: 4-1 TYPE: C
NAT: Communication | Value Creation

7. List and describe the cost components of becoming a franchisee.

ANS:
1. Initial franchise fee: may range from several hundred to several thousand dollars.
2. Investment costs: renting or building an outlet, stocking it with inventory and equipment, insurance premiums, legal fees and other startup expenses.
3. Royalty payments: charged to the franchisee by the franchisor, calculated as a percentage of the gross income.
4. Advertising costs: many franchisees contribute to an advertising fund to promote the franchise, generally 1 to 2 percent of sales.

PTS: 1 REF: p. 102 OBJ: 4-2 TYPE: C
NAT: Communication | Finance