

Reeder CPA Group

Strategic Tax, Accounting, & Advisory



What are the Top 10 things a prospective franchisee should look at when reviewing a Franchise Disclosure Document (FDD)?

Top 10 Key Items to Review in an FDD

When reviewing a Franchise Disclosure Document (FDD), it's important to prioritize sections that directly impact your financial investment, operational responsibilities, and potential success. This guide highlights the top 10 key items to review and additional sections that provide valuable context, along with a recommended reading order for first-time candidates.

1. Item 5: Initial Fees

- Understand the franchise fee and what it includes—such as training, marketing, or operational support.
- Check for discounts for veterans, minorities, women, or multi-unit operators.
- This is a critical starting point to understand what you're paying for upfront and how those funds are used.

2. Item 6: Ongoing Fees

- Evaluate royalties, marketing fees, technology fees, and other recurring costs.
- Note that royalties align the franchisor's incentives with helping you grow your business.
- Fees for marketing or technology reflect the franchisor's investment in tools and systems to support franchisees.
- Recognize these as standard costs of doing business, often with value-added support from the franchisor.

3. Item 7: Estimated Initial Investment

- Review the detailed cost breakdown, typically presented as a range from low to high.
- Plan for the high-end estimate to ensure sufficient working capital for the ramp-up period.
- Don't rely on the low side—budget conservatively to avoid surprises.
- Check if you already own items such as vehicles or equipment that could reduce costs.

4. Item 9: Franchisee Obligations

- Use this section's helpful table to locate details about your operational and financial responsibilities.
- This is a great reference tool if you're unsure where to find specific requirements within the agreement.

5. Item 11: Franchisor's Assistance

- Outlines what the franchisor provides in terms of training, advertising, and technology.
- Understand what resources will be available to you and which responsibilities remain on your shoulders.
- This section is especially useful for assessing how much support you'll have as a franchisee.

6. Item 12: Territory

- Defines your geographic area and whether it is exclusive.
- Clarify how territories are assigned and whether the franchisor protects them from overlap with other franchisees.
- Understand what you're allowed to do outside your territory, such as online sales or non-territory marketing.

(continued on the next page)

Recommended Reading Order for First-Time Candidates

For those reviewing an FDD for the first time, consider following this step-by-step approach:

1. Start with **Items 5 and 7** to understand upfront and total investment costs.
2. Move to **Item 6** to review ongoing fees and their value.
3. Check **Item 12** to clarify your territory and any restrictions.
4. Examine **Item 19** for financial performance data and validation through franchisee discussions.
5. Use **Item 9** as a reference tool for understanding obligations and agreement details.
6. Dive into **Item 11** to confirm the franchisor's support offerings.
7. Scan **Item 17** to understand renewal, termination, and transfer rules.
8. Analyze **Item 20** to assess franchisee churn and growth trends.
9. Conclude with **Item 21** to evaluate the franchisor's financial strength.

Pro Tip: Talk to Franchisees

One of the best ways to validate the FDD is by speaking with current and former franchisees. Ask about their experiences, challenges, and what it takes to succeed. Compare their responses to the data in Item 19 and use their insights to better understand the franchise system's strengths and potential pitfalls.

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Top 10 Key Items to Review in an FDD

7. Item 17: Renewal, Termination, and Transfer

- Provides details on the length of the agreement, rules for renewal, and conditions for transferring ownership.
- Understand what happens if you decide to sell your franchise or face termination scenarios.
- Includes dispute resolution procedures, which are important for managing potential conflicts.

8. Item 19: Financial Performance Representations (FPR)

- This section is a valuable benchmarking tool for assessing potential revenue.
- Use the data to ask targeted questions during discussions with franchisees.
- If no Item 19 is provided, it isn't necessarily a dealbreaker, but you'll need to conduct more due diligence.

9. Item 20: Franchisee Data

- Shows franchisee openings, closures, and transfers over the past three years.
- High turnover rates may indicate systemic challenges, while growth trends could suggest a thriving system.
- Pay attention to state-level data for insights into regional franchise performance.

10. Item 21: Financial Statements

- Review the franchisor's financial health to assess their ability to support franchisees.
- Healthy financials suggest stability and the capacity to reinvest in the system.
- If the franchisor's financial position looks weak, it could indicate future risks for franchisees.

Additional Items to Consider

Consider reviewing these sections to provide extra context:

Item 1: Franchisor's History and Structure

- Understand the franchise's background, ownership changes, and any rebranding efforts.

Item 2: Leadership and Business Experience

- Evaluate the franchisor's leadership team and their experience in franchising and the industry.

Item 3: Litigation and Item 4: Bankruptcy

- Check for litigation or bankruptcy filings.
- Most litigation involves compliance issues (e.g., selling franchises without proper registration), but repeated patterns can be red flags.

Item 15: Franchisee Participation

- Clarifies whether the franchise requires owner-operators or allows semi-passive/manager-run models.



About Reeder CPA Group

Reeder CPA Group is a national, remote CPA firm specializing in strategic tax planning, accounting, and business advisory services for franchisees and entrepreneurs. We guide clients through entity setup, tax optimization, and funding strategies, helping them navigate the financial complexities of business ownership. With strong ties to national franchise networks like IFPG, FranServe, and FBA, Reeder CPA Group is committed to providing proactive, entrepreneurial guidance that empowers clients to make informed financial decisions year-round.

Franchise Vetting Checklist

This checklist serves as a starting point for evaluating a franchise opportunity, but working with a professional, like a franchise broker, can provide step-by-step guidance tailored to your unique goals and needs.

To Review	Reference FDD Item #
Franchise Vetting	
Franchise Fee	5
How Many Units Upfront	5
Years in Business	1
Territory	12
Advertising Fees	6
Franchisee Participation	15
Emerging Market Potential	20
Net Promoter Score (NPS)	-
Financial Data	
Initial Investment Range	7
Liquidity and Net Worth Requirements	5, 7
Break-Even Point	19 can help
Net Profit Margins	19
Recurring Revenue Potential	11
Revenue Benchmarks	19
Cost of Goods Sold (COGS)	7, 19
Royalty Fees	6
Marketing Fees	6
Low Startup Costs	7
Revenues per Appointment/Sale	19
Operational Details	
Training Programs	11
Call Centers and Appointment Systems	11
Support Staff	11
Systems and Technology	11
Product Requirements	8
Employee Model	9
Scalability	20
Recession Proofing	19 can help
Membership-Based Revenue	11
Owner vs. Manager Run	15