



livebetter

Risk or Risky?

Have you heard the phrase "risk versus reward?" I'm certain that as you contemplate making a major career move to peruse and then accept a job offer or invest money to acquire a business or franchise you've asked yourself, "Can I afford to do this? What if I fail, how long will it take to recover financially? If I accept this job and relocate to El Paso, Texas, what happens if there's another lay off?" Many of my clients migrate to what I call a "wishy washy" attitude. The mind set of "*that depends*" takes over. It's best described as believing that the longer one delays, the more one knows or that I'll know it when I see it. This belief is a killer for setting goals, budgets and making clear well thought decisions. No action become the decision making process. This is a job, not an entrepreneur mentality!

In the world of franchising its best to set your budget first, define the ideal characteristics for your perfect business and then investigate ONLY franchises that match that model. Spending more will not guarantee a more successful or profitable business. In your job search, will you take less pay and move to an undesirable location if your job search stretches into six, nine or twelve months?

Risk is defined as a state of uncertainty where some of the possibilities involve a loss, catastrophe, or other undesirable outcome. Risk is measurable; you can calculate the cost, return on investment and time line to achieve your objective. Example: "There is a 40% chance the proposed oil well will be dry with a loss of \$12 million in exploratory drilling costs". Another important factor is uncertainty.

Uncertainty is defined as the lack of complete certainty, that is, the existence of more than one possibility. The "true" outcome/state/result/value is not known.

Follow this link to a chapter five of the book "The Educated Franchisee" by Rick Bisio [why own a business when I can get a job](#). The exercise will allow you clearly define if taking the job is a better long term decision than starting a business or franchise. Another valuable exercise I complete with my clients is this – The scale is from one to ten, with ten being the highest risk possible, such as cliff diving in Acapulco and one is taking no risk what so ever, akin to putting your money in a jar and staring at it. What is the risk factor that best describes you right now in your life? Have your partner or spouse or life partner to complete the exercise too. What was your number? Did that surprise your mate? Did their number surprise you?

The next step is to calculate what your monthly burn rate is. How much money do I need on a month basis to cover ALL my living expenses? This should include your mortgage, car and credit card payments, food, doctor bill and other unexpected expenses. Do you know this number or do you need to set down and figure it out?

Now comes the hard part. Remember the mindset encompassed in the phrase, "that depends" put that on hold and don't let your mind or hear gravitate there for the next few minutes. Put it in the parking lot. In purchasing a business or franchise the total dollar investment is called **"the total turnkey investment."** This is the franchise fee, the cost of the tools, equipment and fixtures to operate the business, the value of the current goodwill if it's an existing operation and enough capital to keep the business going until its making enough money to cover all the expenses. If you're going to borrow funds for the purchase you'll need a minimum of 25% of the total invest in cash from your own pocket. So if the business cost \$200K you must pull from your resources \$50K. Here is the tough question – "What is your budget? What's your total amount your willing to invest? What's the amount of your own cash your willing to put at risk?"

Now let's pull all of this together. John and Mary have a current net worth of \$425K. Net worth is a simple equations, take all of your assets, such as stock,

401k, savings and checking account and the current realistic market value of your home or rental properties. Now add up all of your current liabilities and long term bills, such as credit card debt, student loans and mortgages. Subtract the two. The remaining number is your net worth. Jon and Mary have decided that they are willing to invest \$175K into a business venture. Their monthly burn rate is \$6250 or \$75K per year. Mary plans to keep her job where she makes \$50K. They determined that their individual risk factors where – John was at a 6 and Mary was at a 4.

First let's divide their investment amount into their net worth. This is the magic formula! $\$175 \text{ divided by } \$425 = 41\%$. The ideal percentage for a moderate risk taker is 30% or \$127K. A high risk taker will usually commit up to 50% of their net worth to an investment. In this example 50% of \$425K would be 212K. So what does this mean for John and Mary? They are bigger risk taker than they thought or maybe they should scale back their invest to a more conservative amount. They should seek to invest the lowest possible amount with the highest net profit margin. This is true risk management and better approach than the "that depends" way of thinking.

Below are some of my thoughts and opinions about risk factors and what it translates into practical terms when investigating franchises –

You rated your risk tolerance factor at a 1 or 2. Stay put! You clearly have too many fears or issues for you to take the plunge into business ownership. It's likely that part of your background or upbringing has affected your view of risk taking. However, knowledge does dispel fear. Make it your aim to improve your understanding of entrepreneurship. Read, study, investigate and by all means ask questions.

You rated your risk tolerance factor at a 3. You're very risk adverse; you've been burned before and may have too many concerns to invest in a franchise—unless it's a perfect fit. Your needs may be better met by investing in mutual funds, CDs, or a savings account. See the advice given above.

You rated your risk tolerance factor at a 4. You're somewhat risk adverse and only want to investigate a franchise with strong financial validation and earnings claims in its FDD. Unless it's the perfect fit, you may have too many concerns to invest in a franchise. It's vital that you understand a franchise's success depends on YOU to execute the business plan.

You rated your risk tolerance factor between 5 and 6. You feel most comfortable investigating a franchise that only has strong financial validation and earnings claims in its FDD, with high success rates. The total dollar amount of your proposed business investment should be in the 25% to 30% range

You rated your risk tolerance factor between 6 and 7. You're most comfortable with a franchise that has strong financial validation. You're willing to follow your instincts and will take calculated risks—after doing your own careful research. This is where most ideal franchise candidates land. Your need and drive for change is strong and you've likely done your homework. The total dollar amount of your proposed business investment should be in the 30% to 40% range. You may have a severance package or other uncommitted funds.

You rated your risk tolerance factor between 7 and 8. While you're most comfortable with a franchise that has strong financial validation, you're willing to check out emerging, first-to-market franchises. You also have reasonable expectations about the time it takes to break even and gain positive cash flow. This is where most ideal franchise candidates land. Your need and drive for change is strong and you've likely done your homework. You probably have owned a business before or have family background in business. The total dollar amount of your proposed business investment should be in the 40% to 50% range. You may have a severance package or other uncommitted funds.

You rated your risk tolerance factor between 9 and 10. Wow you're not afraid of anything. You like bungee jumping and sky diving. In this range franchising may be too constricting for you. You are a full blown entrepreneur. If Christopher Columbus asked you to come on his voyage you'd jump at the chance. You're willing to commit up a 100% of your net

worth because you believe you won't fail and can recover from a loss if it does occur.

These are just my opinions and observation from interviewing about 1000 franchise candidates since 2004. I ask everyone to complete the sequence of questions outlined in the above exercise. I would welcome your feedback and comments.

Stephen Hogan

Franchise Recruiting Manager

509-396-6686

shogan@bintheredumpthat.com

<http://www.bintheredumpthat.com/>