Flushing Out Frauds

By Elena Fawkner

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"... ALWAYS carry out your own due diligence! Remember, if it sounds too good to be true, it probably is."

Regular readers will recognize the above language. It comes from the "Caveat Emptor" section which appears towards the end of each issue of A Home-Based Business Online.

Good advice to be sure (even if I do say so myself). But what does "due diligence" mean and how do you do it? Basically, it means to be diligent in researching your proposed business opportunity so you can be as sure as you can be what you're getting into and why.

All very well and good, but how do you actually do it effectively?

Stock-standard advice includes:

1. Check with the BBB about whether your opportunity has any complaints filed against it.

2. Do a Dun & Bradstreet search to find out about its credit history.

3. Check business references.

4. If practical, visit the place of business.

Only one problem with this approach. Although it's a good start for researching a legitimate opportunity, it won't flush out a fraudulent one.

A newly formed company won't have any complaints filed against it with the BBB. D&B won't be much help since scam artists will generally keep their trade creditors in good standing until immediately before they pull up stakes and vanish into the night. Business references are invariably nothing but shills (associates of the scammer paid for their recommendation services). And few potential purchasers living in New York are likely to travel to California just to lay eyes on the so-called corporate headquarters of their opportunity. Even if they do, a serviced office gives just the right professional impression.

So, how do you flush out a fraudulent business opportunity? Well, there's a hard way and there's an easy way. The hard way (which is oh so easy at the time) is to fork over your money and then watch as it flies away. The easy way (which is oh so difficult at the time, at least compared to just handing over your money) is to use your state's and/or the FTC's disclosure laws for business opportunities (if available) and then methodically work through the information available to you until you have enough information to make an intelligent decision.

There are 23 states in the United States with business opportunity laws on their books. Most prohibit sales of business opportunities unless the seller gives prospective purchasers disclosure documentation that has been filed with the state. The 23 states are: California, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Michigan, Minnesota, Nebraska, New Hampshire, North Carolina, Ohio, Oklahoma, South Carolina, South Dakota, Texas, Utah, Virginia and Washington. (See http://www.ftc.gov/bcp/franchise/netbusop.htm for links to more information.)

In addition, if the business opportunity falls within the definition of a franchise or is a vending machine or display rack opportunity, the FTC's Franchise & Business Opportunity Rule mandates detailed disclosures such as identifying information about the franchisor (the person offering the business opportunity), the franchisor's business experience, litigation history, bankruptcy history, initial funds required, recurring funds required, financial information about the franchisor and much more . A franchise is defined broadly and just because it's not referred to as a franchise doesn't mean it isn't. See http://www.ftc.gov/bcp/franchise/16cfr436.htm for the full text of the Rule.

The point of all of this is that many, perhaps most, opportunities you'll come across will either fall within the FTC's definition of a franchise and thereby trigger the federal disclosure requirements (or, if the franchise offer is made in California, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Washington or Wisconsin, state franchise disclosure requirements) or, if not technically a franchise, the opportunity may very well fall within the scope of the state business opportunity disclosure laws of the 23 states listed earlier. So, when considering a particular business opportunity, take this approach:

1. Determine whether it is being offered in one of the 13 states with franchise disclosure laws. If so, determine whether the opportunity is a franchise as defined under the state's law. If so, check whether the state requires the disclosure document to be filed with the state. If so, check whether it has been. If not, assume the opportunity's a fraud until proven otherwise. If the state in question doesn't require the disclosure document to be filed with the state and you're not provided with such a document from the company when you ask for it, assume the opportunity is a fraud until proven otherwise.

2. If the opportunity is not being offered in one of these 13 states, determine whether it falls within the definition of a franchise under the FTC's Franchise & Business Opportunity Rule. If so, check whether a disclosure document has been filed with the FTC. If not, assume the opportunity's a fraud until proven otherwise.

3. If the opportunity doesn't fall within the federal or state definitions of what constitutes a franchise, if it's being offered in one of the states with business opportunity laws on its books which requires disclosure documents to be filed with the state, check that it has been. If not, assume the opportunity's a fraud until proven otherwise. If the state doesn't require filing, and the company doesn't provide you with a disclosure document when you ask for one, again assume the opportunity's a fraud until proven otherwise.

Also, bear in mind that just because your state may not have business opportunity disclosure laws, other states do. Many business opportunities are offered nationally. Where that's the case, make enquiries of the states that do have business opportunity disclosure laws to see if the company has complied. If it has, that should provide some comfort (all other things being equal).

The above approach is kind of an initial disqualifying round. If the opportunity is required to provide some form of disclosure and fails to do so, that's a big red flag.

Of course, just because you receive the disclosure document doesn't necessarily mean that this is a good business opportunity for you. All it does is (theoretically) provide you with enough information from which you can make your determination. At the end of the day, you must still exercise your own good judgment.

There are still going to be situations where a disclosure document is not required to be provided though, simply because the opportunity is not a franchise and it's not being offered in a state that has business opportunity disclosure laws.

So, here's a 10-point checklist of things to do and check when you have nothing else to rely on. In fact, they're a good idea even if you do have a disclosure document to review. Any inconsistency between the disclosure document and your own investigations gives you another question to ask.

1. Check with the BBB in the city in which the company is based. Although no complaints don't necessarily mean anything, complaints that have been filed do.

2. Check with D&B. Again, although a good report doesn't necessarily mean anything, a bad one does.

3. Check with the Chamber of Commerce in the city in which the company is based. Whether the company is a member or not doesn't mean anything but you can still ask about their reputation or whether there's any reason why someone shouldn't do business with them.

4. Check with your state's Attorney General's office and Secretary of State for any complaints or pending investigations.

5. Ask for a list of references of previous local purchasers including name, address, telephone number and when they entered into the opportunity. Make it clear that you want a list of people you can meet face to face. If the company is reluctant to provide this, be suspicious.

6. If your opportunity is being presented on a web site, check to make sure there is a physical address (not just a post office box) and contact telephone numbers. And check them out.

7. Look carefully at the business experience of the management behind your opportunity. If they leave a trail of short-term ventures in their wake this could be a sign they're either not particularly good at what they do or they have to move on frequently (if you get my drift). Also, look for specifics - names, dates, places. Vague statements like "10 years experience in the widget industry" are meaningless. Ask for details. Who, what, when, where and why (did you leave?).

8. Beware vague, generalized or evasive answers to due diligence questions that require simple factual answers. You

want to hear "123 Main Street, Suite 405, Your Town" in response to the question, "What is your corporate address?". If you get a "Why do you want to know?" instead, move on.

9. Beware policies that require payment for product and/or supplies by check or money order only. By not accepting credit cards, the ability dispute charges for defective or non-existent product is eliminated.

10. Most important of all, trust your gut instinct. If it all just sounds too good to be true, it probably is.

Elena Fawkner is editor of A Home-Based Business Online ... practical business ideas, opportunities and solutions for the work-from-home entrepreneur.
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