RESTAURANT BUSINESS

Senators Push for More Disclosure on SBA Franchise Loans

But critics say it's a solution without a problem. And a U.S. Senate hearing on the topic was bogged down by concerns about inflation and whether the government should back loans at all.

By Jonathan Maze

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An effort to require franchisors to provide more information when they received government-backed loans appeared to have won some key support this week.

U.S. Sen. Ben Cardin, D-Md., chair of the Senate Committee on Small Business and Entrepreneurship, backed a pair of proposals by Sen. Catherine Cortez Masto, D-Nev., that would increase the amount of information franchise brands would have to disclose if they receive SBA loans.

One would require the agency to publish franchise brands' default rate on SBA loans every quarter. Another would require such brands to provide prospective franchisees with more financial information.

To backers of the legislation, it would give prospective operators more information to determine the quality of the franchise in which they want to invest. "For many small business owners, franchising has been a path to the middle class and financial security," Cardin said in a statement opening a hearing on the SBA's role in franchising. "For many others, opening a franchise has led to financial ruin. The model has its risks, with a disproportionate amount falling on the franchisee."

The proposals have their critics, notably the International Franchise Association, which argues that the bills are trying to fulfill a need that doesn't exist and that they unfairly target franchisors.

"Our view is that requiring a special kind of disclosure—for franchisors only—that would add additional data to the (franchise disclosure document) would not be useful to prospective franchisees or serve a particularly useful purpose," Matt Haller, CEO of the IFA, said in a statement for the record submitted to Cardin's committee. He added that the Federal Trade Commission, which regulates franchises, is a better forum for franchise disclosure than the SBA.

The hearing also became bogged down by concerns about inflation and whether the government should back business loans in the first place.

U.S. Sen. Rand Paul, a Republican from Kentucky and the ranking minority member, complained that proposed regulations would not do anything to ease inflation or balance the budget, lower taxes or repeal legislation. He said the proposals would “weaken a business model that has been successful.”

He then argued this: “The best way to avoid risk for the taxpayers is to stop having them foot the bill for SBA grants and loans.”

Bryan Tipton, owner of the Arby’s franchisee Tipton Investments, argued in testimony at the hearing that if a borrower needs to get SBA-backed funding, then they’re “probably not doing something right.”

“Taxpayers are taking on risky business loans,” he said. “Most small business owners’ needs can be met in the private lending market.”

The SBA will back loans to small businesses that struggle to get lending from the private market. The agency backed some $36.8 billion worth of loans in its 7(a) program and another $7.6 billion in the 504 program, the two most popular such programs.

Many small businesses cannot get started without them, including franchises. “The IFA is very supportive of SBA loan programs,” Leanne Strapf, chief operating officer and a multi-unit franchise owner of The Cleaning Authority out of Columbia, Md., speaking for the association. “These loan programs are essential to helping small businesses get off the ground, giving the opportunity to those who may not have access to capital realize the American dream.”

The legislation from Cortez Masto comes in reaction to a handful of problems in the franchise sector, notably Burgerim, which signed up more than 1,500 franchisees in a three-year period, the vast majority of which never were able to open a store. Most of those who did lost money and many went bankrupt.

The FTC has since sued Burgerim, arguing that the company violated federal disclosure laws in signing up many of the franchisees. The state of California has ordered the company to pay a $4 million fine and refund franchise fees. **The actions followed a 2020 investigation by Restaurant Business into problems at the franchise**.

The SBA has backed more than 100 loans to the franchise and many argue that the agency should refund those loans in light of the actions by the FTC and California. But many note that the agency should do more to give franchisees information on the investments they’re making.

“They absolutely deserve to know what they are getting into,” Cortez Masto said. “That is not always the case.”

Robert Emerson, a professor of business law with the University of Florida, said he is concerned that bad franchises are a drag on the business model. He doesn’t believe that the disclosure proposals would impact franchisors’ costs because a lot of that work is already being done. Franchisees, he said, “should have better access to information.”

Yet Aaron Yelowitz, a senior fellow with the Cato Institute, a conservative think tank, argued that there is a “statistically insignificant” difference in charge-off rates for SBA loans made to independent businesses or franchises. And he argued that better franchisees will choose brands that provide more information.

“Those providing transparent products will find takers,” he said. “The private market will solve many of these issues.”