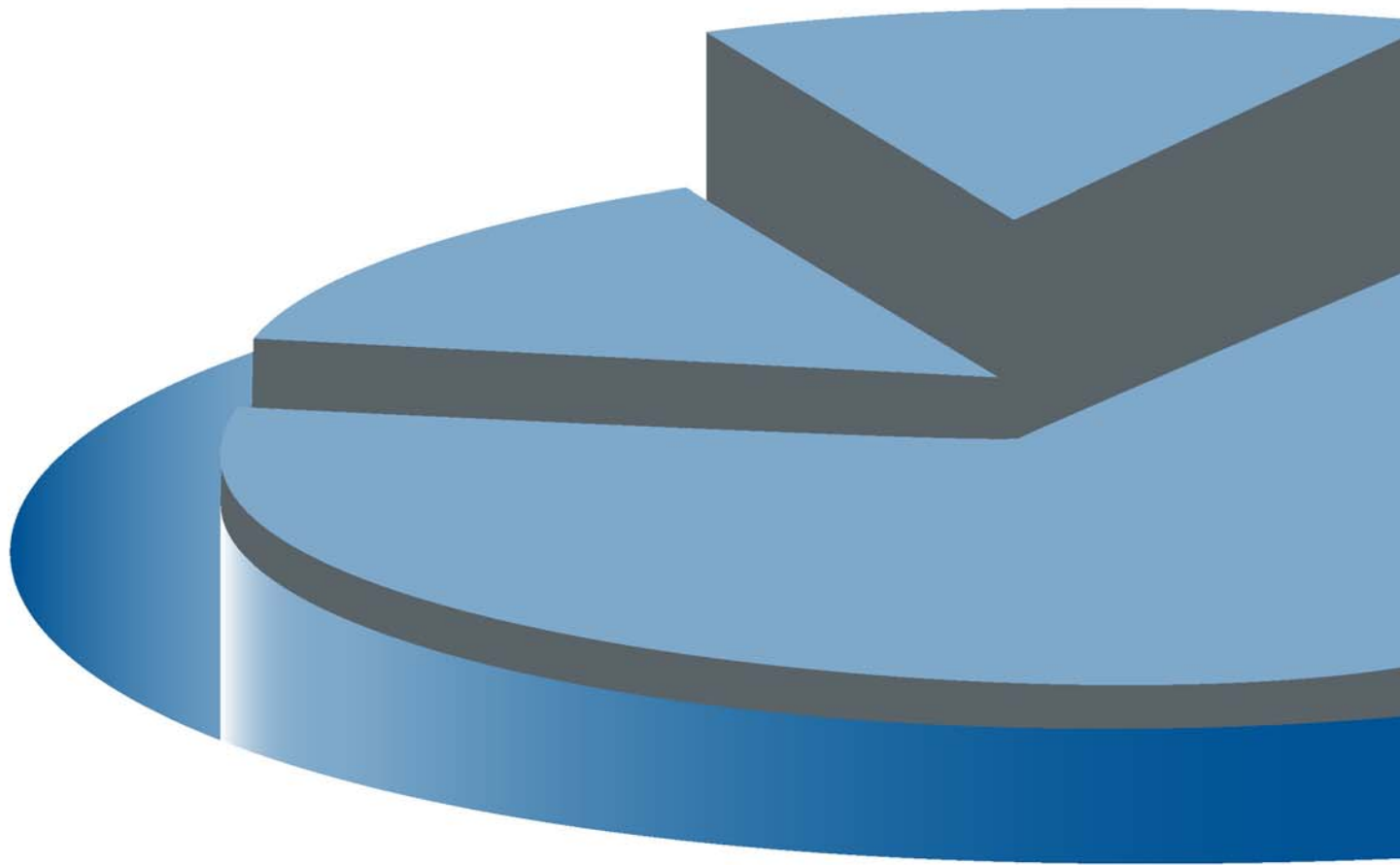


# Small Business Lending Matrix and Analysis

The Impact of the Credit Crisis on the  
Franchise Sector

**May 2009**



## Source Material

Information for this report is based on SBA data, the Economic Impact of Franchised Businesses Study (Volume 1 and 2) and additional third-party data. Additional information in this report was compiled from FDDs received and registered by state franchise examiners. Franchisors are required under state and federal laws to produce and deliver FDDs to prospective franchisees. As part of this disclosure process, certain state regulatory agencies require complete and updated FDDs to be filed and approved before a franchisor is permitted to sell franchising rights within their jurisdictions. These documents must be accurate by law.

More information concerning FDD disclosure guidelines is available at the North American Securities Administration Association (NASAA) website:

[http://www.nasaa.org/Industry\\_Regulatory\\_Resources/Corporation\\_Finance/588.cfm](http://www.nasaa.org/Industry_Regulatory_Resources/Corporation_Finance/588.cfm)

- - - - -

© 2009 Franchise Information Systems, Inc. (all rights reserved)

FRANDATA HAS NOT CONDUCTED ANY INDEPENDENT INVESTIGATION WITH RESPECT TO THE INFORMATION COMPILED BY FRANDATA FOR INCLUSION IN THIS REPORT, AND FRANDATA DOES NOT WARRANT THE ACCURACY OR COMPLETENESS OF THE INFORMATION CONTAINED IN THIS REPORT. FRANDATA HEREBY DISCLAIMS ALL EXPRESS, IMPLIED AND STATUTORY WARRANTIES, INCLUDING, WITHOUT LIMITATION, WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE AND NONINFRINGEMENT.

**FRANdata**<sup>SM</sup> permits no reproduction, electronic transmission or other distribution, of this report, in whole or in part, without written permission. FRANdata may be contacted at:

FRANdata  
4300 Wilson Blvd, Suite 480  
Arlington, VA 22203  
703.740.4700

**FRANdata** and the FRANdata logo are service marks of Franchise Information Services, Inc.

Page left blank intentionally

## Contents

|  |    |
|--|----|
| OVERVIEW.....  | 5  |
| EXECUTIVE SUMMARY.....   | 6  |
| Demand.....  | 9  |
| Franchisor Capacity .....  | 9  |
| Franchisee Demand.....   | 10 |
| Franchisee Ability.....  | 10 |
| Franchisee Willingness.....  | 10 |
| Decrease in Investment Ability and Willingness by Investor Type..... | 11 |
| Estimated Unit Transactions .....                                    | 11 |
| Estimated Average Initial investment.....                            | 12 |
| Advance Rates.....   | 13 |
| Franchising Economic Impact in 2009.....                             | 14 |
| Supply.....  | 15 |
| Lending's Impact on Franchising and the Economy in 2009 .....        | 16 |
| Scenario I: 30% Reduction in Lending .....                           | 16 |
| Scenario II: 35% Reduction in Lending .....                          | 17 |
| Scenario III: 40% Reduction in Lending .....                         | 18 |
| Unit Growth in the Past Recession.....                               | 19 |
| Industry Break Down .....  | 20 |

## OVERVIEW

Small business is a powerful and important driver of economic expansion. The current recession and the corresponding reduction in lending have placed a burden on small business and its ability to grow and to help the economy. The purpose of this report, prepared for the IFA Educational Foundation, is to show the relationship between lending to the franchising industry and the industry's capacity to develop new businesses and expand existing businesses, which in turn creates more jobs and produces more economic growth. This report examines a number of factors which enhance or constrain franchise business growth. However, the primary focus of this report deals with the amount of lending available to franchise businesses and its impact on franchise growth and the economy as a whole.

A typical franchised small business with initial investment requirements greater than \$50,000 directly creates an average of 10.8 jobs and an additional average of 9.8 indirect jobs. It also creates an average of \$828,000 in direct annual economic output and another \$1.3 million in average indirect annual economic output (all excluding the Lodging Industry).<sup>1</sup>

Franchising as a business model has been extremely resilient to economic slowdowns in the past. For example, between 1999 and 2006, the number of franchised units grew at an annual average rate of almost 6%. During the 1999-2002 Tech Bubble, the new unit growth continued at 5%.<sup>2</sup> During past recessions this growth has helped spur the pace of economic recovery and has provided alternatives to individuals who were down-sized or displaced by other businesses or sectors of the economy. However, the present recession presents new challenges. Between 2000 and 2002, lender willingness was constrained but capital was not. This time, the recession has been exacerbated by banks having limited capital to lend with significant implications for small business.

The relationship between lending, franchise small business jobs and economic output can be summed up by the following: For every million dollars of lending obtained by franchised small businesses, 34.1 jobs are created and \$3.6 million in annual total economic output is realized.<sup>3</sup>

The current capital access issues affect franchising and the economy in the following ways:

- Even with lowered expansion expectation in 2009, franchisors, franchisees and prospective franchisees are faced with capital access challenges that will constrain their growth further.
- Franchising will require an estimated \$8.4 billion dollars in financing to meet 100% of demand in 2009.
- Based on the current conditions, it is possible there will be a 40% reduction in franchise lending in 2009 which would limit the total number of unit transactions to 10,781 new units and 16,912 transfers. This amounts to 25,547 lost direct jobs and another 22,992 indirect jobs, or a total of 48,539 jobs. The economy as a whole would lose \$1.9 billion in direct annual economic output and another \$3.2 billion in indirect economic output, or a total of \$5.1 billion.
- Without the current capital constraints, FRANData projects that in 2009 there will be 12,965 new units and 20,338 transfer units. This equates to 151,660 direct jobs and 126,566 indirect jobs either created or protected, for a total of 278,226 jobs. Total direct annual economic output would be \$11.6 billion and indirect annual economic output of \$18.5 billion, for a total of \$30.1 billion of economic output.

<sup>1</sup> Direct jobs and direct economic output refers to the employment and business activity that is created directly by the franchise business. Indirect jobs and indirect economic output occurs when a franchised business and its employees acquires products and services from other businesses.

<sup>2</sup> For purposes of this report a "unit" is one business format franchisee-owned establishment. This report does not include product distribution franchises and company-owned establishments.

<sup>3</sup> Combination of both direct and indirect jobs and economic output.

## EXECUTIVE SUMMARY

### DEMAND

In 2009, FRANdata projects that franchise systems across all industries excluding Lodging<sup>4</sup> will require total capital of \$12.7 billion and total borrowings of \$8.4 billion. These projections are based on the following factors:

1. Average initial investment for a unit transaction
2. The number of unit transactions defined as both new units and transfers
3. Distinctions between prospective franchisee and experienced operator franchisee willingness and ability to start new units and acquire existing units
4. Bank loan terms

The projected average initial investment for 2009 was calculated by analyzing the average initial investment for all brands across industries. Franchises that require an average initial investment of less than \$50,000 were excluded. It was assumed that franchises with initial costs under \$50,000 typically would be financed through non-institutional sources, such as family and friends. Based on historic data, the average initial investment for brands with a minimum requirement of \$50,000 was \$390,152. This number was reduced by 2% to \$382,349 to account for expected declines in initial investment costs in 2009 as franchisors try to reduce such costs whenever possible.

To determine the number of unit transactions requiring financing, FRANdata considered new units and transfers since both transactions involve new financing. FRANdata estimated that franchise systems would try to maintain — but not attempt to increase — their historic growth levels to calculate the number of unit transactions. In 2008, excluding Lodging, there were an estimated 22,547 new units and 22,916 transfers, adding up to 45,463 unit transactions. Consequently, FRANdata assumes that in 2009, unit transactions would be at the same level.

Potential new unit owners were divided into two groups, first time owners and experienced franchisees. FRANdata took into consideration possible changes in both the ability and the willingness to invest in a unit transaction for each group separately. It is assumed that both have decreased due to the effects of the economy on housing prices (down 18% from 2006 to 2008), an unemployment rate of 8.1% in February 2009 (up from 4.5% in February 2007) and 401k portfolio losses (down an average 30%). FRANdata projects that unit transaction investments by experienced franchisees will decrease by 33% and those by first time owners will decrease by 21%. Investments by experienced franchisees are expected to decrease more than those of new franchisees because they are generally leveraged by their current units and the equity in their businesses has not allowed for a significant amount of new leverage. FRANdata estimates that of the 45,463 unit transactions that would require new ownership, excluding Lodging, only 33,302 units will be applying for financing, a reduction of 27% from 2008 estimates.

FRANdata further projects that based on 33,302 unit transactions, excluding Lodging, with an adjusted average initial investment of \$382,349, franchisees will have total capital requirements of \$12.7 billion in 2009.

Lending from banks follows two basic programs, SBA guaranteed loans and conventional bank loans (private placements, securitizations, and public company franchisee activities were deemed to be not

---

<sup>4</sup> Lodging was excluded from the overall analysis because of its capital intensity. The Lodging industry will be examined separately in the last chapter.

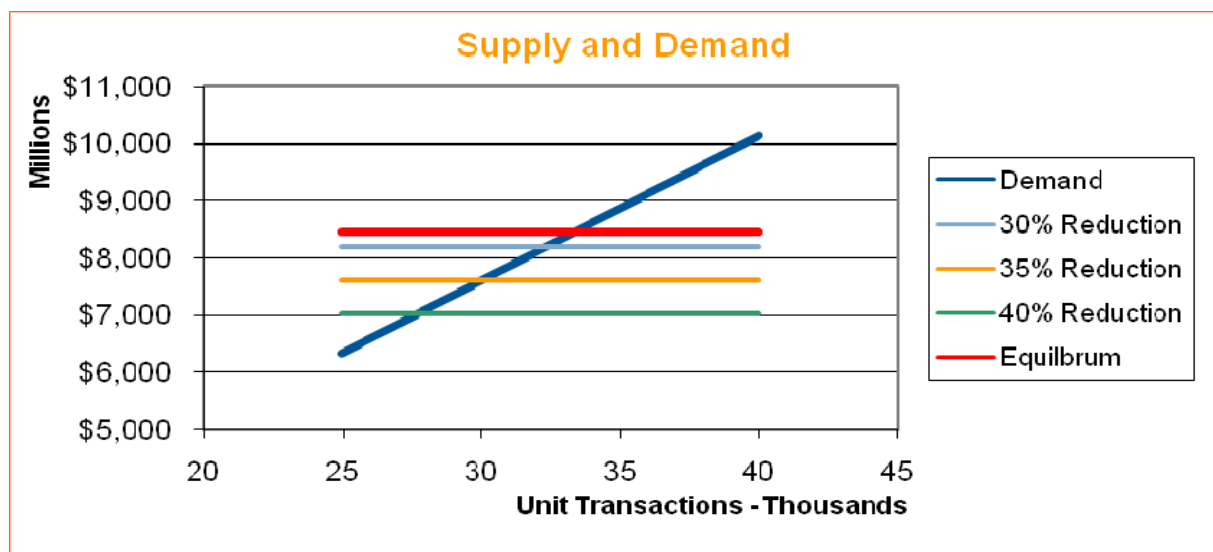
material to this analysis because of the capital market disruptions in 2008). Each type of loan requires different equity levels for borrowers to meet. In 2008, an SBA loan typically required borrowers to put in at least 20% cash while conventional loans typically required 30%. In 2009, these requirements are projected to increase to 30% for SBA and 35% for traditional loans. In 2008, franchisees received about 16% of all SBA guaranteed loans, according to FRANdata estimates. This share is projected to increase in 2009 because the government has more tools to influence SBA lending as it tries to add liquidity to the capital markets. Based on FRANdata's assumption of an increase to 26%, the average overall debt-to-equity required by banks is projected to be 66% in 2009.

FRANdata projects that based on capital requirements of \$12.7 billion, excluding Lodging, and a discount debt-to-equity ratio of 66%, the projected total lending institution borrowing demand for 2009 will be \$8.4 billion.

## SUPPLY

While it is impossible to know how the economic downturn will affect bank ability to lend at this time, several scenarios can be used to understand the impact on franchise unit capital needs. Using the estimated nearly \$12 billion loaned to franchisees in 2008 as a base, a lending contraction of no more than 28% would still allow enough capital availability to meet franchise unit transaction borrowing requirements.

This relationship is displayed in the graph below.



Based on the current banking environment, FRANdata believes lending could be reduced as much as 40% from 2008 estimates.

## ECONOMIC RAMIFICATIONS

Each unit transaction has an impact on the economy as a whole. Based on the Economic Impact of Franchised Business Study, the average franchise unit employs 10.8 directly (excluding Lodging) and creates \$828,353 of direct economic annual economic output (excluding Lodging). These units also create 9.8 indirect jobs and \$1.3 million in indirect annual economic impact. Therefore, every new unit not opened costs the economy 20.6 jobs and \$2.2 million of annual economic output.

Transfer units that are unable to get financing will likely continue in business thus not affecting the economy as a whole. FRANData assumes that 5% of all transfers that fail to get financing will close. These 5% are taken into consideration in the calculations below.

The table below provides to information about the constricted lending scenarios:

| Scenario      | New Units | Transfer Units | Total Jobs | Total Economic Output |
|---------------|-----------|----------------|------------|-----------------------|
| Equilibrium   | 12,965    | 20,338         | 288,153    | \$30,112,041,484      |
| 30% Reduction | 12,577    | 19,731         | 279,549    | \$29,212,864,832      |
| 35% Reduction | 11,679    | 18,321         | 259,581    | \$27,126,231,630      |
| 40% Reduction | 10,781    | 16,912         | 239,613    | \$25,039,598,427      |

Based on the equilibrium scenario under which unit growth is not constrained by financing, the 12,965 new units and the 20,338 transfer units will create, or protect, 288,153 total jobs and create a total annual economic output of \$30.1 billion.

To calculate the number of total jobs lost under each scenario, FRANData multiplied the difference between the equilibrium point and the individual scenarios. The result equals the number of new units not developed and transfers not financed. For example, at a 35% reduction from equilibrium, 1,286 fewer new units will be developed and 2,017 transfer units will not find financing.

The new units that are not being built can be multiplied by the average direct (10.8) and indirect (9.8) number of jobs in order to come up with a total number of jobs not created. For the transfers, only 5% should be taken into consideration to calculate the number of jobs not protected since the other 95% are assumed to continue their operations.

In summary, if lending is restricted by 35%, or \$837 million short of the equilibrium point, the economy will lose 28,572 total jobs and suffer lost economic output of \$3 billion dollars. Another way to say this is that for every million dollars in lending not obtained by franchises, 34.1 jobs and \$3.6 million in output will be lost.

## Demand

The demand for franchise unit debt capital was determined by using 2008 estimates as a baseline and adjusting these estimates for 2009. Three main factors affect borrowing demand: the number of unit transactions, the average initial investment and the bank lending rate. For this analysis, Lodging is removed as an outlier. The Lodging industry is highly capital intensive and its financing comes primarily from capital markets activities that are not often available to other franchise segments. For this reason, the Lodging industry will be examined on its own in the chapter on Industry Break Out and has been removed from the overall calculations.

## Franchisor Capacity

One factor that will determine the number of unit transactions is franchisor capacity to grow franchised unit numbers. It is assumed that all brands will want to grow at 100% of their 2008 capacity but in the face of the current economic conditions would not be adding new capacity for growth. Uncertainty about consumer behavior is likely to deter franchisors from implementing aggressive growth plans. In addition, decreased demand for products and services offered will make most franchisors more cautious and protective about their brand image. While some brands will add capacity, any such capacity increase is likely to be offset by brands that decide to curtail capacity.

To determine 2009 unit growth capacity, FRANData examined a population of 1,630 franchise brands across all industries and sectors. From 2005 to 2008, these brands grew their units on average by 22%, with brands in NEC growing the fastest. Gasoline Services experienced the largest decrease. It should be noted that these latter two NAIC segments had the fewest number of brands and units and thus do not have the same weight as the other larger segments.

It should also be noted that not all franchise brands have provided 2008 unit numbers. Whenever 2008 data were not available, average historical growth rates were used to estimate the expected number of units in 2008. This assumption is based on franchisor feedback stating that for most franchisors the recession started affecting unit growth in the second half of 2008.

| Industry                          | Growth Rate between 2005 and 2008 |
|-----------------------------------|-----------------------------------|
| Automotive                        | 1.23%                             |
| Business Services                 | 21.70%                            |
| Commercial & Residential Services | 20.53%                            |
| Food Retail                       | 26.16%                            |
| Gasoline Service Stations         | -1.90%                            |
| Lodging                           | 10.98%                            |
| NEC - not elsewhere classified    | 79.64%                            |
| Personal Services                 | 33.17%                            |
| Quick Service Restaurants         | 13.18%                            |
| Retail Products & Services        | 15.57%                            |

These percents were then applied to the 2008 unit numbers to project the maximum number of units franchisors could add in 2009.

Based on these estimates, 2009 could see 48,560 unit transactions of which 22,741 would be new units and 25,819 would be transfer units. When Lodging brands are removed, the number falls to 22,547 new units and 22,916 transfers.

## Franchisee Demand

To determine franchisee demand, FRANdata considered several factors. Demand for a new unit is largely driven by a buyer's ability and willingness to invest. Considering the level of willingness is important for the calculations because a new owner can have the ability to invest in a unit transaction due to access to credit and personal assets. However, investment decisions are also driven by less tangible factors such as willingness to invest.

Demand is also influenced by the type of prospective investor. FRANdata distinguishes between new owners and experienced franchisees who wish to add another unit to their existing one(s). For these two types, ability and willingness to invest will differ.

Another factor affecting the number of new franchisees is the recent weakening of the job market. People who lose their jobs may seek out franchising as way to guarantee their future job security. However, even if the potential pool of new franchisees would thus increase, it is not certain whether this would also significantly increase the number of qualified applications. For this reason, FRANdata did not include this as factor in overall new unit demand.

## Franchisee Ability

First time buyers have had their personal ability to invest considerably affected in the past 24 months. According to recent economic figures, housing prices have declined by 18% from 2006 to 2008 and 401k balances are down an average of 30% from 2007 to 2008. These declines in private assets will negatively impact the ability of new franchisees to provide the necessary cash portion of an investment because the equity position of a franchise unit investment is traditionally financed through a mix of home equity debt, personal savings and other assets.

The second group, experienced franchisees, has often already leveraged their homes or 401k plans to purchase their first unit and thus use equity in their existing business to purchase additional units. In a period of decreased consumer sales, many existing franchisees have experienced decreases in operating margins and therefore in company equity. As a consequence, experienced franchisees are exposed to a decline in private assets and business equity and may face even more restrictions on their ability to invest in a unit transaction than new franchisees.

## Franchisee Willingness

While it is difficult to assess emotional and psychological factors that influence willingness, some assumptions are possible. Uncertain economic times, a projected 1.6% decrease in consumer spending in 2009 and lower severance packages for employees are all likely to decrease willingness to take on entrepreneurial business risks. Based on past patterns of business activity during economic downturns, experienced franchisees will try to ride out the economic storm by slowing further development plans. However, past patterns also show some increased willingness on the part of experienced franchisees to acquire existing units, particularly from franchisees that have more recently entered franchising.

Considering how these factors could impact the ability and willingness to invest in a unit transaction for each of the two groups of potential buyers, FRANdata created the following matrix. It is assumed that new franchisee willingness to invest in a unit transaction would be lower than that of existing franchisees because of their lack of franchise experience. The table presents the percent decrease for each transaction type in 2009.

## Decrease in Investment Ability and Willingness by Investor Type

| Franchisee Type               | Decrease in Willingness to Invest |                       |
|-------------------------------|-----------------------------------|-----------------------|
|                               | New Unit Transactions             | Transfer Transactions |
| Existing Operator Willingness | 50%                               | 10%                   |
| Existing Operator Ability     | 60%                               | 10%                   |
| New Franchisee Willingness    | 20%                               | 15%                   |
| New Franchisee Ability        | 40%                               | 10%                   |

Based on the above analysis, the matrix shows the most affected group will be existing operators. The majority of these operators will be the most constricted due to declining personal net worth and greater financial restrictions imposed on their businesses. Also, the bulk of unit transactions will consist of transfers rather than new units. An investment in a transfer is likely to be more attractive because new units that do not have a sales history represent greater investor risk. Transfer unit prices are more affected by future cash flows and not the value of existing assets. A demonstrated performance history makes valuation more certain.

In addition, buying an existing unit will also be an attractive proposition for experienced operators confident of their ability to streamline operations, cut down on expenses and increase profit margins. Units that underperform due to inefficient operations typically are among the first to be put up for sale during economically difficult times.

Given that credit availability and decline in private assets has been significant, FRANdata projects that the ability to purchase a new or existing unit will be a more limiting factor than the willingness to do so.

## Estimated Unit Transactions

Based on the estimated new units of 22,547 (excluding Lodging) and transfers of 22,916 (excluding Lodging), FRANdata projects a maximum of 45,463 unit transactions in 2009. Following recent trend statistics, it is assumed that there will be about an equal number of new franchisees and existing operators involved in unit transactions in 2009. The effects of decreases in ability and willingness result in 12,965 new units (down 43% from estimates for 2008) and 20,338 transfers (down 11% from estimates for 2008) for a total of 33,302 unit transaction in 2009.

## Estimated Average Initial investment

To calculate an average initial investment for each individual business line, FRANdata took a sample of over 1,960 brands and removed all brands with initial investment levels of less than \$50,000 leaving a population in excess of 1,700 concepts. The concepts with initial investment levels below \$50,000 were removed on the assumption that they would finance through non-institutional sources or would not require any debt to start.

Based on the aggregation of franchise brands into eleven NAIC categories, the average initial investment breaks out as follows:

| Industry                          | Average Initial investment | Standard Deviation |
|-----------------------------------|----------------------------|--------------------|
| Automobile & Truck Dealers*       | \$212,933                  | \$230,291          |
| Automotive                        | \$386,188                  | \$653,719          |
| Business Services                 | \$185,779                  | \$192,532          |
| Commercial & Residential Services | \$179,112                  | \$402,337          |
| Food Retail                       | \$366,318                  | \$550,361          |
| Gasoline Service Stations**       | \$854,000                  | N/A                |
| NEC - not elsewhere classified    | \$92,001                   | \$50,669           |
| Personal Services                 | \$274,872                  | \$395,885          |
| Quick Service Restaurants         | \$417,326                  | \$358,754          |
| Retail Products & Services        | \$240,206                  | \$191,673          |
| Table/Full Service Restaurants    | \$1,082,941                | \$871,773          |
| <b>Average Initial investment</b> | <b>\$390,152</b>           | <b>\$389,799</b>   |

\*Automobile & Truck Dealers were rolled up into Automotive because of a limited sample size.

\*\*There is no standard deviation because of a small sample size.

As the table shows the average initial investment across all industries is \$390,152 (Lodging was removed as an outlier). Each industry average initial investment was calculated independently as was the total average initial investment. One challenge for the estimate is the high standard deviation in average initial investment. In each industry there was a wide array of different types of companies and each of these had very different initial costs associated with starting the business. Also, franchisors disclose initial investment levels for each brand as average initial investment, which is based on a range of new unit costs.

FRANdata assumed that transfer unit purchase prices would be similar to the creation of a new unit while any difference in price would be based on individual sales performance, which cannot be measured.

A second factor affecting average initial investment is an expected decrease in prices. In late 2008, price indexes began to fall, driven by lower fuel cost and decreased demand. FRANdata projects prices to decrease by approximately 2% in 2009. As a result, the average initial investment will fall from \$390,152 to \$382,349.

FRANdata used a flat average instead of a weighted average for the overall industry average in an attempt to limit the number of assumptions made about unit growth. The number of factors impacting growth projections varies by industry. Also, additional unknowns would have increased the number of necessary assumptions for this calculation. A flat average avoids such additional assumptions.

Using the adjusted average initial investment of \$382,349 and the total unit transactions of 33,302, FRANdata projects that franchisees will require total capital of \$12,733,166,682 in 2009.

## Advance Rates

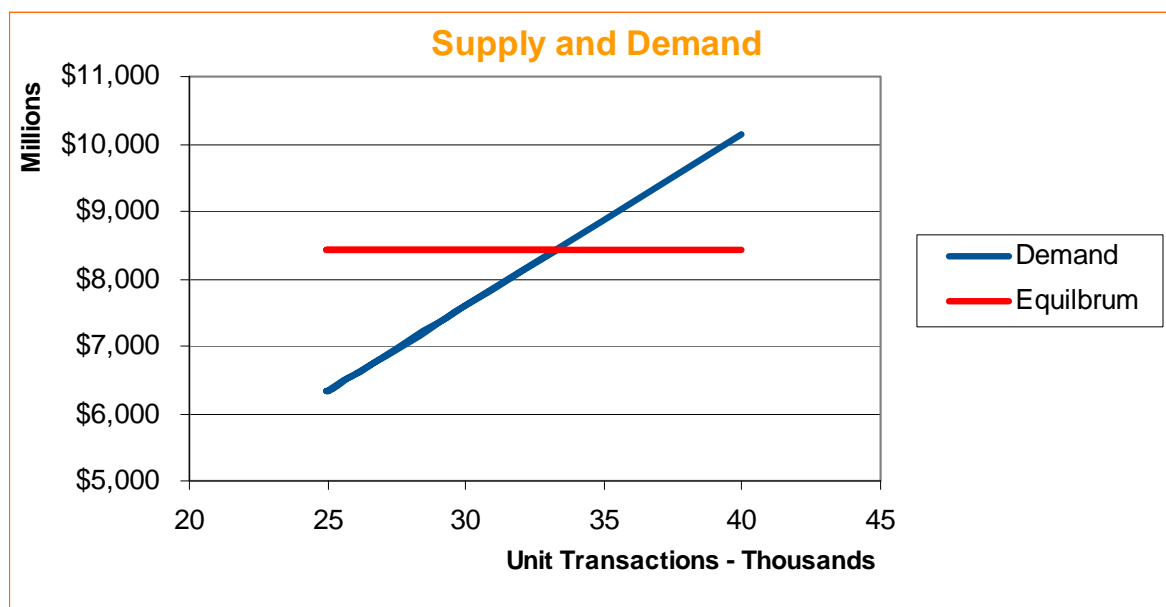
Of the calculated \$12.7 billion in required capital, only a portion will come from lenders because borrowers need to provide a portion of the capital themselves. The advance rate banks expect on franchise transactions is based on the type of transaction. Since SBA loan transactions have a government guarantee protecting the bank from default, they often have a higher advance rate than conventional loans. This means franchisees have to come up with a smaller cash piece to qualify for a loan. In 2008, the SBA debt-to-equity ratio was nearly 80% and for conventional loans it was about 70%. Also, potential new legislation may increase the SBA loan guarantee to 95% of the loan value, which would further decrease the franchisee's cash portion.

In 2009, FRANdata predicts both these ratios will decrease due to the current credit challenges that are likely to continue in 2009. Experts in the lending industry expect that debt-to-equity ratio for SBA loans will be closer 70% in 2009 and conventional loans will have a debt-to-equity ratio of approximately 65%.

In 2008, SBA guaranteed loans represented approximately 16% of total borrowing by franchisees. This percentage is likely to increase. As conventional bank lending decreases, the new administration will look into various ways to ensure capital access for small businesses. According to the Office of Advocacy, small businesses represent over 90% percent of all firms and create more than half of the private non-farm US gross domestic product. FRANdata projects regulatory pressure to increase SBA Loan guarantees to help unfreeze the credit markets. In February of 2009, legislation was passed to increase the SBA loan guarantee to 90% on 7(a) loans. In 2009, FRANdata expects SBA guaranteed loans to represent 26% of the total loan pool or a blended SBA/conventional basis; the average bank advance rate will be 66% in 2009.

Using this ratio, FRANdata projects that total borrowings in 2009 will be \$8,442,089,510.

This is presented below as part of a Supply and Demand graph at the estimated economic equilibrium point.



The equilibrium point represents the amount of funding required to meet the needs of all the franchise unit transactions in 2009. At this point all 12,965 new units and 20,338 transfers, or a total of 33,303 unit transactions, would be able to receive financing.

## Franchising Economic Impact in 2009

Based on the Economic Impact of Franchised Business Study, the average franchise unit provides 10.85 direct jobs and 19.5 indirect jobs (excluding Lodging) and creates \$828,353 of direct economic output and \$2.2 million in indirect economic output (excluding Lodging)<sup>5</sup>.

The following table breaks out the averages by NAIC code per unit:

| NAIC Code                  | # of Direct Jobs per Unit | # of indirect Jobs per Unit | Direct Economic Output per Unit | Indirect Economic Output per Unit |
|----------------------------|---------------------------|-----------------------------|---------------------------------|-----------------------------------|
| Auto                       | 4.94                      | 4.45                        | \$710,355                       | \$1,136,568                       |
| Business Services          | 6.98                      | 6.28                        | \$780,574                       | \$1,248,919                       |
| Commercial and Residential | 5.76                      | 5.19                        | \$603,725                       | \$965,960                         |
| Lodging                    | 18.99                     | 17.09                       | \$1,599,254                     | \$2,558,806                       |
| NEC                        | 4.57                      | 4.12                        | \$775,811                       | \$1,241,298                       |
| Personal Services          | 12.21                     | 10.99                       | \$1,250,911                     | \$2,001,458                       |
| Quick Service Restaurants  | 18.82                     | 16.93                       | \$907,637                       | \$1,452,219                       |
| Retail Food                | 12.76                     | 11.49                       | \$770,000                       | \$1,231,999                       |
| Retail Products            | 6.84                      | 6.16                        | \$464,253                       | \$742,804                         |
| Table Service              | 24.74                     | 22.26                       | \$1,191,912                     | \$1,907,059                       |

\*Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

Combining this information with FRANdata's estimates shows that the projected 12,965 new units for 2009 would create 267,195 new jobs and account for \$27.9 billion in total annual economic output<sup>6</sup>. Transfer units do not generate new jobs or economic output because at existing units all employees have been hired and are already creating output. However, some units that are looking to transfer ownership might not find a buyer. While some franchisors may re-acquire these units and ensure continued operations others might be closed. FRANdata assumed that 5% of transfer units will be closed for this reason. Thus, the 20,338 transfers that would occur without the limitation of lending sustain 20,958 total jobs and protect \$2.2 billion of annual economic output.

In total, FRANdata estimates that unit transitions seeking capital in 2008 would account for 288,153 total jobs and \$30.1 billion in total annual economic output.

<sup>5</sup> Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

<sup>6</sup> Jobs are defined as positions filled by part-time and full-time employees or by self-employed individuals. Economic Output is defined as the gross value of the goods and services it produces.

## Supply

FRANdata used estimates for the amount of lending in 2008 as the basis to estimate lending in 2009. An estimated \$11.7 billion went to franchisees for unit transactions. Of that amount, \$1.9 billion<sup>7</sup> — or 16% — was SBA guaranteed while \$9.8 billion came from conventional loans.

In 2009, banks willingness to lend will be restrained. According to the Federal Reserve October 2008 Senior Loan Officer Opinion Survey on Bank Lending practices<sup>8</sup>, banks are tightening their credit policies in response to the current economic climate. Of the banks surveyed, 85% are tightening lending for commercial real estate and 60% mentioned tightened credit policies for consumer lending. Based on this data, it can be assumed that commercial lending policies will also be tightened considerably. This will make obtaining franchise loans more difficult.

The amount of money banks are able to lend to franchisees is also likely to be constrained. In 2008, a number of large financial institutions have announced plans to reduce the available amount for small business lending which will also limit the funds available to franchisees. In both, SBA and conventional lending markets, a handful of national lenders had a significant percentage of all the franchise lending activity in recent years. Even if regional and local banks increase the commercial lending activity, as early evidence in 2009 suggests, it will be very hard to replace the large volume that the big financial institutions represented.

Based on these data and interviews with experts and professionals in the banking field, FRANdata projects that overall bank lending would decrease by 30% to 40% from last year. FRANdata projects that in the 30% reduction scenario there will be \$8.2 billion available for banks to lend. In the 40% reduction scenario, banks will only have \$7 billion to lend for franchise unit transactions.

The graph shows the relationship between supply and demand based on FRANdata's estimates. The equilibrium point is above the 30% scenario line meaning that at best there will be a short-fall of \$252,089,510 in requested funds from franchisee transactions and 994 fewer unit transactions.

The following table breaks out the numbers for each scenario:

| Scenario      | Units  | Unit Shortfall | Dollars         | Dollar Shortfall |
|---------------|--------|----------------|-----------------|------------------|
| Equilibrium   | 33,302 |                | \$8,442,089,510 |                  |
| 30% Reduction | 32,308 | 994            | \$8,190,000,000 | \$252,089,510    |
| 35% Reduction | 30,000 | 3,302          | \$7,605,000,000 | \$837,089,510    |
| 40% Reduction | 27,693 | 5,610          | \$7,020,000,000 | \$1,422,089,510  |

<sup>7</sup> The SBA estimates its lending to franchises at \$1.2 billion. FRANdata assumes this is an underreported amount caused by bank keying errors in SBA applications.

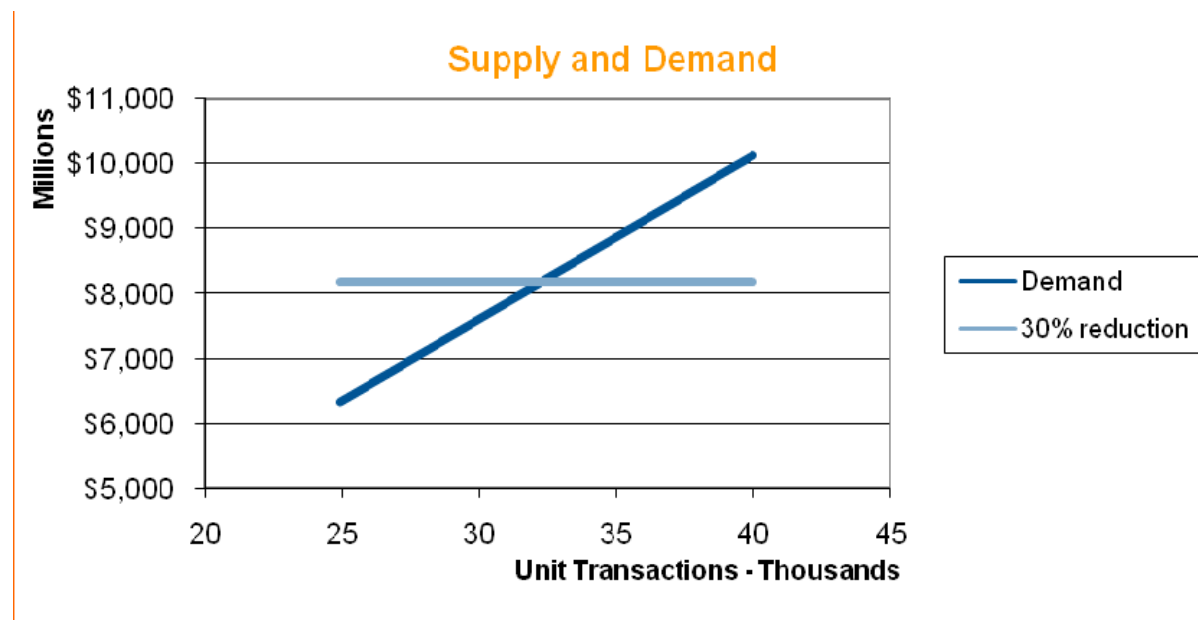
<sup>8</sup> <http://www.federalreserve.gov/boarddocs/snloansurvey>

## Lending's Impact on Franchising and the Economy in 2009

To put this information into perspective, the following section describes how each scenario will affect jobs and economic output.

### Scenario I: 30% Reduction in Lending

In the first scenario, lending is constrained by 30% of last year's amount.

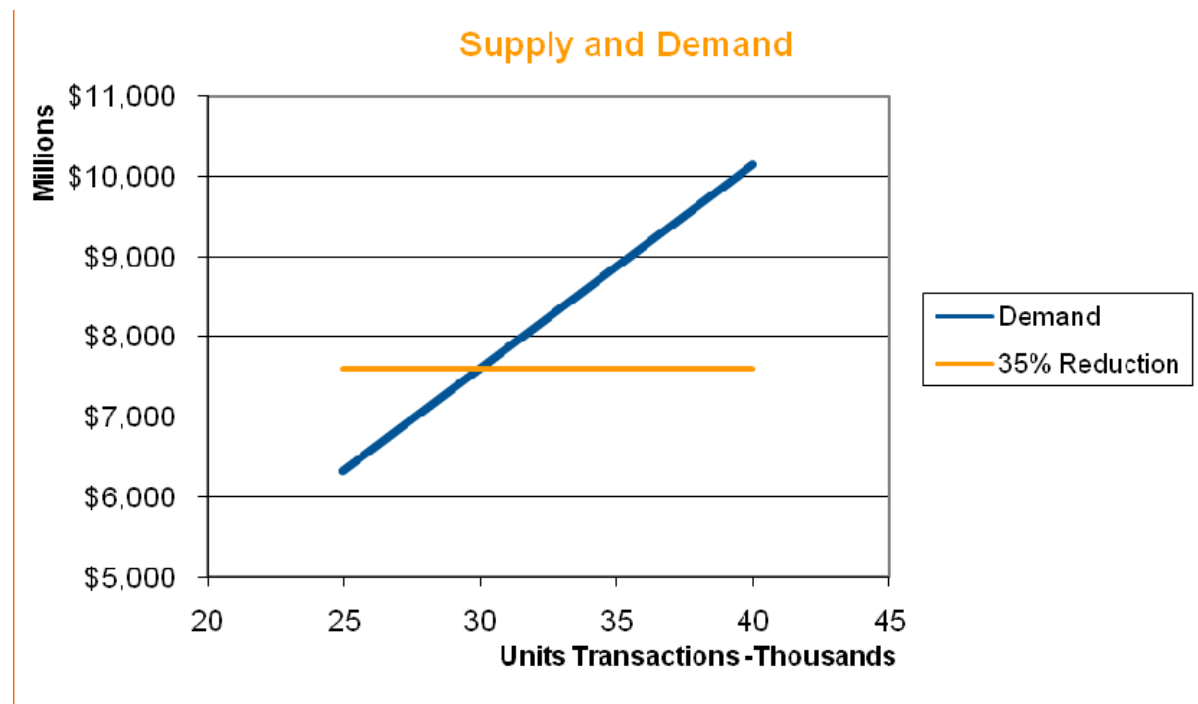


In this scenario, due to reduced bank lending there will be \$8.2 billion dollars available for franchises in 2009, instead of the \$11.7 billion in 2008 and the \$8.4 billion required at equilibrium. This reduces the number of new units created from 12,965 units at equilibrium to 12,577 new units. This equates to 4,199 direct jobs not created and 4,076 indirect jobs from new units not opened. This in turn equates to \$320 million in lost direct annual economic output and \$513 million in indirect annual economic output from these new units not being opened.

In this scenario, transfer units receiving financing will decrease from 20,338 to 19,731. FRANData assumes that 5% of these 19,731 units will not be able to complete transfer transactions and will be required to close. This reduction in transfer units decreases total jobs from 288,153 to 279,549 and total annual economic output decreases from \$30.1 billion to \$29.2 billion, a drop of approximately 3% for equilibrium for both employment and economic output.

## Scenario II: 35% Reduction in Lending

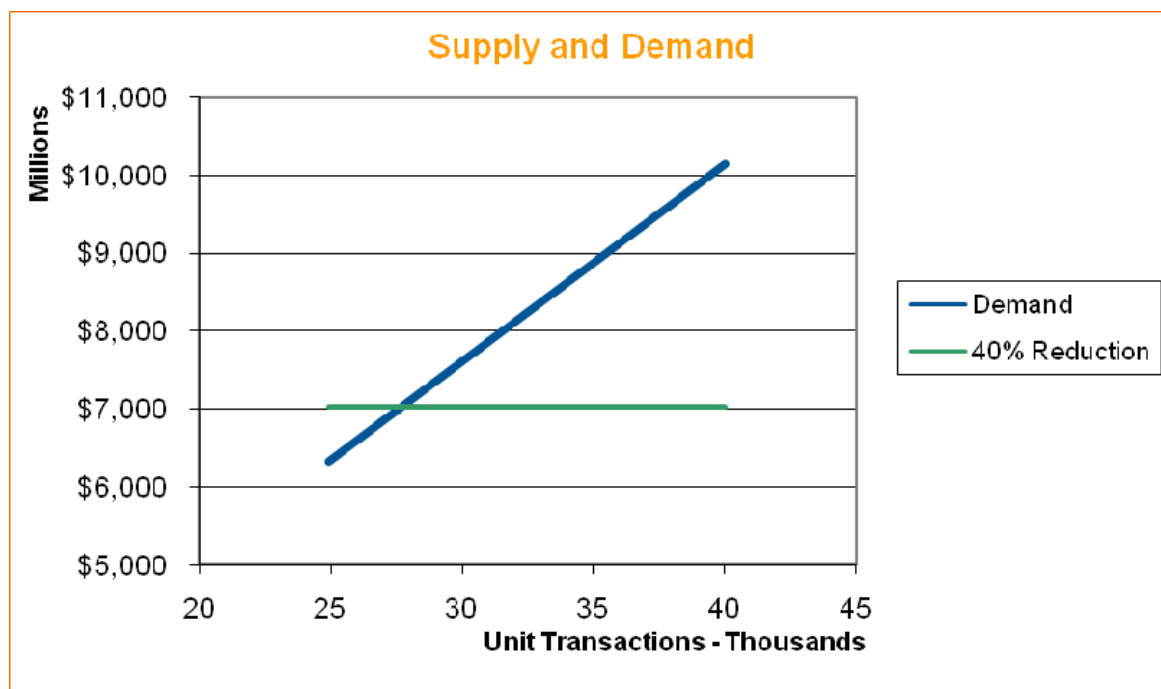
In the second scenario, lending is reduced by 35% from 2008 levels. This equates to an estimated lending pool of \$7.6 billion dollars for franchising verse the \$8.4 billion required at equilibrium.



At this level of lending, the number of new units opened is reduced from 12,965 to 11,679 or a 10% decrease from equilibrium and the number of transfer units is reduced from 20,338 to 18,321, also 10% of equilibrium. Using the same assumptions from above, this will result in 13,944 direct jobs not created and 12,550 indirect jobs not created from new units and 1,094 direct jobs and 984 indirect jobs lost from incomplete transfer units for a total of 28,572 jobs lost. These lost units and jobs total \$3 billion in lost economic output.

### Scenario III: 40% Reduction in Lending

In the third scenario lending is reduced by 40% from 2008 levels. This equates to an estimated lending pool of \$7 billion dollars for franchising vs. the \$8.4 billion required at equilibrium.



In this case the number of new units is reduced from 12,965 to 10,781, or a 17% decrease from equilibrium and transfer units are reduced from 20,338 to 16,912. This equates to 45,010 total jobs not created from new units and another 3,530 total jobs lost from transfers not completed, summing up to a total of 48,540 total jobs either lost or not created and economic output lost or not created of \$5.1 billion.

Table below summarizes all scenarios:

| Scenario      | New Units | Transfer Units | Total Jobs | Total Economic Output |
|---------------|-----------|----------------|------------|-----------------------|
| Equilibrium   | 12,965    | 20,338         | 288,153    | \$30,112,041,484      |
| 30% Reduction | 12,577    | 19,731         | 279,549    | \$29,212,864,832      |
| 35% Reduction | 11,679    | 18,321         | 259,581    | \$27,126,231,630      |
| 40% Reduction | 10,781    | 16,912         | 239,613    | \$25,039,598,427      |

\* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

Another way to put it is that for every one million dollars in lending lost to franchises cost the economy 34.11 total jobs and \$3.6 million in economic output.

## Unit Growth in the Past Recession

Enabling franchisees to access capital is all the more crucial during a recession, particularly given that franchising has always been a resilient business strategy. Companies that grow through the franchising business model have weathered many serious economic storms in the past and have always done well. In fact, franchises continued to grow units in the face of recessions. From 2000 to 2002, the U.S. economy suffered through the tech bubble recession. The table provided below shows unit growth by industry during the recession and immediately after. As the table shows, franchises maintained an average yearly unit growth of 5.9% in spite of the harsh economic conditions.

| Industry                          | 1999 to 2000 | 2000 to 2001 | 2001 to 2002 | 2002 to 2003 | 2003 to 2004 | 2004 to 2005 | 2005 to 2006 |
|-----------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Automotive                        | 4%           | -4%          | -4%          | 3%           | -1%          | 2%           | 4%           |
| Business Services                 | 12%          | 5%           | 6%           | -3%          | 4%           | 8%           | 13%          |
| Commercial & Residential Services | 6%           | 5%           | 2%           | 3%           | 2%           | 4%           | 6%           |
| Food Retail                       | 4%           | 6%           | 5%           | 3%           | 4%           | 2%           | 3%           |
| Lodging                           | 12%          | 5%           | 3%           | 1%           | 0%           | 2%           | 3%           |
| NEC - not elsewhere classified    | 5%           | 12%          | 13%          | 7%           | 8%           | 42%          | 27%          |
| Personal Services                 | 6%           | 11%          | 15%          | 17%          | 11%          | 7%           | 3%           |
| Quick Service Restaurants         | 10%          | 4%           | 5%           | 6%           | 5%           | 5%           | 4%           |
| Retail Products & Services        | 1%           | 3%           | 2%           | 3%           | 2%           | 1%           | 4%           |
| Table/Full Service Restaurants    | 13%          | 6%           | 5%           | 5%           | 6%           | 5%           | 4%           |
| <b>Average</b>                    | <b>7%</b>    | <b>5%</b>    | <b>5%</b>    | <b>5%</b>    | <b>4%</b>    | <b>8%</b>    | <b>7%</b>    |

The franchise business model has proven to be resilient through previous recessions.

## Industry Break Down

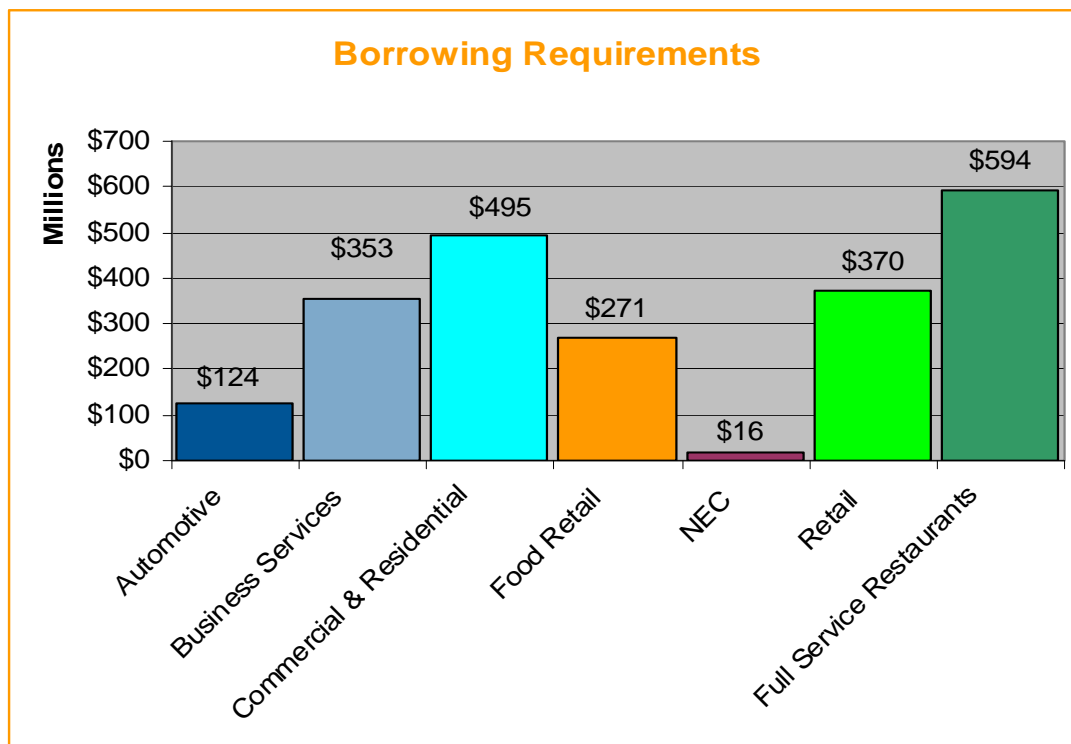
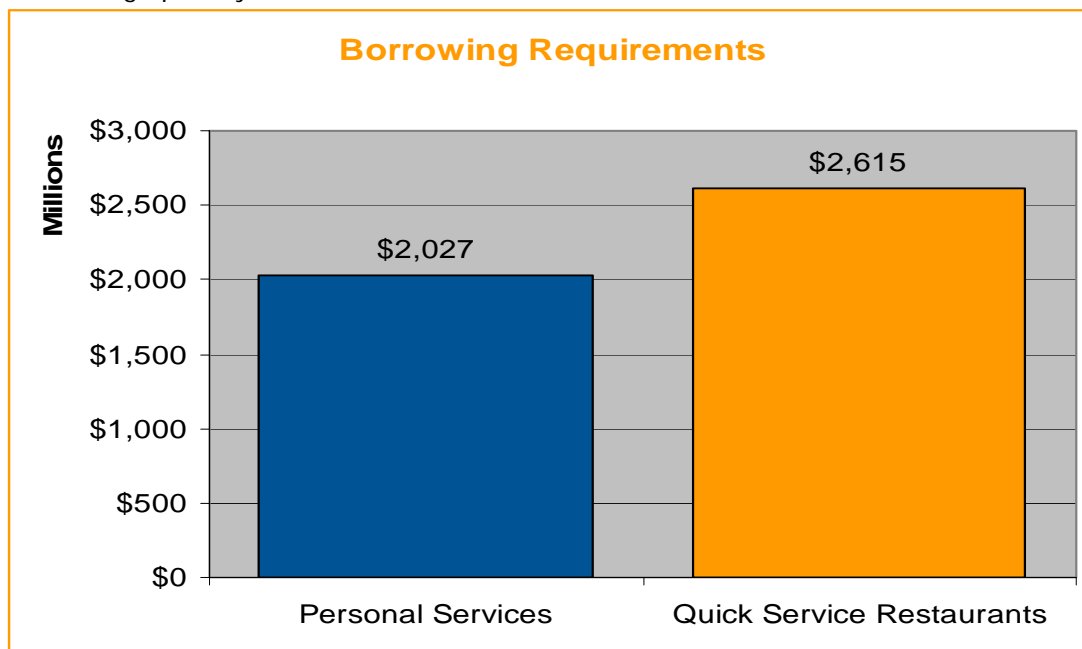
For a more granular approach, FRANdata examined the estimated borrowings by ten different industries. To attain the expected borrowing requirements FRANdata assumed unit percentage growth would be consistent from 2008 to 2009 and that each industry would suffer the same percentage decrease in demand for new unit transactions. The debt-to-net worth was also held consistent for all industries. Each industry average initial investment was applied to calculate the estimated requested borrowings in 2009. It should be noted that the industry totals do not sum back to the overall estimated borrowings. The reason for this is that a flat average was used to estimate the overall required borrowings and not a weighted average<sup>9</sup>.

The table below breaks out total estimated borrowings by ten industries.

| Industry                  | Estimated Borrowings |
|---------------------------|----------------------|
| Automotive                | \$123,673,800        |
| Business Services         | \$353,358,652        |
| Commercial & Residential  | \$495,248,923        |
| Food Retail               | \$271,294,824        |
| Full Service Restaurants  | \$593,618,707        |
| Gasoline Service Stations | \$206,845            |
| NEC                       | \$16,477,605         |
| Personal Services         | \$2,027,224,848      |
| Quick Service Restaurants | \$2,614,843,586      |
| Retail                    | \$370,321,633        |

<sup>9</sup> As mentioned above, the calculations were based on flat averages rather than weighted averages in order to avoid additional assumptions. Mathematically this means that applying an industry average to the following calculations leads to a different total as opposed to using the total average.

Presented graphically:



\*Gasoline Service Stations were removed as an outlier

| <b>Automotive</b>  |                |
|--|----------------|
| New Units  | 192            |
| Transfer Units   | 301            |
| Total Unit Transactions  | 493            |
| Bank Lending Rate  | 66%            |
| Industry Average Initial Investment                                | \$ 386,188     |
| Overall Average Initial Investment                                 | \$ 390,152     |
| Required Borrowings (based on Industry Average Initial Investment) | \$ 123,673,680 |
| Required Borrowings (based on Overall Average Initial Investment)  | \$ 124,943,161 |
| Average Number of Employees per unit*                              | 4.94           |
| Average Output per unit*   | \$710,355      |
| Average Number of Indirect Jobs created per Unit*                  | 4.45           |
| Average Indirect Economic Output per Unit*                         | \$1,136,568    |

\* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

| <b>Business Services</b>   |                |
|--|----------------|
| New Units  | 1,140          |
| Transfer Units   | 1,788          |
| Total Unit Transactions  | 2,927          |
| Bank Lending Rate  | 66%            |
| Industry Average Initial Investment                                | \$ 187,779     |
| Overall Average Initial Investment                                 | \$ 390,152     |
| Required Borrowings (based on Industry Average Initial Investment) | \$ 353,358,652 |
| Required Borrowings (based on Overall Average Initial Investment)  | \$ 742,083,113 |
| Average Number of Employees per unit*                              | 6.98           |
| Average Output per unit*   | \$780,574      |
| Average Number of Indirect Jobs created per Unit*                  | 6.28           |
| Average Indirect Economic Output per Unit*                         | \$1,248,919    |

\* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

| <b>Commercial &amp; Residential Services</b>                       |                  |
|--|------------------|
| New Units  | 1,657            |
| Transfer Units   | 2,599            |
| Total Unit Transactions  | 4,256            |
| Bank Lending Rate  | 66%              |
| Industry Average Initial Investment                                | \$ 179,112       |
| Overall Average Initial Investment                                 | \$ 390,152       |
| Required Borrowings (based on Industry Average Initial Investment) | \$ 495,248,923   |
| Required Borrowings (based on Overall Average Initial Investment)  | \$ 1,078,781,525 |
| Average Number of Employees per unit*                              | 5.76             |
| Average Output per unit*   | \$603,725        |
| Average Number of Indirect Jobs created per Unit*                  | 5.19             |
| Average Indirect Economic Output per Unit*                         | \$965,960        |

\* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

| <b>Food Retail</b>   |                |
|--|----------------|
| New Units  | 444            |
| Transfer Units   | 696            |
| Total Unit Transactions  | 1,140          |
| Bank Lending Rate  | 66%            |
| Industry Average Initial Investment                                | \$ 366,318     |
| Overall Average Initial Investment                                 | \$ 390,152     |
| Required Borrowings (based on Industry Average Initial Investment) | \$ 271,294,824 |
| Required Borrowings (based on Overall Average Initial Investment)  | \$ 288,946,576 |
| Average Number of Employees per unit*                              | 12.76          |
| Average Output per unit*   | \$770,000      |
| Average Number of Indirect Jobs created per Unit*                  | 11.49          |
| Average Indirect Economic Output per Unit*                         | \$1,231,999    |

\* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

| <b>Gas Stations*</b>   |            |
|--|------------|
| New Units  | -          |
| Transfer Units   | 1          |
| Total Unit Transactions  | 1          |
| Bank Lending Rate  | 66%        |
| Industry Average Initial Investment                                | \$ 854,000 |
| Overall Average Initial Investment                                 | \$ 390,152 |
| Required Borrowings (based on Industry Average Initial Investment) | \$ 206,845 |
| Required Borrowings (based on Overall Average Initial Investment)  | \$ 94,498  |

| <b>NEC - not elsewhere classified</b>                              |               |
|--|---------------|
| New Units  | 107           |
| Transfer Units   | 168           |
| Total Unit Transactions  | 276           |
| Bank Lending Rate  | 66%           |
| Industry Average Initial Investment                                | \$ 92,001     |
| Overall Average Initial Investment                                 | \$ 390,152    |
| Required Borrowings (based on Industry Average Initial Investment) | \$ 16,477,605 |
| Required Borrowings (based on Overall Average Initial Investment)  | \$ 69,877,339 |
| Average Number of Employees per unit*                              | 4.57          |
| Average Output per unit*   | \$775,811     |
| Average Number of Indirect Jobs created per Unit*                  | 4.12          |
| Average Indirect Economic Output per Unit*                         | \$1,241,298   |

\* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

| <b>Personal Services</b>   |                  |
|--|------------------|
| New Units  | 4,419            |
| Transfer Units   | 6,932            |
| Total Unit Transactions  | 11,351           |
| Bank Lending Rate  | 66%              |
| Industry Average Initial Investment                                | \$ 274,872       |
| Overall Average Initial Investment                                 | \$ 390,152       |
| Required Borrowings (based on Industry Average Initial Investment) | \$ 2,027,224,848 |
| Required Borrowings (based on Overall Average Initial Investment)  | \$ 2,877,428,580 |
| Average Number of Employees per unit*                              | 12.21            |
| Average Output per unit*   | \$1,250,911      |
| Average Number of Indirect Jobs created per Unit*                  | 10.99            |
| Average Indirect Economic Output per Unit*                         | \$2,001,458      |

\* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

| <b>Quick Service Restaurants</b>                                   |                  |
|--|------------------|
| New Units  | 3,754            |
| Transfer Units   | 5,889            |
| Total Unit Transactions  | 9,643            |
| Bank Lending Rate  | 66%              |
| Industry Average Initial Investment                                | \$ 417,326       |
| Overall Average Initial Investment                                 | \$ 390,152       |
| Required Borrowings (based on Industry Average Initial Investment) | \$ 2,614,843,586 |
| Required Borrowings (based on Overall Average Initial Investment)  | \$ 2,444,580,142 |
| Average Number of Employees per unit*                              | 18.82            |
| Average Output per unit*   | \$907,637        |
| Average Number of Indirect Jobs created per Unit*                  | 16.93            |
| Average Indirect Economic Output per Unit*                         | \$1,452,219      |

\* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

| <b>Retail</b>  |                |
|--|----------------|
| New Units  | 942            |
| Transfer Units   | 1,449          |
| Total Unit Transactions  | 2,373          |
| Bank Lending Rate  | 66%            |
| Industry Average Initial Investment                                | \$ 240,206     |
| Overall Average Initial Investment                                 | \$ 390,152     |
| Required Borrowings (based on Industry Average Initial Investment) | \$ 370,321,633 |
| Required Borrowings (based on Overall Average Initial Investment)  | \$ 601,491,029 |
| Average Number of Employees per unit*                              | 6.84           |
| Average Output per unit*   | \$464,253      |
| Average Number of Indirect Jobs created per Unit*                  | 6.16           |
| Average Indirect Economic Output per Unit*                         | \$742,804      |

\* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

| <b>Full Service Restaurants</b>                                    |                |
|--|----------------|
| New Units  | 328            |
| Transfer Units   | 515            |
| Total Unit Transactions  | 844            |
| Bank Lending Rate  | 66%            |
| Industry Average Initial Investment                                | \$ 1,082,941   |
| Overall Average Initial Investment                                 | \$ 390,152     |
| Required Borrowings (based on Industry Average Initial Investment) | \$ 593,618,707 |
| Required Borrowings (based on Overall Average Initial Investment)  | \$ 213,863,548 |
| Average Number of Employees per unit*                              | 24.74          |
| Average Output per unit*   | \$1,191,912    |
| Average Number of Indirect Jobs created per Unit*                  | 22.26          |
| Average Indirect Economic Output per Unit*                         | \$1,907,059    |

\* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.

## Lodging

Lodging has been removed from the previous calculations of the totals for several reasons. First, because of its capital intensity, the industry often accesses capital in different ways. Lodging has the highest average initial investment of all industries, which would have highly slanted the estimate used for the calculations. Second, new units take a longer time to be built than most other franchise units, and to operate which makes Lodging likely to lag behind other industries. Third, the larger capital amounts required for a unit in the Lodging industry make the industry more susceptible to economic downturns.

For these reasons Lodging is presented here as an independent industry. FRANdata used the same estimates to determine unit growth and bank lending rates.

| <b>Lodging</b>   |                |
|--|----------------|
| New Units  | 3              |
| Transfer Units   | 65             |
| Total Unit Transactions  | 68             |
| Bank Lending Rate  | 66%            |
| Industry Average Initial Investment                                | \$ 11,691,871  |
| Overall Average Initial Investment*                                | \$ 1,331,962   |
| Required Borrowings (based on Industry Average Initial Investment) | \$ 516,573,986 |
| Required Borrowings (based on Overall Average Initial Investment)  | \$ 58,849,171  |
| Average Number of Employees per unit**                             | 18.99          |
| Average Output per unit**  | \$1,599,254    |
| Average Number of Indirect Jobs created per Unit**                 | 4.12           |
| Average Indirect Economic Output per Unit**                        | \$1,241,298    |

\*The Average Initial Investment was adjusted to include Lodging

\*\* Data was derived from the Franchise Business Economic Outlook report and the Economic Impact of Franchised Business, Volume 2, published by the IFA Educational Foundation.



## **About FRANdata**

Founded in 1989, FRANdata is the franchise industry's number one source for objective information and analysis. FRANdata receives no advertising or other fee arrangements that might influence its objectivity. Using its proprietary software to access data from various sources, including its library of more than 15,000 Uniform Franchise Offering Circulars, FRANdata supports the research and competitive intelligence functions of franchisors, helps franchisees evaluate different concepts, provide information and analysis for legal and financial organizations, and provide marketing access to franchisors and franchisees. FRANdata also is the exclusive contractor for the SBA Franchise Registry.

**800.485.9570**  
**[www.frandata.com](http://www.frandata.com)**