Statement of Matthew R. Shay
President & CEO
International Franchise Association

Before the House Committee on Small Business

Hearing on *Increasing Access to Capital for Small Businesses*

October 14, 2009

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Good afternoon Chairwoman Velázquez, Ranking Member Graves and members of the committee. My name is Matthew Shay. I am President and CEO of the International Franchise Association (IFA), and I am grateful to have the opportunity to speak to you today about the credit crisis facing small business entrepreneurs and the need for legislation such as the Small Business Credit Expansion and Loan Markets Stabilization Act. During my statement, I will make three key points:

1. The current credit crisis is becoming increasingly more dire for small businesses;
2. The depth of this crisis calls for extraordinary action, and Congress should support changes to SBA programs including increasing the maximum SBA loan limits to $5 million to accommodate the needs of more small businesses; and,
3. A renewed emphasis on loan programs for small business start-ups, expansions and acquisitions will promote faster job creation and lead to a stronger recovery.

The legislation currently before this committee provides a foundation for addressing these goals. There are several additional steps that can be taken to strengthen this proposal. Making SBA lending programs work better for entrepreneurs seeking capital to open, acquire or expand a business will allow the economy to recover faster and provide the necessary bridge to a functioning commercial lending market once the recovery is complete. In many ways, franchised businesses are an excellent way to understand what is happening to small businesses during the current recession. Franchising is found in almost every sector that small businesses operate, and it is a clearly defined subset that is more easily tracked and analyzed.

As the largest and oldest franchising trade group, the IFA's mission is to safeguard the business environment for franchising worldwide. IFA represents more than 85 industries, including more than 11,000 franchisee, 1,200 franchisor and 600 supplier members nationwide. According to a 2008 study conducted by PricewaterhouseCoopers for the IFA Educational Foundation, there are more than 900,000 franchised establishments in the U.S., providing 21 million American jobs and generating $2.3 trillion in economic output. The business methods, training and support franchise systems provide to their franchisees together with improved access to credit will result in faster and more sustainable job creation.

Under normal circumstances, small businesses can tap financing from a number of different sources, including national and community banks as well as many non-bank lenders. Typically, the SBA loan programs are not the first stop for an entrepreneur, but they serve an essential function as a lender of last resort for business owners who cannot find appropriate financing in the commercial marketplace. During this recession, however, most commercial lenders have dramatically curbed their willingness to assume risk. Prior to 2009, the top small business lenders for franchising were GE Capital and CIT. GE Capital is no longer lending and we all have read about the ongoing struggles at CIT to stay afloat. Some credit might be available at smaller institutions, but the restrictive terms and delays that entrepreneurs are encountering can be staggering. Moreover, many lenders that could now be serving the small business marketplace are not participating in SBA lending programs because they either may lack expertise or they may find the SBA's requirements too burdensome.

Franchised businesses play an important role in the economic health of the U.S. economy, and they are poised to help lead the economy on the path to recovery. IFA Educational Foundation reports show that the franchise industry consistently outperforms the non-franchised business sector, creating more jobs and economic activity in local communities across the country. Released in February, 2008, *Volume 2 of the Economic Impact of Franchised Businesses*, for example, documents that franchising grew at a faster pace than many other sectors of the economy from 2001 to 2005, expanding by more than 18 percent. During this time, franchise business output increased 40 percent compared to 26 percent for all businesses.

The findings of a 2009 study, *Small Business Lending Matrix and Analysis*, prepared by FRANdata for the IFA Educational Foundation, demonstrate that meaningful economic recovery and job creation can start with small business lending. In fact, the study determined that for every $1 million in new small business lending, the franchise business sector would create 34.1 sustainable jobs and generate $3.6 million in economic output.

Earlier this year, Congress and the new Administration worked quickly to address the current economic crisis. The stimulus plan authorized spending of nearly $800 billion, including more than $650 million to support small business lending. The recovery bill made important changes to SBA programs such as a temporary increase in the loan guarantee from 75 percent up to a maximum of 90 percent, and the bill suspended loan fees for borrowers that can add up to 3.75 percent to the cost of a loan. These were crucial first steps, and we would strongly urge you to act to ensure that these temporary provisions are available through 2010.

So far, the 7(a) and 504 loan programs have supported $11.3 billion in lending since the Recovery Act was signed, but there is significant demand for more lending that has not been satisfied. The franchise business community believes that there are several important steps that

Congress should consider to make it easier for entrepreneurs to access capital and create jobs. Most importantly, Congress should increase the standard 7(a) maximum loan limit from $2 million to $5 million and increase the maximum guarantee amount proportionately. The economic downturn has resulted in borrowers having less collateral due to declining home values and reduced investment and savings accounts. Increasing the loan limit will allow more individuals and businesses to take advantage of the 7(a) program, expanding the job creation potential of the program.

A majority of franchised businesses in the United States today are operated by multi-unit owners. Growth beyond the first unit is not just an aspiration for many entrepreneurs in franchising; it is an essential part of helping ensure that their business will reach a level of scalability and sustainability. Businesses that cannot reach a certain level of scalability naturally find it more challenging to survive.

There are over 400 different franchise brands in the United States that have an average initial investment requirement of $750,000 to $2,000,000 per unit. For these franchised small businesses, an entrepreneur reaches the SBA's current loan limit by the time they want to build the second or third store. In the past, the policy of lower loan limits may have ensured that SBA programs assisted only the smallest of small businesses, while businesses reaching a larger scale of operation could reasonably be expected to find financing from many places other than SBA backed loans. In the current credit crunch, however, other commercial financing options may not be available, and the lower loan limits are now operating as a restriction to success for many small business owners. Similarly, lower loan limits are restricting the true job creation potential of our economy.

There are approximately 325,000 franchised businesses in the United States owned by "multi-unit" small business franchisees. Our studies show that these multi-unit operators will be the most successful over time. Fifteen percent of all small business franchisees in the United States own between two and five units, and this category of franchise ownership is the fastest growing. If these businesses can grow at the five percent annual rate that we saw between 2001 and 2005, franchising will grow 16,250 new businesses per year. These new businesses will create 243,750 to 325,000 jobs (assuming 15-20 direct jobs per store) plus an additional 245,000 to 325,000 indirect jobs. Therefore, we believe that a larger loan limit will enable some of these franchise small business owners to expand into new markets and help the U.S. create between 450,000 to 650,000 new jobs within the next 12 to 18 months.

We urge this Committee to consider examining a market-based loan pricing model for SBA loan programs. In this crisis, the real issue for many small business borrowers is basic availability of start-up capital rather than the cost of capital. Between January 2008 and September 2009, the SBA loan interest rate cap dropped from 9.75 percent to 6 percent. During that same time period, the rate premiums that business lenders offering conventional loans required increased dramatically for those lenders willing to provide conventional business loans. While conventional lending is market driven, SBA lending can be influenced by policy. The highest business risk category—start-ups—are the most credit starved. While a continued 90 percent guarantee certainly helps, further inducement in the form of market based rates or rate buy-downs is necessary to open credit to this group. We understand this is a politically challenging issue; however, we consider this to be a major policy breakdown that is contributing to the credit crisis while undermining economic stimulus efforts.

Banks are reluctant to expand lending through the SBA programs. If banks were clamoring to participate in and make SBA loans, one might assume that the interest rates were an attractive inducement to lend. Today, the opposite is true. Borrowers are clamoring for loans, and banks are reluctant to provide them. The statutory rate sets an artificial price that is too low for the demand. Policymakers, economists and consumers all want small businesses to lead the recovery. Borrowers are not reporting that SBA loan interest rates are too high or restrictive—they are frustrated that they cannot obtain a loan—SBA or conventional. By addressing the pricing of SBA loans, Congress can deliver on its policy goals of improving access to credit for small businesses in order to lead the economy out of recession.

The IFA strongly recommends that this Committee look at new ways to stimulate small business lending so that funds are available specifically for business start-up and expansion. Much of the increase in SBA lending activity in 2009 has taken the form of refinancing real estate. We believe that this is not the intention of Congress when they enhanced the tools available to small businesses in the Recovery Act.   We urge the Committee to consider a set of changes that would specifically promote loan guarantees for start-ups, expansions and acquisitions. To achieve this goal, we suggest that Congress consider re-instituting the borrower fees on all 7(a) loans with amortizations over 15 years while eliminating or reduce lender fees on all 7(a) loans with amortizations under 15 years, or alternatively, on true start-ups with all amortizations. This change would shift the focus of the 7(a) program back toward true business start-ups and expansions. Congress could also consider making the 90 percent guarantee permanent for all loans with amortizations under 15 years, and adding a 100 percent guarantee for first two years of a franchise start-up. For loans with amortizations over 15 years, we recommend that Congress restore the 75 percent guarantee.

We also support congressional efforts to improve SBA audit standards. At the same time that policymakers are encouraging banks to expand their small business lending during a weak economy, we cannot afford to undermine these efforts by creating an environment where banks are questioning the reliability of an SBA guarantee. Stories of loan guarantees revoked due to small errors continue to loom large in the minds of bankers, and we fear that lenders will remain hesitant to participate in all SBA programs unless they can be sure of the guarantee. This is especially true for the repurchase of existing SBA guaranteed loans that are repackaged on the secondary market. The committee heard earlier this year from the Independent Community Bankers of America, whose members report facing long waiting periods to hear from SBA and refusals to pay the guarantee. If the prevailing perception among lenders becomes a lack of faith in the SBA guarantee, then small business lending will decline further and these entrepreneurs will face a much greater challenge to be the engine of economic recovery. The SBA should work closely with these and other stakeholders to improve communication and develop clearly defined standards.

I want to again thank the members of the Committee for the opportunity to participate in today's important hearing on the Small Business Credit Expansion and Loan Markets Stabilization Act. The IFA looks forward to working with this Committee throughout the legislative process to ensure SBA's programs will work to help our country's small businesses lead us out of the recession.

Thank you.