July 24, 2019

The Honorable Tom Cotton
Chair, Subcommittee on Economic Policy
Senate Banking Committee
U.S. Senate
Washington, DC 20510

The Honorable Catherine Cortez Masto
Ranking Member, Subcommittee on Economic Policy
Senate Banking Committee
U.S. Senate
Washington, DC 20510

Dear Chairman Cotton, Ranking Member Cortez Masto, and Subcommittee Members:

On behalf of the International Franchise Association (IFA), I would like to thank you for convening the July 17, 2019, hearing titled “Economic Mobility: Is the American Dream in Crisis?” While the role of franchising in America was emphasized during the hearing, the perspective shared is not illustrative of the positive benefit the franchise business model provides to small business entrepreneurs and their employees across the country. Much of the discussion surrounding franchising simply ignored or misconstrued how current federal and state laws govern both franchise disclosures and the SBA lending process. Furthermore, the discussion cherry-picked outdated and extreme examples rather than holistically examining the largely healthy and iterative relationships that exist between franchisees and franchisors. IFA would like to offer our association as a resource and deliberative partner as the Subcommittee continues to examine the regulation and role of franchising in America.

IFA is the world’s oldest and largest organization representing franchising worldwide. The association collectively represents the franchising business model, including franchisor brands, locally-owned small business franchisees, and the network of businesses that contribute to the business model. Specifically, IFA members include more than 1,300 member franchise companies in more than 300 different business format categories, individual franchisees, and companies that support the industry in marketing, law, and business development.

As an association dedicated to excellence in education and advocacy, we take seriously our members’ desire for consensus-based policymaking. Our association’s mission is to “protect, promote, and enhance franchising” in order to ensure the small business model is accessible to persons of all identities, backgrounds, and beliefs. We take pride in the diversity of franchising, as 30% of franchise businesses are minority-owned, compared to less than 20% of non-franchised businesses. We also take pride in promoting the economic impact of more than 733,000 franchise establishments, which support nearly 7.6 million jobs and $674.3 billion of economic output for the U.S. economy.

IFA and its many members have, over the years, collaborated with public officials domestically and internationally to shape the laws and policies that govern franchising, with the goal of promoting franchise growth and protecting the critical interests of both franchisees and franchisors. As IFA’s nearly 60-year record of accomplishments amply demonstrates, IFA has consistently supported regulatory policies designed to ensure that prospective franchisees receive relevant and material information about their proposed franchise purchases sufficiently in advance of such purchases to enable them to make informed and unpressured purchase decisions.

The United States Federal Trade Commission (FTC) enacted the Federal Franchise Rule in 1979; it has since been refined and amended, most recently in 2008, to provide strict guidelines and definitions around what constitutes a business format franchise. The FTC’s Franchise Rule established three criteria that have been defined and enforced by the federal agency, state regulators, and court systems on both the federal and state levels. Franchises are strictly creatures of statute and are regulated as such only if they fit...
the statutory definition. The primary purpose of the Franchise Rule is to provide prospective franchisees with the material information they need to weigh the risks and benefits of purchasing a franchise. That material information is conveyed via the Rule’s requirement to provide a Franchise Disclosure Document (FDD), which includes 23 specific items of information about the franchisor, the franchise business, its franchisees, and the terms of the franchise agreement. Since its development, the Rule has been one of the most, if not the most, important laws for the franchise sector.

The FTC Franchise Rule was updated more than a decade ago following a 10-year-long, constructive, consensus-based process jointly led by franchisors and franchisees. That process worked, and the current FTC rule has led to a growing franchise economy with more than 733,000 locations who together employ nearly 8 million Americans. In March 2019, the FTC opened for comment its 10-year, systematic review of the Franchise Rule, requesting public comment on the efficiency, costs, benefits, and regulatory impact of the Rule. After forming an internal membership Task Force to guide IFA’s position, IFA submitted the attached regulatory comments, which emphasized the need to continue the Rule. The Rule has created a more efficient franchising system, where expectations are clear, rules are clear, and all systems are obligated to comply with its requirements.

IFA strongly believes that the current Rule supports a proper balance between the legitimate disclosure needs of prospective franchisees and the compliance burdens and costs, borne by both franchisors and franchisees, such that a disclosure inevitably requires. Eighteen bipartisan Members of Congress, led by Reps. Tony Cardenas and Gus Bilirakis, agree with the association, echoing the need for a continuation of regulatory oversight over the business model.1 Notably, IFA further urged the FTC to continue the Rule, expressing a concern that the Franchise Rule could be at risk of elimination or material change under Executive Order 13771, “Reducing Regulation and Controlling Regulatory Costs.” We also highlight that the association has encouraged the FTC to consider some mechanism, short of an additional rulemaking, that would permit the FTC to implement evolutionary, rather than revolutionary changes, in the disclosure process. This is consistent with the association’s interest in developing consensus-based policymaking, as we welcome participation in any such further discussions that the FTC might propose.

The positive role played by the Rule and its success as a behavior-changing directive are apparent from the significant growth in franchising over the years and, most importantly, the high degree of franchisee satisfaction. Over the past 10-plus years since the Rule was last amended, the number of business-format franchised units has skyrocketed 16% from 381,890 outlets to 441,300 outlets.2 Most importantly, franchisee satisfaction is at an all-time high.

According to research conducted by Franchise Business Review,3 whose results were publicly released on April 18, 2019, 88% of franchise owners surveyed indicated that they “enjoy operating their business,” and 87% said they “enjoy being part of their franchise organization.”4 With respect to the future outlook for their businesses, 67% rated their long-term growth opportunities as “very strong” or “strong.” Only 8% rated their long-term growth opportunity as “weak” or “very weak.”5 Franchise Business Review’s current data is based on surveys from October 2017 through March 2019 of more than 29,300 franchisees representing 310 different franchise systems. Key drivers of franchisee satisfaction included training,
marketing, technology, innovation, and franchisor-franchisee relations, all of which are addressed to varying degrees in the current Rule disclosure framework.

The FTC Rule provides a standardized framework that drives both regulatory oversight and market discipline. The Rule was set up for regulatory oversight to come from individual states. All states have business laws. About a quarter of all states have specific franchise regulatory departments from which enforcement actions flow. Market discipline comes in two forms from the information in an FDD. First, there is considerable case law involving the franchise business model that has defined how the business model is executed. Second, the general availability of FDDs with their standardized reporting requirements and public scrutiny of brand performance have created competitive pressures for franchise brands because the market is watching how brands perform.

As an example, market forces have driven franchisors to provide increasing transparency into their systems’ financial performance disclosures, with 66% of franchisors disclosing revenue information in their Item 19s in 2017, compared to only 52% in 2014. Furthermore, franchisors have improved the quality of their disclosures and the level of transparency into unit financial performance under the Rule’s current framework. 47% of franchisors with an Item 19 disclose operating expenses, and 34% provide some measure of profitability, including operating income, net income, or earnings before income, taxes, depreciation, and amortization (EBITDA). Since 2014, almost half of franchisors have increased the sample basis of their reporting to include a larger portion of their franchised system, on average, representing 77% of their franchised system.

These statistics reflect, unlike what was highlighted in the July 17th hearing, that the actual experiences of an overwhelming number of franchisees once they start operating their franchised businesses are consistent with their pre-investment expectations for those businesses—expectations created and nurtured in large measure by the FTC Franchise Rule-based disclosures they received.

The Small Business Administration (SBA) plays an equally important role to franchising as the FTC. Approximately 117,000 new small businesses opened between 2015 and 2017 through franchising and much of the financing was through SBA-guaranteed lending programs, including the 7(a) and 504 loan programs. It is an understatement to say that the role of the SBA in ensuring small business entrepreneurs can access these loans is essential.

Importantly, the SBA has important checks and balances to ensure that its loan guaranty programs are strong. On the front end of the lending process and starting on January 1, 2018, the SBA initiated a new Franchise Directory and revised its requirements for franchisors to qualify their franchisees for SBA financing programs. Under the new process, a brand operating with an agreement that meets the FTC definition of a “franchise” is listed on the SBA Franchise Directory only if it has been found by SBA to meet SBA’s “affiliation,” “business eligibility,” and “franchise” definitional requirements. If a franchise system is not on the SBA Franchise Directory, a franchisee’s application for SBA financing cannot be processed. The mandatory identification of franchisee loan recipients provides data to SBA that is much more complete than prior to the process changes. Further, the SBA’s Office of Inspector General and Office of Advocacy have important roles to play in the oversight process.

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6 Id.in
8 The SBA Franchise Directory can be accessed at www.sba.gov/for-lenders.
For the reasons set forth above, IFA stresses to the Subcommittee that the perspective shared during the July 17, 2019, hearing is not illustrative of the positive benefit the franchise business model provides to small business entrepreneurs and their employees across the country. IFA looks forward to continuing our discussions with the Subcommittee on these important issues, and we thank you again for considering our views.

Sincerely,

Matt Haller
Senior Vice President of Government Relations & Public Affairs
International Franchise Association