Statement of Senator Catherine Cortez Masto
before the
Senate Small Business Committee: Small Business Franchising: An Overview of the Industry, SBA's Role, and Legislative Proposals
March 16, 2022

Chairman Cardin, Ranking Member Paul, and distinguished members of the committee:

Thank you for inviting me to testify about the role the Small Business Administration can play in protecting franchisee borrowers from harmful practices in the franchise industry.

There are terrific franchise corporations out there that provide opportunities for entrepreneurs to own successful businesses. But there are also franchise corporations that treat entrepreneurs incredibly unfairly.

Last year, I released a report detailing how the franchise system has left some entrepreneurs financially devastated. I've heard from Nevadans who have lost their retirement funds, their life savings, and their homes trying to repay loans on unprofitable businesses.

Our small business owners don't expect their businesses to be risk-free. But if they purchase a franchise, they absolutely deserve to know what they're getting into. Right now, that's not always the case, and the Small Business Administration can do more to fix it.

The SBA is the go-to source of funding for many new franchises.

My report indicates that franchise loans make up 13% of the SBA's total loan portfolio.

In 2019 alone, SBA guaranteed more than 7,000 loans to franchise owners.

Yet some franchise brands consistently see high rates of default. And the SBA Inspector General has repeatedly raised concerns about these high-risk franchises.

This is why it matters: Franchise owners often sign a personal promissory note. If they can't pay the loan from profits from the business, they will be on the hook for repaying the loan from their savings, their retirement funds, or their homes.

If those assets are not enough, the SBA will pay off the loan. Those repaid funds are paid for by other small business borrowers, and sometimes, the taxpayers.

I recommend that the SBA require franchise corporations to share historical financial performance data with the potential franchise owners before the SBA guarantees a loan. It's a simple step that could help investors avoid devastating defaults.

I've introduced two bills that ensure franchisee borrowers have access to critical historical financial information they need.

The *SBA Franchise Loan Default Disclosure Act* requires the SBA to publish default rates by franchise brand over the past decade.

This is simple: Every lender reports to the SBA monthly on loan performance. The SBA can easily make default rates on loans it guarantees publicly accessible on its website. Publishing defaults by brand gives entrepreneurs information about the risks they might face.

The second bill, *the SBA Franchise Loan Transparency Act*, requires franchise corporations to give accurate historical financial performance information to anyone applying for SBA government-backed loans.

When I talk with franchise owners, they repeatedly tell me that they did their research before investing. Yet prospective franchise owners are not getting all the historical financial performance data they need. Any information they get in the Franchise Disclosure Document is required by law to be accurate.

But because franchise corporations know that everything in the FDD has to be accurate by law, some of them intentionally leave out key pieces of financial performance information. Instead, they will give that information to franchise owners *outside* the FDD—where they can present it in an overly rosy or inaccurate way.

My bill requires the franchise corporations to provide specific historical performance data in the FDD, so that borrowers can make an informed decision about the risks they face.

People buy franchises because they want to invest in a business that's proven successful. Only brands willing to share revenue data on how their franchises have performed in the past should earn the privilege of having their investors receive SBA-guaranteed loans. In that sense, my bill sets a standard for franchise corporations.

Although I've introduced bills to make these changes, the Small Business Administration has the power to take these steps on its own.

Many franchises are wonderful business opportunities for hardworking Nevadans. We need to do more to ensure that all franchise owners have that experience. The SBA should not be guaranteeing high-risk loans.

I'll continue to work with the members of this committee to make much-needed changes that protect hardworking franchise owners. Thank you.