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**TESTIMONY BEFORE THE U.S. SENATE COMMITTEE ON SMALL
BUSINESS AND ENTREPRENEURSHIP**

**HEARING ON “SMALL BUSINESS FRANCHISING: AN OVERVIEW OF
THE INDUSTRY, SBA’S ROLE, AND LEGISLATIVE PROPOSALS”**

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Introduction

Chairman Cardin, Ranking Member Paul, and distinguished members of the Senate Committee on Small Business and Entrepreneurship. My name is Leanne Stapf, and I serve as Chief Operating Officer and multi-unit franchise owner of The Cleaning Authority, which is part of Maryland-based Authority Brands. I look forward to sharing my experience with you today.

Thank you for the invitation to appear before this Committee to discuss small business ownership and the views of local business owners as it relates to empowering American workers in today's hearing. I appear before you on behalf of the International Franchise Association, the world's oldest and largest organization representing franchising worldwide. The IFA works protect, enhance and promote franchising and the approximately 775,000 franchise establishments that support nearly 8.2 million direct jobs, \$787.7 billion of economic output for the U.S. economy, and almost 3 percent of the Gross Domestic Product (GDP). IFA members include franchise companies in over 300 different business format categories, individual franchisees, and companies that support the industry in marketing, law, technology, and business development.

I have been dedicated to franchising for the past 10 years as both a franchisor and franchisee and have seen firsthand how it can change lives and change communities. The economic benefits of the franchise model are undeniable, and the state of franchising has never been stronger. While our businesses need more workers, today 88% of franchisees are satisfied in their brands, and franchises have led the economic recovery, with the highest growth rate since we have been tracking data, reaching nearly 775,000 total franchise establishments in 2021 and achieving an astounding 16.3% growth in output. Franchising remains the ultimate, hybrid business model between standalone small businesses and big corporations, and this model continues to empower people from all backgrounds to achieve their dream of business ownership more than any other format in America. I hope today to bring to life the compelling evidence and research that clearly outline the economic benefits of the franchise business model.

Franchising has helped lead the economic recovery. By providing advancement opportunities at all levels of the economic ladder, from entry-level to manager and from manager to owner, franchises across America aided not only large-scale reentry into the workforce, but also the possibility of coming back better than ever. The unique business model also put the overall economy on more solid ground, with steady growth on business openings and output contributions.

There are so many of us that have an entrepreneurial spirit but don't necessarily have the expertise to be efficient at all aspects of running a business. A franchise offers that structure, that framework. Without that, there would be challenges – challenges that would cost time and money (and frustration). Most of these are avoidable if you have a solid franchise system at your back.

I am a franchise owner. I am a franchise founder. I am also the Chief Operating Officer for a franchisor. My story is just one of millions of folks who work in a franchised business or who are franchise owners, and I am here to tell you the truth about franchising.

In my testimony, I will describe how franchising positively effects the economy, how franchisees are generally satisfied with the current structure and stress the importance of addressing the relatively small number of fraudulent actors within the franchise industry.

The franchise business model

Franchising is perhaps the most important business growth strategy in American history. Today, there are approximately 775,000 franchise establishments, which support nearly 8.2 million jobs and \$7.87 billion of economic output for the U.S. economy.¹ “Franchising is a method of marketing goods and services” that depends upon the existence of the franchisor’s control over a trademark, other intellectual property or some other commercially desirable interest sufficient to induce franchisees to participate in the franchisor’s system by distributing goods or services under the franchisor’s name.²

Simply put: A franchisor is an entity that, in exchange for critical business support, collects royalties from its franchise owners who operate independently and locally owned and operated businesses. But like with any business, it all comes down to execution.

Despite how it is often characterized, franchising is not an industry. Franchising is a business growth model used within nearly every industry. More than 230 different sectors are represented in franchising, and franchise brand companies offer a huge range of services from lodging to fitness, home services to health care, plumbing, pest control, security, and lawn care. In my case, we specialize in home cleaning. Furthermore, notwithstanding any popular misapprehensions, franchising consists of far more than merely the “fast food” industry. There are far more local (50% of all franchised brands) and regional brands (34% of all franchised brands) whose names you might not recognize than the fast-food giants that garner the most attention. In fact, 63% of companies that franchise are not in the food services at all, and 83% are not in fast food.³

There are two principal explanations given for the popularity of franchising as a method of distribution. One is that it “was developed in response to the massive amounts of capital required to establish and operate a national or international network of uniform product or service vendors, as demanded by an increasingly mobile consuming public.”⁴ The other is that “franchising is usually undertaken in situations where the franchisee is physically removed from the franchisor, and thus where monitoring of the performance and behavior of the franchisee would be difficult.”⁵ These two motivations are consistent with a business model in which the licensing and protection of the trademark rests with the franchisor and the capital investment and direct management of day-to-day operations of the retail outlets are the responsibility of the franchisee, which owns, and receives the net profits from, its individually-owned franchise unit.

It is typical in franchising that a franchisor will license, among other things, the use of its name, its products or services, and its reputation to its franchisees. Consequently, it is commonplace for a franchisor to impose standards on its franchisees, necessary under the federal Lanham (Trademark) Act to protect the consumer. Such standards are essential for a franchisor that seeks to ensure socially desirable and economically beneficial oversight of operations throughout its network. These standards allow franchisors to maintain the uniformity and quality of product and

¹ 2022 Franchising Economic Outlook. Provided by FRANdata. (2022)

² Joseph H. King, Jr., *Limiting the Vicarious Liability of Franchisors for the Torts of Their Franchisees*, 62 Wash. & Lee L. Rev. 417, 420-21 (2005).

³ FRANdata research. (2021).

⁴ Kevin M. Shelley & Susan H. Morton, “Control” in *Franchising and the Common Law*, 19 Fran. L. J. 119, 121 (1999-2000)

⁵ Paul H. Rubin, *The Theory of the Firm and the Structure of the Franchise Contract*, 21 J. Law & Econ. 223, 226 (1978).

service offerings and, in doing so, to protect their trade names, trademarks and service marks (collectively the “Marks”), the goodwill associated with those Marks, and most importantly, the protection of the consumer. Because the essence of franchising is the collective use by franchisees and franchisors of Marks that represent the source and quality of their goods and services to the consuming public, action taken to control the uniformity and quality of product and service offerings under those Marks is not merely an essential element of franchising, it is an explicit requirement of federal trademark law.

I came into franchising after starting my career in computer programming for boutique insurance firms specializing in Section 125 (cafeteria plan) benefit administration. I was looking for the next step in my career and ready for a lifestyle change that allowed me to be with my family over the holidays, and I found a job description matching my technical expertise that came up for The Cleaning Authority. I assumed they would be behind the ball on technology because they focused on residential house cleaning. What I discovered couldn't have been farther from the truth. In 2013, this company was more sophisticated, more invested in technology, more aware of consumer behavior than I had ever seen. It was a franchisor. From that moment, I was hooked.

The driving force behind the WHY of the technology I was developing was to help franchise owners – to help them do what they do better, faster. It was from the franchise owners that we found our best ideas to make the business scalable, to improve offerings and marketing programs. As I now lead that organization that I joined as a computer programmer, I can tell you to this day that is exactly the same magic and perspective that makes a franchisor great. I took that same foundation – of listening to franchise owners and learning from them – with me as I developed and founded my own franchise concept. In 2013, I was asked by one of the founders of The Cleaning Authority to work with him on a new business venture – to franchise a business that provided senior living referral services. In August of 2013, we began the journey of drafting the Operations Manuals, the software system and the marketing programs, filing the FDD in April of 2014. Within 4 months, we had our first new owner training class.

Franchising creates opportunities for people of all backgrounds

In addition to my personal story and what I've seen firsthand, I'd like to spell out the incredible opportunities that franchising provides – whether it is in the form of entrepreneurship, job creation, or uplifting communities, the business model is uniquely positioned to make a difference.

In a recent study, Oxford Economics found that franchising offers a path to entrepreneurship to all Americans, but especially to minorities and women. The study found that the industry provides better pay and benefits than non-franchised businesses. In addition, franchising offers entrepreneurial opportunities that would not otherwise be available, especially to women, people of color, and veterans.⁶ On average, franchises report sales 1.8 times as large and provide 2.3 times as many jobs as non-franchise businesses. Sales and jobs in franchised businesses exceed non-franchised businesses across all demographic cuts, including gender and race. For example, Black-owned franchise firms generate 2.2 times as much in sales compared to Black-owned non-franchise businesses, on average.⁷

Franchising democratizes business ownership for people of all backgrounds. There is a higher minority ownership rate among franchised businesses than in non-franchised businesses: 30.8

⁶ *The Value of Franchising. Oxford Economics (2021).*

⁷ *The Value of Franchising. Oxford Economics (2021).*

percent of franchises were owned by minorities, compared to 18.8 percent of non-franchise businesses. Asians, Blacks, Hispanics, and “other” minorities had a higher rate of ownership of franchises than non-franchised businesses in 2012, while American Indians and Pacific Islanders had roughly the same ownership rates among franchised and non-franchised businesses. Asians owned 11.8 percent of all franchises, compared to 6.3 percent of non-franchised businesses. Hispanics owned 10.4 percent of all franchised businesses, compared to 7.2 percent of non-franchised businesses. Blacks owned 8.0 percent of all franchised businesses compared to 4.7 percent of non-franchised businesses.⁸

When asked what factors help to enable franchised businesses to reach a larger scale, respondents discussed what was most useful in franchisor support. Results suggest the important areas are franchisee training, meetings and events, and technology platforms. Even in areas where franchisor support is less widespread, such as access to capital support (received by 42% of respondents), the positive effects of the business model are striking. Some 21% of respondents report being capital constrained when starting their first franchise business and that being a franchisee provided them with access to capital. In addition, 32% of all respondents report they would not own a business if they were not franchisees. This proportion is even greater among both female owners and owners for whom a franchise was their first business (39%).⁹

The study also found that franchises are locally owned and tend to keep resources in the local community. Unlike the multi-unit company-owned business model, franchises allow local franchisees to buy and own the units they operate. By doing so, franchisees become small business owners, who live and work in their local communities. The brands they represent largely recruit and train local residents rather than bringing in workers from other parts of the country.

In my own experience, the Cleaning Authority has impacted hundreds of thousands of lives. Each one of our professional housecleaners has a clear path to career advancement. We provide training at all sections on the path: from cleaner, to certified cleaner, to trainer, to inspector to assistant manager to manager. In the past year, we have had two managers purchase the Franchise Location from their owner. A majority of our workforce is female and giving these women and their families stability and growth is one of my passions. We are rolling out new personal and professional development courses to employees including Personal Finance, Customer Service, and Internet Skills. These will be made available, free of charge to all employees of The Cleaning Authority franchise owners.

I am so proud of what The Cleaning Authority has accomplished for the more than 200 communities we operate in. Through our TCA Cares program, which was designed by franchise owners and facilitated by the franchisor, we have had 12 food drives, collecting over 1 million pounds of food—equal to 894,000 meals to over 600 food banks within our communities. Last year, our first coat and outerwear drive last year we saw almost 10,000 articles of clothing donated. We also award ten \$1000 scholarships to employees and their dependents of The Cleaning Authority to align with our mission to positively impact the quality of life of the people we employ.

There is no doubt that the franchise model therefore encourages local employment and wealth-sharing with local communities. The franchise census suggests franchisees purchase 21% of their inputs from local suppliers, indirectly contributing to their local economies through their supply chains. Over a third of respondents (36%) purchase at least 25% of their intermediate goods

⁸ *Franchised Business Ownership by Minority and Gender Groups*. IFA Foundation (2018).

⁹ *The Value of Franchising*. Oxford Economics (2021).

locally. In addition, some 65% of franchisees give to local charities according to the franchise census. This is in line with findings that suggest 66% of all small businesses do so. Among donors, franchisees donate an average of 6% of their profits (also in line with small businesses' data).¹⁰

The IFA estimates that U.S.-based companies operating as franchises jointly donated a total of \$1.5 billion to charity in the year before the pandemic and raised over \$900 million over the same period. Some 18 million hours of volunteering were sponsored by franchised businesses in 2019, which are worth hundreds of millions of dollars to society more broadly, and I'm so proud of the examples that my own company can show to this.

The state of franchising in small business economic recovery

In 2017, I became a franchise owner myself. I knew the system backward and forward, and I knew all I had to do was follow the playbook. Being a business owner is one of my proudest accomplishments, and The Cleaning Authority of Harrisburg, Pennsylvania has changed my life and my family's life. I am able to make decisions that benefit myself, my family, and my employees. I would have never thought I would be in the position that I find myself in. Being a franchise owner is not easy, just like certain jobs – like being a senator – aren't for everyone. The week before COVID hit, my business hit a record-breaking revenue milestone. I was on top of the world. Then the world spiraled out from under me. We all know there was no playbook for that.

When the COVID pandemic hit in March 2020, I watched my revenue that I worked so hard to build drop in half, then in third, then to 1/5 of my average weekly revenue in just six short, but very long and gut-wrenching weeks. I watched my life's investment plummet in value. I eyed my children's college education fund. I called my bank to get a line of credit against my house. I was devastated, until Congress and the Small Business Administration (SBA) stepped in. Without the waiver of affiliation rules for franchise owners like me that was included in the CARES Act and Paycheck Protection Program, my employees would have suffered. Because of what Congress and the SBA did, I was able to keep every single person on my payroll, even without customer payment coming in. Because of what the Congress and the SBA did, Genelle Rice, an employee who has been with me on this journey for 6 years, was able to tell her family, "Don't worry, The Cleaning Authority is taking care of me." I will be forever grateful to the U.S. Congress for its work on PPP.

Obviously, I was not alone. The COVID-19 pandemic battered small businesses in historic ways. By August 2020, within the first six months of the COVID-19 outbreak, an estimated 32,700 franchised businesses had closed; 21,834 businesses were temporarily closed, while 10,875 businesses were permanently closed.

We are proud of the growth that franchising has had and its role in the economic recovery. Franchising had an exceptional year in 2021, and 2022 looks to be another strong year of recovery. Bolstered by both the strengthening labor market and steady consumer spending, franchising is expected to continue to expand, trending upwards with the United States' overall economic progression, but the pace of the growth in 2022 is most likely to moderate, due to the current headwinds in the economy.

Some key predictions for 2022 include: Franchises' GDP contribution to the overall economy will remain stable at 3% in 2022, but the growth rate is likely to slow to 5.7%, still higher than the pre-pandemic level, to a total of \$501 billion. Franchise employment is forecast to grow at a slightly

¹⁰ *The Value of Franchising. Oxford Economics (2021).*

lower rate of 3.1% to a total of 8.5 million jobs, a net gain of almost 257,000 jobs compared to 2021. The output of franchise businesses in nominal dollars is forecast to improve by 4.9% to \$826.6 billion in 2022. It is forecast that franchising will end the year with more than 792,000 establishments, adding a net gain of 17,000 new locations, with a marginally lower growth rate of 2.2%.¹¹

This recovery is remarkable, and that's largely in thanks to the hard work of these local business owners who prioritized their workers and did everything they could to keep their businesses on solid footing with the backing of a strong brand – and much of it would not have been possible without the Paycheck Protection Program (PPP) program that the IFA helped secure for franchised businesses, and the support from the SBA through it all.

Franchising is a symbiotic relationship between franchisors and franchisees

Founding a franchise concept is without a doubt the hardest thing I have done. I can't imagine how we would have done it with even more challenges and regulations in our way. Promoting access to capital is one of the most important ways lawmakers can ensure entrepreneurship opportunities are available to the next generation of people from all backgrounds.

The IFA is very supportive of SBA loan programs. 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. While legislation intended to ensure more transparency and disclosure is well intended, it will end up hurting those who need access to capital most. The SBA is also not the appropriate forum for increasing disclosure requirements on franchisors – that role resides with the Federal Trade Commission (FTC) and with state franchise laws.

The Federal Trade Commission authorizes and regulates the sale of franchises in the U.S. and defines a “franchise” in part as “any continuing commercial relationship or arrangement” whereby the franchisor promises that the franchisee “will obtain the right to operate a business that is identified or associated with the franchisor’s trademark.”

In 1978, the FTC published the Franchise Rule, which provides prospective purchasers of franchises information they may use to weigh the risks and benefits of a franchise investment and requires franchisors to provide potential franchisees with specific items of information about the offered franchise, its officers, and other franchisees. The IFA supports this rule, as it has helped empower current and prospective franchise owners by requiring clear and consistent disclosure of information at the outset of all franchise relationships. The IFA also supports improvements to the Franchise Rule, and has recommended a number of steps the FTC should take to improve the rule for franchising.¹²

Importantly, the Franchise Rule mandates that a franchisor “exert a significant degree of control over the franchisee's method of operation.”¹³ However, many state independent contractor laws require businesses to classify workers as employees unless they are “free from control” and direction while performing their work. Taken in a literal sense, this requirement would ignore the

¹¹ *Franchise Economic Outlook. International Franchise Association (2022).*

¹² IFA comments on FTC Franchise Rule: https://www.franchise.org/sites/default/files/2019-05/IFA%20Comment%20on%202019%20FTC%20Franchise%20Rule%20Review%20-%20Final_1.pdf

¹³ *Ibid.*

realities of the franchise model, and so the conflicting “control” requirements of the FTC’s Franchise Rule and the Lanham Act must be viewed as preemptive.

The success of the franchise model hinges upon smart and effective regulation. Indeed, the IFA’s founders worked cooperatively with the FTC staff during the 1970’s to develop the regulatory model that has governed franchising for almost half a century. Since 1978, the FTC Franchise Rule has served as an important tool to require franchisors to prepare and provide an extensive pre-sale disclosure document to prospective franchisees. That policy decision to favor pre-sale disclosure instead of rigidly prescriptive regulation has led to the franchise sector flourishing with thousands of franchise companies in more than 230 industries contributing considerably to entrepreneurship as well as the economy’s growth and vitality.

The Franchise Rule is currently undergoing the periodic decennial review by the FTC and is the single most important government regulation affecting franchising. By requiring clear and consistent disclosure of information at the outset of all franchise relationships, and through its evenhanded federal application, the existing rule sets the stage for franchise brands and franchise business owners to succeed together.

The Lanham Act is the federal law regulating trademarks, service marks, and unfair completion, and it mandates that owners of trademarks must “maintain[] sufficient control of the licensee’s use of the mark to assure the nature and quality of goods or services that the licensee distributes under the mark.”¹⁴ Moreover, because the Lanham Act provides that a trademark can be deemed “abandoned” when “any course of conduct of the owner . . . causes the mark . . . to lose its significance,”¹⁵ franchisors have a strong incentive to control the nature and quality of the good or services sold by their franchisees. As a result, franchisors are compelled to establish and monitor brand standards and provide global oversight of their franchisees. Likewise, it is imperative that franchisees protect their franchisors’ brands, and the trademark value of those brands. A franchisee, functioning as an independent operator under a Brand License, is trusted and relied upon (by the franchisor) to protect the trademark value in implementing brand standards, and to exercise day-to-day management over the operation, since the franchisor is not present at every individual franchise location. Because franchising requires the collective use by franchisees and franchisors of Marks, all stakeholders affiliated with a brand collectively share risks and rewards.

For example, if a franchisee fails to take adequate steps to protect the brand or otherwise engages in an action that injures the brand’s reputation, the damage inflicted on the brand impacts all of the brand’s stakeholders, including all other franchisees and the consuming public. With that being the case, it is essential to franchising that all the stakeholders understand the expectations for brand protection standards and take all necessary action to ensure that those standards are met.

Furthermore, these rights and obligations are enunciated in well-drafted franchise agreements and reviewed in advance under a prescribed set of mandated disclosures. Franchising is also subject to joint employment tests under multiple federal laws. Under the Fair Labor Standards Act, courts around the country have issued divergent rulings on the joint employer issue, most of which purport to apply the Department’s previous, outdated joint employer regulation. The number of different standards and factors employed in each test by various courts has bewildered and frustrated employers seeking to operate franchise businesses efficiently and profitably, without inadvertently creating joint employment. By way of examples only, the Second Circuit has applied a

¹⁴ 15 U.S.C. § 1064(5)(A).

¹⁵ 15 U.S.C. § 1127.

six-factor test in *Zheng v. Liberty Apparel Co.*, while the Third Circuit applied four different factors in *Enterprise Rent-A-Car Wage & Hour Employment Practices Litigation*, the Fourth Circuit utilized a different six-factor test in *Salinas v. Commercial Interiors, Inc.*, while various cases in the Seventh Circuit have applied “economic realities” tests (that are indeterminate in nature), and the Eleventh Circuit applied an eight-factor test in *Freeman v. Key Largo Volunteer Fire and Rescue Dept., Inc.* Adding to this complication, under federal civil rights laws, courts have applied (again, not always uniformly or consistently), a multi-factor “common law” test.

We understand concerns about recent reports about fraudulent actors in the franchise space, and the IFA has expressed support for the actions taken by the FTC, the Department of Justice and state regulators to prosecute bad actors. The fact that brands are being held accountable for abuses of the franchise system shows the current system is working, not that new regulatory measures are needed. If anything, the existing regulators simply need more resources to further enforce existing law and improved data that would paint an accurate picture of any discrepancies in franchise loan performance at the SBA compared with non-franchise businesses. In other words, the actions of a few bad actors should not lead to new laws that will impact the overwhelming majority of the more than 3,000 franchise brands like ours, and the hundreds of thousands of franchisees, who support the current regulatory framework.

Additionally, the notion that franchisees like me are being “squeezed” by brands is simply not accurate. According to Franchise Business Review, an independent research firm that has surveyed 30,000 franchisees annually for 17 years, franchisee satisfaction is at an all-time high, with 80 percent of owners reporting they would recommend their franchise organization to others.

We urge the committee to keep in mind that multiple federal statutes currently provide the rules of doing business by the franchising method. Indeed, franchising is already a “heavily regulated” method of doing business, as it is fundamentally governed by the FTC Franchise Rule, the Lanham Act and multiple joint employment tests. In addition, Maryland is one of about 15 states in the United States that requires “registration” of franchise offerings. Before you offer or sell any franchise in Maryland or to any Maryland residents, you must first register your franchise offering with the Securities Division, Office of the Attorney General.

By requiring clear and consistent disclosure of information at the outset of all franchise relationships, and through its evenhanded federal application, the existing rules allow for transparent information to be provided to prospective franchisees so that they can make informed decisions before entering commercial relationships. As a result, franchise brands and franchise business owners have succeeded together. The appropriate regulatory framework for a sector as diverse and complex as franchising must allow all stakeholders in the arrangement to have proper access to information and avoid changing the balance, for the betterment of all stakeholders concerned, including franchisors, franchisees, borrowers, and lenders.

Upholding the highest standards is critical to the success of franchising. That is why the International Franchise Association has prioritized franchise education and certification to elevate the performance of franchising. Last year, the organization created the IFA Standards Task Force to ensure that IFA members are credible and meet its membership standards, while more importantly, examining methods to improve the information available to prospective franchisees. Working together, with government as a partner not an adversary, the franchise business model can continue to improve and benefit franchisors, franchisees, and consumers alike.

You might have heard an old saying: If you want to go fast, go alone. But if you want to go far, go together. I believe America needs to go far. I believe we need to go together. And I believe we can do it by keeping franchising alive and well.

Thank you for the invitation to appear today.