

GAO Highlights

Highlights of [GAO-13-759](#), a report to congressional requesters

Why GAO Did This Study

From fiscal years 2003 to 2012, SBA guaranteed franchise loans under its 7(a) program totaling around \$10.6 billion. SBA made guarantee payments on approximately 28 percent of these franchise loans, representing about \$1.5 billion, according to SBA. GAO was asked to examine SBA-guaranteed loans to franchisees, and to investigate an allegation that a loan agent provided exaggerated revenue projections to franchisees of the same franchise organization to help them qualify for SBA loans.

This report describes (1) the magnitude of SBA-guaranteed loans to franchisees of the franchise organization, and (2) the results of GAO's investigation into the allegation, and aspects of SBA's oversight of its 7(a) loan program with respect to loans made to franchisees of the franchise organization.

GAO examined SBA's loan data and files of loans made to franchisees. GAO used the franchise organization's revenue data to compare to revenue projections in SBA applications, as well as revenue reported in the organization's disclosure documents. As part of the investigative work, GAO interviewed the franchisor, loan agents, and select borrowers to better understand the franchising experience.

GAO is not making any recommendations. In their comments, representatives of the franchise organization state that GAO's comparison of average revenue in the disclosure document and the first-year average revenue calculation is potentially misleading and inaccurate. GAO disagrees, as discussed in more detail in this report.

View [GAO-13-759](#). For more information, contact Stephen M. Lord at (202) 512-6722 or lords@gao.gov or Wayne A. McElrath at (202) 512-6722 or mcelrathw@gao.gov.

September 2013

SMALL BUSINESS ADMINISTRATION

Review of 7(a) Guaranteed Loans to Select Franchisees

What GAO Found

Analysis of guaranteed loans to franchisees of a select franchise organization reviewed by GAO, approved from January 1, 2000, to December 31, 2011, showed the Small Business Administration (SBA) approved a total of about \$38.4 million for 170 loans made by 54 lenders. SBA's guaranteed portion on these loans was approximately \$28.8 million. Of the total population of 170 loans, 74 loans defaulted, 55 of which (74 percent) originated from four lenders that had the highest loan volume and default rates on loans to the franchisees. SBA made guarantee payments of around \$11 million on the defaulted loans to franchisees, including about \$8.5 million in guarantee payments on the 55 defaulted loans from these four lenders. Of the 88 loans reviewed from the four lenders, 55 (63 percent) defaulted. In comparison, 19 of the 82 loans (23 percent) that originated at the other 50 lenders to the franchisees defaulted. As part of GAO's investigative work, GAO interviewed the owners of 22 franchisees of the franchise organization in GAO's review, of which 16 defaulted on their loans and 10 filed for bankruptcy protection. Interviewed franchisees noted difficulties meeting anticipated revenue estimates and limited access to information that would aid in business planning.

GAO was unable to conclusively determine whether the loan agent referred to GAO for investigation intentionally provided exaggerated revenue projections to franchisees to help them qualify for SBA loans, and SBA has taken initial steps to enhance program oversight. The loan agent stated that she obtained the revenue projections from her employer and former clients, one of which she identified. She then provided these revenue projections to clients. The employer and former client she identified denied providing the revenue projections to the loan agent. SBA's Office of Credit Risk Management debarred the loan agent and her employer for encouraging false statements, among other things, making them ineligible to work with the federal government for a period of 3 years beginning in January 2012. According to GAO's analysis, the first-year projected revenues on loan applications involving the loan agent or her employer were, on average, more than twice the amount of actual first-year revenue for 19 of the 24 franchisees reviewed. Potential franchisees should include first-year revenue estimates in their SBA loan applications. However, this information is not necessarily available to potential franchisees in the franchise organization's disclosure document, which provides information about the organization's financial performance representations and franchisees' estimated initial investment, among other things. Further, federal regulations do not require franchise organizations to provide actual first-year average revenues for start-up businesses in their disclosure document. Thus, potential franchisees may have to conduct due diligence to identify this information from other sources, if available. GAO also identified discrepancies and other issues in SBA's franchise loan data with respect to fields used for risk-based oversight of its loans portfolio, such as default status, number of loans, and loan agent information. SBA has taken, or is considering steps, to address these issues and enhance oversight of loan agents. For instance, SBA is working with a third-party vendor to replace SBA's current franchise codes with publicly available identifiers used in the franchise industry. At the time of GAO's review, it was too early in the process to assess the effectiveness of these actions.