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Business Lending News

GETTING THE 'RIGHT READ' ON A FRANCHISE BRAND

FRANdata's Tools for More Accurate Credit Risk Analysis

Good news for franchise lending. According to leading franchise analysis and advisory firm FRANdata, franchise lending is growing and is trending upward. We're longtime supporters of franchise lending. Here's why: With franchise lending you can grow your portfolio, help people run their own business, and stimulate the economy - all with the mitigated risk franchise loans offer. As a lender, how can you get an accurate "read" on franchise risk potential? We spoke with FRANdata President Edith Wiseman who walked us through the challenges, data and available resources.

As we know, having the right information to make good credit decisions is the foundation of a successful small business lending program. We also know that underwriting business loans is a mix of art and technology, typically relying on the four Cs: Character, Capacity, Capital, and Comprehensive Risk Analysis.

Franchised businesses have a wealth of information to help you better understand all Four C's, which should give franchises an advantage. Further, franchise systems are built on brand uniformity and conformity: Every franchised Papa Murphy's is designed to run exactly like every other Papa Murphy's franchise. So knowing how Papa Murphy's franchises are performing and what factors affect performance, should give you a good idea of credit risk for a new Papa Murphy's franchise. This information, added to your bank's underwriting of the borrower, should lead to positive outcomes. In short: Franchise loans should yield better results than typical small business loans.

Yet Edith Wiseman tells us that most lenders report overall returns on franchise small business lending are about the same as non-franchised small businesses. They point to SBA statistics, which tend to support that assessment. Clearly, something's not right.

What's the Problem?
Franchise lenders tend to rely on four things for understanding a franchisor's potential risks. Yet these sources have their limitations, which can lead to misleading information. Let's take a look:

1. **Franchise Disclosure Documents (FDDs)** were never meant to be used as credit risk documents. Understanding what they say and don't say about the risks associated with a brand takes specialized expertise that most lenders don't have time to obtain.
2. **The Lender's Portfolio Experience** is helpful if the lender has enough long-time loan activity with individual brands. Most lenders don't have this experience.
3. **SBA Franchise Statistics** are simply not accurate, something SBA concedes when the agency distributes franchise information. The reasons: Many franchise names are wrongly associated with other brands or they're not identified as franchises. Most loans submitted for guarantees get properly noted during SBA review, yet the denominator in failure rate percentages (all SBA loans associated with a brand) rarely is accurate. What's more, SBA borrowers and franchise borrowers are generally different populations with different credit risks. So even with accurate loan data, the results wouldn't represent the credit risks associated with a franchise system as a whole.

4. **Third Party Analyses such as Bank Credit Reports (BCRs)** can be valuable in assessing a franchise system's credit risks. The problem: A franchisor needs to request a BCR from FRANdata, and then supply it to a potential lender. Although valuable to lenders, the BCR process is time consuming for the franchisor. One reason fewer than 200 brands out of more than 3,000 franchises looking for third-party capital have done it! As a lender, how can you check out franchisors without Bank Credit Reports?

An Alternative: The FUND Report
FRANdata developed the FUND Report as an answer for brands without BCRs. To truly understand franchise system credit risk, FRANdata's Edith Wiseman advises lenders to continue encouraging franchisors to produce Bank Credit Reports. For franchisors that haven't done so, the FUND Report is a lender's next best resource. While not as detailed as a BCR, the FUND Report gives lenders a good idea of a franchise system's financial and operational feasibility. So for a franchisor like Jamba Juice, which doesn't have a BCR, the FUND Report would be a useful assessment tool.

BCRs vs. FUND Reports: What's the Difference? The biggest difference is the sources of information comprising the performance metrics analyses. BCRs are based on a mix of confidential and public information franchisors provide FRANdata. The FUND analysis is developed by FRANdata and is based solely on publicly available information about a franchise brand, including FDDs, social media, and third party information.

BCR credit risk scoring is based on 20 key performance metrics. FUND Reports generate an overall comparative credit risk score based on varied weightings of 13 franchise credit risk categories. FUND Reports have a maximum total score of 950. Scores above 750 represent higher performance outcomes. Scores of 550-750 represent average credit risk systems, and scores below 550 indicate significant credit risk.

The Upshot: How to Get These Reports
BCRs are free to lenders, while there's a charge for FUND Reports. Get online access to a BCR through FRANdata's website, franchiseregistry.com. Sign up for a free Franchise Registry membership and search the brand you're interested in. If the brand has a BCR, sign an online disclosure form and download the report. Your bank can also download FUND reports directly from the Franchise Registry by doing a search for the brand after you've accessed the site. If you have any questions about the FUND Report, the Bank Credit Report or franchise financing in general, you can contact FRANdata directly: Call 800.485.9570 or emailfranchiseregistry@franchiseregistry.com.

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