

Proposal – Reforming the Canada Small Business Financing Program (CSBFP)

The Canadian Franchise Association helps everyday Canadians realize the dream of building their own business through franchising. We connect prospective franchisees with education about franchising and the opportunities in franchising. Our members are diverse and range from small/emerging to mature/established franchise systems in a variety of industries and sectors. Our membership also includes service suppliers to the franchise industry, such as banks, accountants, lawyers, consultants, and brokers.

Differences between franchised businesses and other start ups

There's a big difference between operating a franchise and running your own business. In a traditional business, you have to create your own systems and that's done by trial and error which means higher risks for the lenders and the owners.

Under a franchise you're operating under the trademark and business systems of a fully formed business rather than developing your own business from the ground up. This business-in-a-box approach brings some benefits over starting from nothing which also tends to reduce the number of failures/bankruptcies compared to other start-ups in the same sector. A business owner working with a franchisor already has those processes in place, and they've been tested and honed across many other branches within the franchise system.

Access to capital

Many franchised businesses require access to capital for start-up, expansion and growth just like any other business. The CSBFP is one of the resources available. Unfortunately, the CSBFP does not allow a number of expenses that are key to helping get a franchisee up and running. The program does not allow for working capital for soft costs such as franchise fees, training, building permits, etc. which makes it very difficult for franchised businesses to take advantage of the program.

For bricks and mortar franchise systems the physical locations typically have hard costs admissible to the program but a number of start-up costs (40%) that do not qualify. For example, it costs approximately \$220K to get a new The UPS Store up and running. That includes \$135K of hard costs qualify for the program but \$85K in soft costs like working capital and fees that are disqualified from the program.

In contrast, most non-traditional and/or home-based franchise systems do not have the same hard cost requirements and are therefore unable to access the CSBFP. Non-traditional/home-based franchise businesses require unique financing for working capital facility for soft costs like franchise fees, education/training/tuition, etc. which are not eligible under the current structure of the program. This impedes these businesses from getting established and from growing.

Without this program there will be a funding gap

If the CSBFP did not exist there would be a funding gap that the private sector would not fill. The banks have said to us that higher risk areas such as retail and hospitality would have difficulty accessing capital. As the market has changed with the advent of Covid-19 those businesses access to capital will further shrink as the current bear market moves into the predicted recession.

Increase maximum loan amount

Under the current program criteria, the maximum loan amount a borrower can access under this program is \$1 million, of which no more than \$350,000 can be used to finance the purchase or improvement of equipment and the purchase of leasehold improvements.

The maximum loan amount needs to be increased to \$1.5 million with borrowers being allowed to use up to \$1 million to finance the purchase or improvement of equipment and the purchase of leasehold improvements.

Increasing the rate will allow more businesses to take advantage of the program helping spur economic growth as we recover from Covid-19. The federal government has already invested \$10 billion to ensure the banks have sufficient liquidity during this economic downturn. By increasing the loan amounts the banks will then be able to flow loans to businesses that will help signal Canada's recovery.

Franchised businesses have a better track record of success than new independent businesses because of the brand recognition that helps bring customers in more quickly than non-franchised businesses.

Allow a portion of working capital to be financed by the program

One of the largest concerns for a franchise is working capital especially as they get started or work through economic downturns. According to Innovation, Science and Economic Development Canada, thousands of companies fail in Canada every year because they have no access to additional working capital.

While it may be possible for some larger companies to take out a loan many franchised businesses, especially new franchised business locations are not able to do so as banks are not willing to flow loans that are unsecured to new business.

By allowing a portion of the CSBFP to be used for working capital it can help franchises to solve temporary cash flow issues and fund investments.

Changes within lenders have helped the flow of funds

From 1999 to 2015, the number of CSBFP loans made decreased almost every year which was primarily a result of bank policies and structures that made it more complicated for a small business to work with their lender to gain access to the program.

Since 2015 the loans made under the CSBFP has started to increase. According to the banks, this is a result of many of the banks offering discount rates to small businesses and changes to how they finance franchise systems within their bank. Many financial institutions have created franchise specific financing groups which has helped. They have also introduced Behaviour Scoring Models to continue monitoring borrowers once funds are advanced. Some banks have also introduced centralized processing for CSBFA loans eliminating the complexity for their front-line employees.

Recommendation

The CFA recommends that

- 1) The Government of Canada expand the program to include soft costs such as training, franchise fees and some working capital to be considered eligible expenses under the program which will allow traditional business, bricks and mortar franchised businesses and non-traditional/home-based/service-based franchises to take advantage of the program.
- 2) Increase the maximum loan amount to \$1.5 million with borrowers being allowed to use up to \$1 million to finance the purchase or improvement of equipment and the purchase of leasehold improvements.
- 3) Allow up to \$250,000 of the loan to be used for working capital which will help new businesses get onto a more secure financial footing from the beginning while also allowing them to deal with temporary cash flow issues that may arise.