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Testimony before the U.S. House Small Business Committee

Hearing on ""A Small Part in A Big Company: Examining the Power of Franchising in the American Economy""

May 15, 2025

Good morning, Chairman Williams, Ranking Member Velazquez and distinguished members of the Committee. My name is Craig Wright, CEO of Aqua-Tots Swim School, a swim school franchise based in Mesa, Arizona.

I appear today on behalf of the International Franchise Association (IFA), the world's oldest and largest organization representing franchising worldwide. IFA works through its government relations and public policy, media relations, and educational programs to protect, enhance and promote franchising and the approximately 830,876 franchise establishments that support nearly 8.8 million direct jobs, $896.9 billion of economic output for the U.S. economy, representing 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.

Aqua-Tots Swim School is a family-owned business that began in 1991 with one simple goal: to make quality swim instruction accessible, safe, and convenient for families. What started as a single swim lesson taught by a teenage lifeguard in Tempe, Arizona, has grown into one of the world's largest swim school franchises.

Initially operating in backyard and hotel pools, Aqua-Tots pioneered one of Arizona's first indoor, year-round swim facility – an innovation that removed seasonal limitations and allowed children to build life-saving skills in a safe, dedicated environment throughout the year. The success of this business concept laid the foundation for the brand's expansion under the franchise model. In 2007, Aqua-Tots launched its franchise in Phoenix, Arizona, with the goal of empowering local entrepreneurs to bring professional swim instruction to their communities. Today, Aqua-Tots operates in more than 170 locations across 14 countries, having provided over 47 million swim lessons to more than 2.5 million children worldwide. The majority of our 75+ franchise groups are made up of first-time business owners and families who are passionate about water safety and childhood development.

Since 2017, I have had the distinction of leading Aqua-Tots as Chief Executive Officer. My background consists of more than three decades of executive leadership experience across the grocery, logistics, and specialty retail industries. Under my leadership, the Aqua-Tots brand has strengthened our operational systems, global footprint, and franchise support network, equipping franchisee owners to build sustainable businesses while helping children become safe and confident swimmers for life.

It's an honor to be here today to give my perspective on the impact of franchising and its hundreds of thousands of small businesses. Further, I look forward to giving my perspective as a franchisor on the National Labor Relations Board's joint employer rule, the need to extend Tax Cut and Jobs Act provisions, such as bonus depreciation, interest deductibility, and Section 199A deductions for Qualified Business Income (QBI) – which are important to both franchisors and franchisees alike, as well as shine light to the welcome news of the return of the Small Business Administration's Franchise Directory and the importance for a review and renewal of the Federal Trade Commission's Franchise Rule.

The Franchise Model

Franchising is perhaps the most important business growth strategy in American history. First beginning in 1731, when Ben Franklin entered into a partnership with Thomas Whitemarsh, who franchised Franklin's printing business – *The Pennsylvania Gazette*, the franchise system has served as a core American model over centuries for opportunity and entrepreneurism, contributing to robust job creation and providing foundational skills development for small business owners and workers.

Despite how it is often characterized, franchising is not an industry, rather it is a business growth model used *within* nearly every industry. There are more than 300 different sectors that are represented in franchising, and franchised companies offer a huge range of products and services from lodging to fitness, home renovators to hair salons, plumbing to pest control, restaurants, security, lawn care, and yes, school systems, like Aqua-Tots swim school. So again, franchising is utilized far beyond the fast food brands that most associate with it. In fact, 60% of franchises are outside of the restaurant sector.

At its core, franchising is about the relationship between the franchisor and its franchisees — how the franchisor supports its franchisees, the franchisor's brand value and how the franchisee then meets its obligations to deliver the products and services to the system's brand standards. A franchise relationship is a long-term relationship that spans a decade and in many cases more than 20 years. These long-term relationships only work where the parties can trust that the relationship and the expectations each party has of the other will remain stable.

Often mischaracterized as "big business," franchising is in fact the exact opposite. A franchise is first a local business, distinguished from other local businesses because it licenses the branding and operational processes of a franchisor while operating independently in a defined market. The local owner, or franchisee, is responsible for hiring staff, organizing schedules, managing payroll, and all daily operational tasks as well as local sales and marketing. The value of franchising then lies in a strategic balance in the relationship between a franchisor and franchisee: the independence of a franchisee to manage its day-to-day operations and connections with its employees, consumers and the local community, balanced with the franchise system giving aspiring small business owners a head start toward becoming their own boss, with a proven business model that can set up new business owners for success and easier access to financing than a traditional business.

There are two principal explanations 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." The other is that franchising uniquely provides an opportunity for an aspiring business owner to own their own business with a brand, concept, and system for support in place, while having the autonomy to run their own day-to-day business operations. 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 each franchise unit are the responsibility of the franchisee who 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 operational processes and systems to its franchisees. The turnkey nature of operating a franchised business is why so many franchisees purchase a franchise. Franchisees look to the franchisor to protect the brand, trade names, trademarks and service marks (collectively the "Marks") by establishing and enforcing standards on all franchisees in a system. Such standards are essential for protection of franchisees' equity in their businesses and consumers of the brand. These standards allow franchisors to maintain the uniformity and quality of product and service offerings and, in doing so, to protect their Marks, the goodwill associated with those Marks, and most importantly, consumer confidence in the Marks and brand.

Joint Employer Rule

Beyond explaining how the franchise model allows for the creation of small businesses, I first want to bring attention to and highlight a volatile and ambiguous joint employer standard that has plagued the franchise model since the National Labor Relations Board's (NLRB) 2015 *Browning-Ferris* decision, a shift that upended decades of precedent and expanded the factors determinative of a joint employer relationship under the National Labor Relations Act (NLRA) to include not only direct control but also indirect and reserved control over broadly-defined essential terms and conditions of employment. Put more simply, franchise businesses have faced four different definitions of a joint employer standard over the past decade.

In 2023, during the Biden Administration, the NLRB doubled down on its overreach, rescinding without any basis the joint employer rule issued during the first Trump Administration and issuing a new rule more expansive than the standard established by *Browning-Ferris*. The rule—like *Browning-Ferris*—threatened the ability of hundreds of thousands of local small business franchise owners, like mine, to make their own employment decisions – as it would ultimately lead to higher costs, less autonomy, and less equity for franchisees. When the joint employer standard was similarly expanded under *Browning-Ferris*, it cost franchised businesses $33 billion per year in operational costs and led to a 93% increase in lawsuits.

Last Congress, both the House and Senate passed a resolution of disapproval under the Congressional Review Act (CRA) to overturn the harmful 2023 joint employer rule on a bipartisan basis. Although then-President Biden vetoed the resolution, this vote was a clear indication that Congress does not support unelected regulators at the NLRB or elsewhere dramatically rewriting federal labor law with the stroke of a pen. Fortunately, just over a year ago, the NLRB's flawed 2023 joint employer rule was struck down by the courts.

While a reprieve from the previous NLRB's joint employer rule has been welcome news, I wanted to stress the importance that the current, commonsense standard in federal labor law has on franchises, like Aqua-Tots, and state that any action towards permanently preserving the current NLRB rule would not only protect both businesses and workers, but also create the regulatory conditions that allow both franchisors and franchisees to thrive, grow, and create jobs and opportunities in the communities that they serve.

Legislation such as the Save Local Business Act would help franchise small businesses tap into their potential to be an economic power engine and further assist the workforce issue. This important piece of legislation would keep the hard-earned equity of business owners invested into their stores, community, and workers.

The Importance of Tax Policies that Support Small Businesses

In 2017, Congress enacted the Tax Cuts and Jobs Act (TCJA), which significantly overhauled large portions of the tax code for individuals, families, and businesses. While many of these changes for corporations were permanent, many of the individual and small business provisions are expiring at the end of this year.

Several of these expiring provisions are critical for both franchisors and their locally owned franchises. I appreciate the urgency with which Congress is seeking to address these as the uncertainty created by their looming expiration is giving small businesses pause as they make investment decisions that will allow them to grow and create jobs.

Bonus Depreciation

The TCJA allowed businesses to immediately write off 100% of the cost of capital investments in qualified property placed in service after September 27, 2017, and before January 1, 2023. This provision encourages businesses of all sizes to make investments that will boost wages and increase hiring.

Bonus depreciation allows businesses to deduct a large percentage of the cost of eligible assets in the year they are purchased. This immediate deduction significantly reduces taxable income, leading to lower tax liabilities and improved cash flow. For our businesses, this influx of cash is crucial for reinvestment, expansion, or managing operational costs. More importantly, the provision incentivizes businesses like our franchisees to invest in new equipment, technology, and other qualifying assets, leading to increased productivity, efficiency, and overall economic growth. By allowing a business to make capital expenditures sooner rather than later, our franchisees have the ability to take a large deduction upfront simplifying tax planning, and reducing the complexities associated with traditional depreciation schedules.

As the bonus depreciation percentage decreases each year, the immediate tax savings for businesses also diminish. This means that businesses will have to spread out their deductions over a longer period, resulting in a delayed tax benefit. The phase-down ultimately leads to a higher tax burden for businesses in later years, as we can no longer claim the same level of immediate deductions.

The phasing down of this provision adds further complexity to long term business planning, and capital expenditure planning. Businesses must now plan for the future, knowing that the tax benefits are being reduced.

In essence, while the bonus depreciation provision provided a substantial boost to small businesses, its phase-down creates a growing concern about increased tax burdens and potential disincentives for investment. For these reasons, I strongly support restoring and making 100% bonus depreciation permanent.

Deductibility of Interest

Under the TCJA, prior to January 1, 2022, businesses' interest expense deductions were limited by section 163(j) to 30% of their earnings before interest, tax, depreciation, and amortization (EBITDA). Interest deductions are now limited to 30% of earnings before interest and tax (EBIT) – a stricter limitation. This change, combined with rising interest rates, is proving to make incremental investments by small businesses much more expensive. On average, a business affected by the change could see a three-fold increase in its incremental tax burden, facing both higher interest rates when financing improvements and a very high tax rate.

I was pleased to see this standard extended for another 5 years in the House Ways and Means reconciliation bill. I urge Congress to support this limitation to an EBITDA basis.

<u>Section 199A Deduction for Qualified Business Income</u>

The TCJA created the Section 199A deduction that provides passthrough businesses with a 20% deduction for qualified business income to provide a degree of parity with the large rate cut included in the bill for C corporations. Unlike the corporate rate cut, the 199A deduction, which functions much like a reduced tax rate on qualified business income, will not be available beyond 2025 unless Congress acts. Notably, more than 95% of franchised businesses are organized as pass-throughs.

Much like the rest of small business owners, the 199A deduction has enabled our franchisees to increase investment in new equipment, technology, and facilities, driving growth and innovation, while the extra financial breathing room has allowed them to hire more employees, and provide better benefits to existing team members.

More importantly, this deduction has helped level the playing field, allowing our franchisee businesses to compete, providing a level of financial stability that has been very valuable. The thought of these hard-earned gains being jeopardized is deeply unsettling. It's not just about numbers; it's about the livelihoods of families, the vitality of communities, and the spirit of entrepreneurship.

It was welcome news to see the House Ways and Means committee include the pass-through deduction in their reconciliation bill, further increasing it to 23% and potentially made permanent. I recommend Congress support this important provision to provide relief to all small business owners.

<u>Estate Tax</u>

The TCJA made permanent the $5 million estate tax exemption, spousal transfer and stepped-up basis that was passed as part of the American Taxpayer Relief Act of 2012 and increased the exemption to $11 million through the end of this year. These provisions are critical to allowing family businesses to be passed down to the next generation without selling or taking on crushing debt burdens. This is especially critical as most of our franchisees are family-owned and operated.

Estate taxes can pose a substantial burden on family-owned businesses when the owners pass away. Without careful planning, heirs may be forced to sell off parts or all of the business to cover the tax liability. The TCJA's increased estate tax exemption helps maintain the business's continuity and preserves the family's legacy. Family businesses often have significant value tied up in illiquid assets, such as property, equipment, and inventory. Paying a large estate tax can create a liquidity crisis. By increasing the exemption, the TCJA has lessened the immediate financial strain on these businesses, enabling our families to focus on long-term strategic planning rather than worrying about immediate tax liabilities.

I appreciate the House Ways and Means committee for potentially making this provision permanent and providing relief to all family-owned businesses.

SBA Lending and the Franchise Directory

The Small Business Administration (SBA) and the access to capital that its lending programs provide are an instrumental part of the franchise success story. In fiscal year 2024, the SBA guaranteed $31.1 billion in 7(a) loan volume and $6.7 billion in 504 loan volume. Historically, franchises have represented about 20% of SBA loans by dollar volume.

On April 25th, the franchise community welcomed the SBA's news that it would be reinstating the Franchise Directory. The Directory, which was unfortunately eliminated in 2023, is an essential and centralized tool for lenders to assess SBA loan eligibility and financing for franchisees, like some of ours at Aqua-Tots. The SBA Directory has also served as a beneficial tool for prospective franchisees as they evaluate franchise opportunities, like the ones we offer at Aqua-Tots.

In reinstating the Franchise Directory, the SBA identified opportunities to optimize the process for determining if a franchise meets the criteria for listing in the Directory. Key improvements advocated for by IFA and reflected in the updated version of the Franchise Directory include:

- Replacing the SBA Addendum (Form 2462 or negotiated addendum) with a certification signed by the franchisor acknowledging the conditions required to be listed on the Directory, including many conditions franchisors will recognize from the prior Franchise Directory.
- Franchisors previously included in the Directory may sign the certification within a specified period to remain on the Directory.
- Franchisors not previously included in the Directory must submit an application to the SBA demonstrating they meet the eligibility criteria for listing in the Direcotry.
- Listing on the Franchise Directory will remain at no cost to franchisors, which is important because a franchisor must be listed in the Directory for its franchisees to access SBA funding.

On behalf of IFA, we appreciate the Committee's attention to this issue given how critical SBA lending is to new franchisees and appreciate your efforts to once again have the use of the Franchise Directory for both banks and borrowers.

FTC Franchise Rule

Lastly, I want to bring to the Committee's attention the Federal Trade Commission's (FTC) Franchise Rule, which requires franchisors, like me, to disclose key details to potential franchisees in the sale of a franchise. The Franchise Rule is subject to review every 10 years, and the review of the current Franchise Rule began in 2019 but was never completed. It is of utmost importance that the FTC's Franchise Rule is reviewed and renewed regularly, so that it can be modernized to improve transparency and create an environment where franchisees are able to make well-informed decisions with a clear understanding of the risks and rewards of beginning a franchise. The current Franchise Rule was issued before the very first iPhone and is wholly out of touch with the method by which consumers engage with information, yet we are bound to this antiquated disclosure regime in our franchise sales process.

With modernized pre-sale disclosure requirements, a renewed FTC Franchise Rule will provide a strong foundation for the decades-long relationships we establish with our franchisees by providing clarity regarding the rights and obligations of franchisees and us—the franchisor—under the franchise agreement. A strong foundation is critical to the sustainability of long-term contractual relationships that underpin the franchise model. Absent modernization of the current disclosure regime, prospective franchisees turn to AI tools and unqualified advisors to assist them in navigating n complicated document spanning hundreds of pages that is intended to serve as a "plain English" tool for understanding a franchise opportunity.

In May 2024, IFA put forward a series of policy recommendations to improve pre-sale disclosure requirements and to make due diligence more robust, facilitating a stronger foundation for all franchise relationships.

As the 119th Congress continues, we will continue to stress the importance of modernizing the FTC Franchise Rule and appreciate the Committee's consideration to the matter.

Conclusion

Mr. Chairman, and distinguished members of the Committee, thank you again for the opportunity to testify. I am happy to answer any questions you may have.