

Submission to the Senate Inquiry – The Operation and Effectiveness of the Franchise Code of Conduct

I was the chief financial officer of the Back In Motion Health Group (BIMHG), a franchise system in the allied health sector, from October 2013 through to July 2016. My submission is based on my experiences working with this organisation during this period. I believe franchising can and should be an important part of our economy but at present there is a very inadequate regulatory system, which places far too much power in the hands of franchisors and this power is being abused, severely damaging what should be a thriving sector and severely affecting the physical and financial health of thousands of vulnerable Australians.

The problems I observed at BIMHG I believe are widespread following interaction with Fairfax journalists and the recent publication of stories coming out of organisations including 7 Eleven, Caltex and The Retail Food Group.

The risks posed to franchisees by predatory franchisors are enormous. The stress placed on franchisees by a weak business model and bullying tactics from the franchisor have resulted at BIMHG in incidents including mental health problems, multiple miscarriages, extreme financial distress and in one case, a franchisee contemplated suicide.

The franchisees, to a very large extent, are exposed to all of the risks of equity and few of the benefits. About a quarter of the systems' stores eventually achieve gross sales exceeding \$1m at which point they will normally be making a reasonable return on investment. Unfortunately, the majority will never get there. In FY17, over half of the group's stores had annual revenue of less than \$750,000, a point below which they will generally be unable to generate profit to pay themselves a reasonable wage (an average physio in the hospital system makes about \$80,000) or recoup their initial investment (typically around \$300,000 for the upfront franchise fee and store fitout) let alone receive a reasonable rate of return on their capital investment.

One franchisee I spoke to recently has had an experience typical of many. His total fees to the franchisor over a seven year period exceed \$500,000. Moreover, the franchise agreement to which he is bound demands that he pay another \$600,000 to exit the group if he wishes to retain his store. His practice, which has annual sales of around \$800,000 has never been able to pay him a salary of more than \$80,000 per annum. If he does not choose to buy out his store, his employment options are limited and a provision in the franchise agreement prevents him from trading within

10km of his existing business, from employing any of his previous staff or from seeing any of his existing clientele for a period of one year.

Franchisees are required to comply with all directions of the franchisor which in some cases are unachievable or unreasonable. This may include a requirement to update signage or furniture and fittings at unaffordable cost. Franchisees as part of their agreement are required to increase sales by 5% each year each which in many cases proves impossible. If a franchisee is unable to comply with a requirement of the franchisor they are at risk of having their agreement terminated and losing their practice.

Around 10 BIMHG stores have exited the group during its 10 year history and the emotional and financial price paid by those who have left or attempted to do so have been horrific. Even the most successful of franchisees fear for their future because their conscience won't allow them to sell their practice to another individual within the group. Those franchisees leaving the group have mostly been required to sign non disclosure agreements.

Facing enormous pressure to perform and survive, good people in two instances that I am aware of, have been tempted to defraud compensable bodies in a desperate attempt to make ends meet.

Approximately ten complaints have been made to the ACCC by BIMHG stakeholders in recent years but this has not been sufficient to trigger an enquiry. One franchisor wrote a sixty page submission to the Franchise Council of Australia detailing their dispute with the franchisor including details of severe bullying but was told that the FCA were unable to help them.

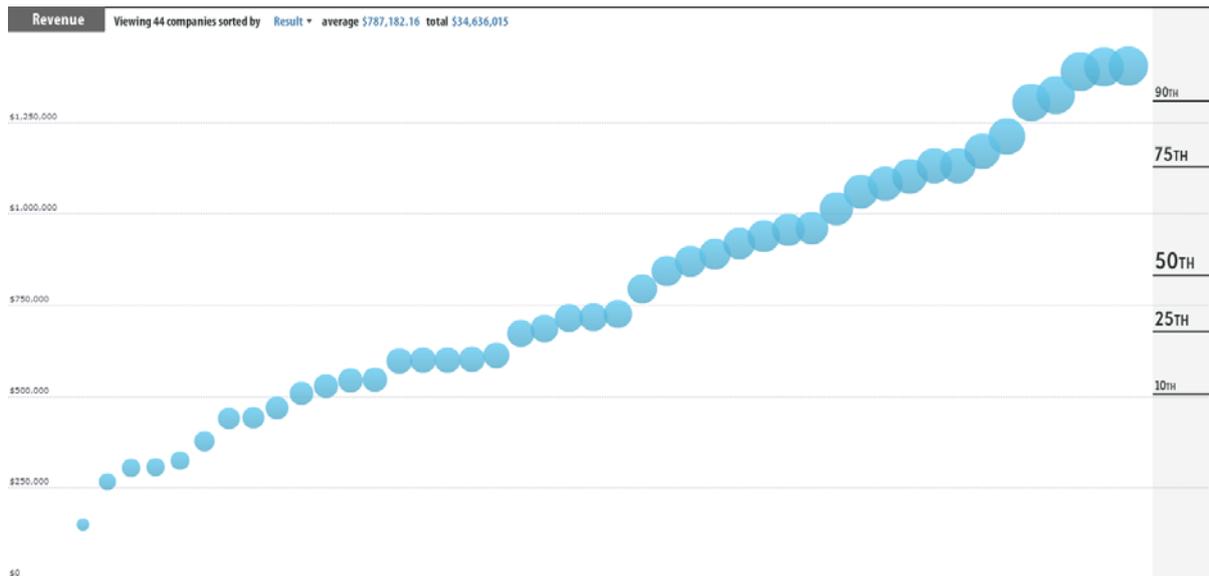


Figure 1 – A plot of the revenue achieved by the remaining 44 franchisees during the year ended 30 June 2017. Only 13 out of 44 (30)% of practices exceeded a revenue of \$1m at which point practices generally become viable (capable of paying the owner a reasonable wage, repaying debt achieving some ROI and providing for future capital costs). 23 out of 44 achieved revenue of less than \$750k where such provision is very unlikely.

The business model is so poor that the franchisor has attempted to divest all fully owned or partly owned company stores. During 2014/2015 the franchisor invested in some company owned stores and as a result recorded a loss of \$1.3m in the year ended 30/6/2016.

Excluding investment in company owned stores, the franchisor has made profits in recent years of around \$1m, which represents an appalling inequity in the division of group profits.

The franchisor employs a “strategic advisory board” consisting of [REDACTED], who was formerly associated with the now infamous Gloria Jeans brand and [REDACTED], an expert in “sales strategies”. My attempts to raise my concerns with these individuals following my resignation in July 2016 have been ignored.

In January 2016, [REDACTED] employed [REDACTED] as its Chief Executive. A very capable group of senior staff who could very possibly have reformed the franchisor into a good organisation have now left, all citing [REDACTED]’s bullying and heavy handed tactics. The organisations’ head office has experienced a greater than 100% turnover of its approximately 20 staff during [REDACTED]’s tenure.

The group's charismatic founder, [REDACTED], published an "international best seller" called *Get Yourself Back In Motion* in 2012 which currently sits at 351,533rd spot on the Amazon best sellers rank. Its total sales of several hundred over the last six years have almost exclusively been to franchisees required to buy and market them by the franchisor.

In a healthy franchise system a franchisee expects certain benefits: a recognized brand backed by strong marketing, an efficient operating system, predictable costs and access to training and advice. But when the minuses outweigh the pluses—as a result of heftier fees, revenues not matching promised expectations, more onerous rules or reduced support—the relationship can break down quickly.

I believe the risks to franchisees can be appropriately remedied with the following changes to legislation:

- (i) Franchisors are required to provide a summary of the audited profit and loss results of all franchisees, prepared on a consistent basis, to all prospective and existing franchisees and in annual disclosure statements. (At BIMHG, current marketing material provides only revenue growth figures of a small portion of the most successful stores)
- (ii) Mandatory investigation by the ACCC of any complaint made by a franchisee
- (iii) Summarised online information of the number of complaints made against franchisors and their outcomes
- (iv) Restrictions on the total operating fees that a franchisor can charge a franchisee (eg – total fees limited to 7%p.a. of sales)
- (v) Stricter restrictions on the fees a franchisor can charge a franchisee to leave a franchise system.
- (vi) Significant increases to the powers, responsibilities and resources of the ACCC to investigate complaints and ensure that franchise systems are based on sound business models with an appropriate balance of power between franchisors and franchisees
- (vii) The creation of a substantial fund to investigate those who have abused the current imbalance, to compensate victims and appropriately punish guilty franchisors

Peter Bain