

## Submission - Franchise Code Of Conduct - April 2018

### **Summary**

Our submission includes a short context outlining our experience with franchising followed by some thoughts per your terms of reference.

Our contact details have been provided separately via the myParliament account through which this submission was lodged.

### **Context**

For a number of years we were the owner/operators of a Boab Boats franchise

These comments are based on our experiences within that franchise model.

This submission is meant as a commentary on the franchise legislation rather than on the Boab Boats franchise model and management.

The major issues concern the non-performance of a franchisor and the power imbalance between franchisor and franchisee that leaves franchisees unable to drive a resolution of these non-breachable performance issues. This is exacerbated by the toothless dispute resolution process in the code.

Secondarily, the disclosure requirements and the enforcement of their accuracy needs attention.

Finally, restraint of trade for existing franchisees leaving the network should remain firm to protect 'good' franchisors' but be relaxed should a franchisor's performance be the reason for the exit.

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## Comments per terms of reference:

We have provided some thoughts against some but not all, of the items in your terms of reference:

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*(a) the operation and effectiveness of the Franchising Code of Conduct, including the disclosure document and information statement,[.....], in ensuring full disclosure to potential franchisees of all information necessary to make a fully-informed decision when assessing whether to enter a franchise agreement, including information on:*

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*(i) likely financial performance of a franchise and worse-case scenarios,*

### **Experience:**

Today a franchisor does not have to provide likely financial performance for a particular franchise if it is new or 'too hard' to do so. This important part of the disclosure process is currently 'optional'.

The risk falls solely on the franchisee and of course, the franchisor will verbally outline how great things are going to be to allay the fears of the prospective franchisee and get them over the line to make the capital investment in a franchise area.

The franchisor will often see the sale of a franchise for many tens of thousands of dollars as 'mission accomplished'. Indeed if that franchisee folds and the franchisor gets to sell that same franchise area again then all the better.

Today there is nothing in the legislation that puts the franchisor on the hook for ensuring a return on investment by the franchisee, or at least on the hook for them having a realistic chance to achieve a financial return.

### **Solution:**

Not only should a franchisor be compelled to provide a 'reasonable' set of financial scenarios for the franchise area they are selling but, if the area fails to deliver on those projections (perhaps within an agreed percentage band) during the first year of operation the franchisee should be able to recover their franchise fees and exit the franchise network subject only to IPR constraints.

This will give the franchisor a real incentive to make sure they are more honest up front and they remain focused on the success of their newly onboard franchisees.

The argument that a franchisee that performs badly is not the franchisor's fault is a good one but perhaps this solution will force franchisors to tighten up their franchisee selection process.

A year-on-year achievable growth figure that triggers similar 'get-out' clauses would further arrest churn and focus franchisors on the performance of their franchisees' businesses.

Any franchisees exiting in this manner should be logged in a publicly accessible register so they are available for prospective franchisees to contact - this will arrest, or at least expose, the issue of franchisor's churning franchise areas for future prospective franchisees.

Protection for the franchisor against poor performing franchisees is built in - why would a franchisor want to keep a sub-par franchisee in the network. Better to let them leave and then replace them with a better one. This does mean the franchisor needs faith in their models and their numbers of course.

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*(iv) the expected running costs, including cost of goods required to be purchased through prescribed suppliers;*

**Experience:**

A franchisor may provide a spreadsheet model but inputs for a given franchise area have to be provided by the prospective franchisee. This includes costs, sales/orders, manpower, time etc.

A prospective franchisee is not best placed to provide these inputs.

This point can however be addressed through item (i) above in the form of an agreed forecast, the non achievement of which will trigger “get-out” clauses.

**Solution:**

Any financial model must include the likely costs, the achievable revenues and the achievable gross and net margins forecast for that franchise area. A complete & populated model must be provided by the franchisor.

Inaccuracies outside of the the percentage band mentioned in (i) above would be considered an acceptable trigger for a franchisee to recover their fees and leave the network free of any constraints other than IPR. This would function a little like an extended cooling off period to allow new franchisees to see if the realities of the franchise network they have joined are anything like what they franchisor ‘sold’ them.

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*(b) the effectiveness of dispute resolution.*

The existing mediation process, starting with the required notice of dispute and followed by face to face mediation, lacks any teeth.

There is nothing to compel a franchisor to do more than attend. They are certainly not compelled to act on their shortcomings.

**Experience:**

A number of franchisees made multiple approaches individually and then as a group over a period of more than two years to try to improve the performance of their businesses as impacted directly by the franchisor's behaviours. This included individual approaches, group approaches, formal notice of dispute and then two of the franchisees went on to mediation with OFMA.

It became very clear that a franchisor has absolutely no incentive to act, nor penalty for refusing to act, on any such approach.

There is always going to be a gap between the 'breachable' terms of a franchise agreement and the day-to-day operational shortcomings of a franchisor's skills, focus or professionalism.

**Example:**

A franchisor may be obliged to provide central capability such as marketing, a phone answering service, a website, an online booking system or an email service. If these are delivered poorly by unsuitably-skilled/trained/experienced staff, riddled with bugs, unreliable, unfit for purpose or, through poor customer experiences, cause the franchisees to lose business there is little that can be done to compel a franchisor to effect a fix, short of a costly and risky legal battle in the courts.

**Solution:**

The publication (searchable by franchisor-name & ABN) of a public register of 'unresolved' notices of dispute, along with a right to append a written reply from the franchisor, will provide both the incentive for a franchisor to act more reasonably and also help prospective franchisees better judge the true worth of the their future franchisor and the nature of their relationship with their franchisees.

This "risk to brand" may focus the franchisors on fixing issues as it has the potential to affect ongoing franchise sales if left un-actioned.

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*(f) the imposition of restraints of trade on former franchisees following the termination of a franchise agreement;*

**Experience:**

The reason for the ending of a franchise relationship must have a bearing on the restraint of trade of former franchisees.

When we left the franchise network we did so due to no renewal being offered by the time mandated under the franchise code. Indeed it took our franchisor a month and a half beyond their obligated milestone to offer a renewal by which time we had assumed they were not going to do so and had progressed to a sale of our assets.

There was nothing at all we could do to 'encourage' our franchisor to act within the franchise code of conduct as, even though there was a breach, there was no meaningful penalty and it seemed they were better off having us leave, shut down and allow them to churn our franchise area for another fresh franchisee to pay them a franchise fee.

We were left unable to renew, unable to sell our business as a going concern and due to restraint of trade, unable to operate the business under our own brand - all due to franchisor non-performance.

**Solution:**

If a franchisee leaves a franchise network due to poor performance of their franchisor then a lesser restraint of trade should be applicable - again, without an incentive to perform better than a franchisor is only encouraged to churn out franchisees for financial gain.

When leaving due to franchisor non-performance the only survivable contractual terms should be those around IPR - other restraints should be waived so that franchisees that were considering a move into this area of business are not locked out having tried a franchise approach, only to find they are let down by their franchisor. They should be free to remain in the business and in the territory just as if they had never joined the franchise network.

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