

## Michael Sherlock – Franchising code of contact submission

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### **Parliament of Australia – Senate Enquiry**

#### **Corporations and Financial Services**

#### **The operation and effect of the Franchise code of conduct**

#### **Submission by Michael Sherlock,**

#### **Email**

#### **Michael Sherlock – Short Introduction**

I have been involved in franchising for 45 years – I worked for a company known as Brumby's Bakeries Ltd. In 1982 we commenced franchising – our documentation was drawn up by Howard Bellin from International Franchising. I have worked with the Brumby's chain in various roles for the different owners of the brand and in 2000, I was appointed CEO until July 2007 when it was purchased by Retail Food Group (RFG) via a hostile takeover.

During my association with the Brumby's group I have been a franchisor and franchisee – having had part ownership in about 20 stores. When RFG purchased Brumby's in 2007 I had part ownership of 7 stores under their franchise system. I sold my interest in all of these stores – settling the last one in December 2016.

Since exiting my role in Brumby's in 2007, I have been associated with the franchise industry in various roles as a Director – Advisor – Franchisee – Consultant – writer and speaker at franchise conferences and workshops – summary below:-

- Appointed Adjunct Professor at Griffith University – APCFE – where I served on the advisory board and conducted masterclasses for franchisees
- Written a book on franchising, Jumpshift!, and have been a columnist for Franchising Magazines and BRW
- Director of Krispy Kreme Australia for about 5 years. They held the Master Franchise from the USA company for Australia and New Zealand
- Director of Franchise Food Company, who own a number of brands including Cold Rock Ice Cream. I also was a shareholder in a Cold Rock Franchise outlet in Ivanhoe, Victoria
- Board advisor to other franchise systems – Begin Bright Early Childhood Education, Stepz 24/7 Gyms.

More details [www.michaelsherlock.com.au](http://www.michaelsherlock.com.au)

I now work as a Marketing Officer for Sentinel Property Group who own and manage over \$1B of commercial properties around Australia that contain many franchise outlets. I keep up to date with developments in franchising and retail and attend conferences around the world.

#### **Key Points of Submission**

I believe the solution to the current state of play in franchising is to have more transparency not more regulation. Australia has sufficient laws and regulation which have not prevented the current poor state that franchising now finds itself.

I recommend four simple changes to the existing regulations that will provide transparency and expose of the franchise systems that choose to operate unethically. Having been a franchisee and a franchisor, I am a

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firm believer that if franchising is done well it is an ideal system to support those wishing to start their own business. If more and more complex laws are introduced, it will drive operators away. What is needed are some simple changes to the existing regulations to expose the franchisors who choose to exploit the Franchisor Franchisee relationship as seen with the 7/11, Domino's and RFG cases.

### **Four changes to existing laws**

I propose that they will provide transparency for franchisees and expose the franchisors who choose to operate unethically. I have reflected on the RFG case and identified these changes that if made would have prevented much of the suffering to franchisees as they would have been better informed as to the practices of RFG.

I also contend that a majority of franchisors who do the ethical thing would have no objection to these changes as they do not exceed what would be considered to be a fair contract between Franchisor and Franchisee .

#### **1. Advertising Levy Money collected spent on Actual Advertising**

The current law is amended to include any money collected by franchisors and should be spent as it is intended - to drive network sales. At present many franchisors see the money collected as a revenue stream and impose head office overheads or made-up expenses to retain the money collected. They also spend it on unrelated matters or offset it to their own marketing and branding costs which is not what it is designed for. It is meant to drive the sales/revenue of the franchisees. I have seen examples where less than 5% of the money collected is spent on driving sales.

My proposal is that franchisors must state in their disclosure document, at the fee summary page, the actual percentage collected and that is spent on driving franchisee sales. The amount should not fall below an agreed percentage of, say, 75%.

Careful wording would be needed to make it fair as to what expenses the franchisor can levy.

A list should be publicly available so it is a name and shame situation. From the information supplied to me, RFG spend only 18% on actual advertising to benefit franchisee sales.

#### **2. Rebates from Suppliers**

At present franchisors are required to list the suppliers who may provide rebates; most have a telephone book list of suppliers with no detail or transparency. In RFG's case I have seen examples where franchisees pay more for their goods purchased/supplies than they would if they were a sole trader.

One of the original benefits of purchasing a franchise was that the franchisee would get the buying power benefit of the group and have cheaper operating costs that went a long way towards offsetting the franchise fees.

I understand that RFG collect more money on rebates from suppliers than they collect in weekly licence fees. My proposal is for more transparency on supplier rebates. This would require careful drafting to maintain commercial terms between a supplier and the franchisor but consideration could be given to: –

- Percentage of item purchased - actual cost amount and rebate added
- Benchmark of top 20 items by dollar which a franchisee purchases with rebate percentage added
- A ratio of weekly licence fees annualized collected to rebates received annually from all suppliers, shown in Disclosure Document and publically available.

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This is will continue to be one of the most contentious issues facing the sector. Transparency is needed so franchisees get back to enjoying the buying power of the group and franchisors cannot use rebates as their main source of revenue. I support franchisors getting some rebates for use on Research and Development, Franchisee Conferences etc., but for too long this item has been exploited.

### **3. Simple summary of all Fees / Levies and directions to spend capital provided in Disclosure Document**

When purchasing or renewing a franchise, franchisees are given a Franchise Agreement and a Disclosure Document. The main fees such as weekly licence fee, advertising levy, up-front franchisee fee and renewal costs are listed in the Disclosure Document.

But there are many other fees that a franchisor can make franchisees pay that are not clear as they are hidden in the documentation and arise as a consequence of a direction by the franchisor.

My proposal is for all fees that may be charged during the term of the Franchise Agreement should be set out in a schedule in the Disclosure Document in a simple table in plain English. If the fee is not listed here but included in the other documentation it should be invalid.

Examples of unexpected fees are but not limited to:-

- Franchisor directs franchisee to purchase new equipment for a new product
- Direction to purchase new Point Of Sale Equipment and sign up for software and support
- Direction to change store image and branding – complete re-fit
- Costs of selling a store
- Directions to attend training courses, conferences
- Extra site visits or audits
- Costs of renewal of current deed upon expiry or option
- The list can go on and on

The common theme is that these are unexpected costs that the franchisee's business plan has not provided for. If they are plainly stated they can make allowances before they commit to the purchase and know the true cost of entering into the franchisee agreement during its entire term.

### **4. Registration of Franchise Documents and Disclosure Agreements**

At present franchisors are required to have their documentation completed by October 1<sup>st</sup>. I propose that these documents are registered in a similar way to commercial leases and be publicly available for those who wish to search. A registration fee should be paid to ACCC which is based on the number of outlets the franchisor has trading. This will also help fund ACCC to investigate complaints received.

There should be stiff fines for late registration and ACCC should publish a list on their website of those franchise systems that have submitted and paid their fees.

Any person or corporation selling a franchise without registering with ACCC should face heavy fines and the Franchise Agreement should not be valid.

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### **Summary**

There are other issues to address such as the operation of the Franchise Council of Australia (FCA). But I believe that if the above four simple transparency suggestions were adopted, the marginal operators would be exposed and the “best practice” operators would enjoy the support of the community for operating an ethical franchise system with all the benefits to the Australian society and economy.

Over complex regulations have not worked in the past and could kill off this essential sector which has been given a bad name by a few.