

Friday, September 12, 2008

Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
PO Box 6100 Parliament House
CANBERRA ACT 2600

By email: corporations.joint@aph.gov.au

RE: FRANCHISE INQUIRY – PARLIAMENTARY JOINT COMMITTEE

Dear Sir/Madam,

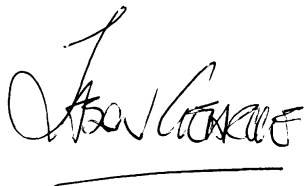
Please find attached the Franchise Advisory Centre's submission to the current inquiry into franchising being conducted by the Parliamentary Joint Committee on Corporations and Financial Services.

The submission is made up of the information on the following pages, as well as a number of appendices, which are all numbered and referenced in this document.

I would be pleased to provide further input into this inquiry if required.

Please feel free to contact me if you would like any further information on any of the concepts raised in this submission.

Yours sincerely,



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Franchise
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Franchise Advisory Centre

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Background – Franchise Advisory Centre

The Franchise Advisory Centre was created in late 2004 to provide best practice professional development to franchisors, franchisor personnel and franchisees, as well as to provide advice and consulting services to both franchisors and franchisees.

It conducts franchise training in Brisbane, Sydney, Melbourne, Perth and Adelaide, offering more than 14 different professional development programs across a total of 60 locations and dates in 2008 alone.

The Centre is highly involved in the franchise sector, and publishes ***Franchise News & Events***, the only fortnightly national news bulletin for the sector. It has provided input to the administration of the Franchising Code of Conduct through submissions to the previous franchise inquiries in Western Australia and South Australia earlier this year, as well as submissions to the Productivity Commission's inquiry into the Market for Retail Tenancies in 2007, and the 2006 Matthews Report into the disclosure provisions of the Franchising Code of Conduct.

For more detailed information about the Franchise Advisory Centre and its franchise training programs, visit www.franchiseadvice.com.au.

Centre director Jason Gehrke has 18 years experience in the franchise sector at franchisee, franchisor and advisor level. He writes regularly on franchising issues in Australian online and print media, and advises both franchisors and franchisees on best practice issues. He is the course convenor of undergraduate franchising studies at Griffith University, a member of the Australian Competition & Consumer Commission's (ACCC) Franchise Advisory Panel, and a committee member of the Queensland Chapter of the Franchise Council of Australia. For more information on Jason, see **Appendix 1**.

Inquiry Reference Item #1:

The nature of the franchising industry, including the rights of both franchisors and franchisees:

The need for free pre-entry education seminars for franchisees

The concept of franchising as a commercial marriage between franchisee and franchisor has been part of the franchising vernacular for many years, however the practice can sometimes result in one party (usually the franchisee) making starry-eyed decisions before fully considering the documentation provided and the prospects of a successful long-term business relationship.

In order to ameliorate some of the naïve enthusiasm of potential franchisees (who in our experience are more driven by the emotional satisfaction of being self-employed rather than by an objective business case for investment), the Franchise Advisory Centre recommends that the Australian Government support the introduction of periodic free public information seminars for potential franchisees.

A precedent for this initiative already exists. The Franchise Advisory Centre and its director, Jason Gehrke, has extensive experience in the organisation and presentation of such seminars (titled "*What you should know before buying a franchise*") and has delivered these under contract to both the ACCC in 2007, and the Queensland Government's Department of State Development in 2001 and 2002. Of these, the seminars conducted for the Queensland Government most closely resemble the model the Centre would suggest for use ongoing implementation.

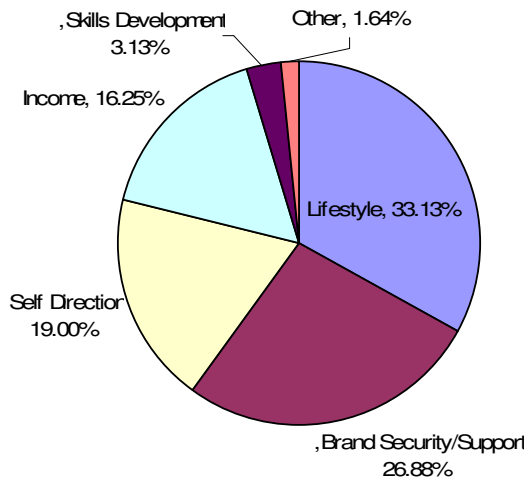
But before detailing the model, it may be best to address the question why the seminars need to be free.

Practical experience at the Franchise Advisory Centre indicates that most people take between three months and three years to research and select a franchise. An independent survey by market research firm 10,000 Feet in 2007 found that the timeframe to research a franchise was three to 12 months (see **Appendix 10** attached). In either case, the Centre's experience is that potential franchisees are generally not prepared to pay for advice or information about franchising during this search phase, and only do so at the end of their search when they have identified a business to buy. Subsequently, the decision is then made on the basis of emotional, rather than objectively rational decision-making processes to buy the franchise. The Centre's experience in this regard is consistent with anecdotal evidence from countless lawyers and accountants who frequently bemoan that their new franchisee clients only want advice to rubber-stamp a decision they have already made. Unfortunately at this point, the value of advice is limited.

This point is further illustrated by research conducted by the Franchise Advisory Centre in 2007 which indicated that non-financial factors accounted for nearly 80% of the reason to buy a franchise, with lifestyle as the single-largest contributor at nearly 33%, followed by brand security at 27% and taking charge of one's own future (self-direction) at 19%. (See Figure 1 next page).

However reasons for leaving a franchise were primarily based around income (accounting for 45% of the decision to leave), suggesting that while a sustainable income level may not have appeared so important, or was potentially taken for granted on the way into the business, it eventually becomes the basis of the reason to leave, suggesting that franchisees have not properly assessed the financial viability of their business investment beforehand.

Reasons for becoming a franchisee



Reasons for ceasing to be a franchisee

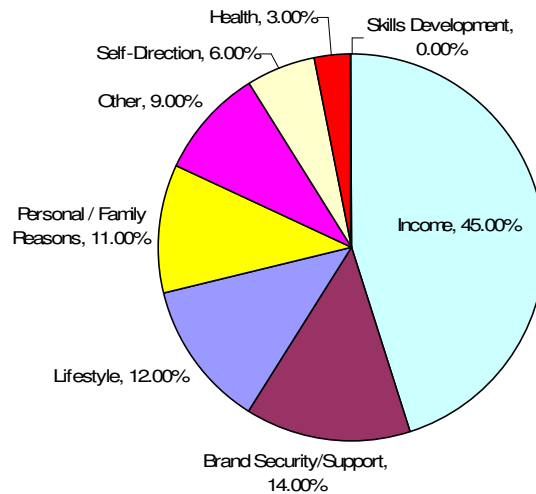


Figure 1: Why franchisees come & go? 2007 service system case study (Franchise Advisory Centre)

By conducting free public information seminars, prospective franchisees who are at an early stage in their search for a franchise, and who perhaps don't even have a particular franchise in mind, can learn of critical things to consider, such as their own suitability for self-employment, the nature of the franchise relationship, fees and royalties paid to the franchisor, acceptable rates of return and the protections and requirements under the Franchising Code of Conduct. More importantly they can be made aware of the need for competent and experienced advice in assessing the viability of the franchise being offered.

Using a successful pre-purchase seminar formula developed by Franchise Advisory Centre director Jason Gehrke (who was contracted at the time to the Franchise Council of Australia), the **Queensland Government** funded more than 20 *What you should know before buying a franchise* seminars attended by more than 1,000 people during an 18 month period during 2001-2002.

These 3-hour seminars were staged in metropolitan and regional locations throughout Queensland, were advertised in mainstream media, and supported by the local offices of the then Department of State Development. Attendance for all participants was free, with more than 100 people attending individual seminars in Brisbane and the Gold Coast. Participants were exposed to key information about franchising, the Code of Conduct, their rights, and what steps to consider in their assessment of a franchise business opportunity.

While it is impossible to know the full benefits that flowed from these seminars to the Queensland Government or economy, it is potentially indicative of their success that no inquiries have been called for franchising in Queensland, and that the state has the second highest proportion of franchisees per head of population of all Australian states. More importantly, if as a result of attending these seminars, some attendees chose NOT to buy a franchise (and consequently avoided a potential business failure), the financial and social benefits to the state are significant.

Based on the success of the 2001-2002 seminars, the ACCC commissioned the Franchise Advisory Centre to write a business plan to conduct a series of *What you should know before buying a franchise* seminars nationally in 2007. The ACCC organized two trial seminars in Brisbane in August 2007 but promoted these differently to the business plan and consequently the seminars did not achieve strong attendances. The ACCC has not repeated these seminars since. A copy of this business plan can be made available to the Inquiry if required.

The Franchise Advisory Centre strongly recommends that a pre-entry franchisee education initiative such as the *What you should know before buying a franchise* seminars be undertaken, and would be pleased to work with the Australian Government to make this initiative a reality.

Copies of reports submitted to the Queensland Government for the franchising seminars conducted in 2001 and 2002 are attached as **Appendix 11** and **Appendix 12** respectively. Please note that the author of this submission is the same author of the original reports, and presented the entire seminar series.

By conducting free pre-entry seminars for franchisees, accessible and meaningful franchise education is available before the commencement of a franchise relationship. Even though reputable franchisors will insist on franchisees accessing legal, accounting and/or business advice prior to buying a franchise, advice alone is pointless without the knowledge of franchising to understand that advice.

Free pre-entry education seminars – A final note:

The seminars must be free to maximize attendance by potential franchisees, who could be anywhere in their journey to buy a franchise. Occasionally, the seminars will also pick up curious accountants and lawyers, as well as small business owners thinking about franchising, which in turn improves their understanding of franchising and their capacity to assess franchise opportunities.

Why seminars and not the web? Pre-entry information for franchisees is already available on the ACCC's and various other websites, but nothing beats a personal delivery of information where the audience can question a speaker and get an immediate response. It allows them to engage with the topic and understand it more comprehensively in a shorter period of time. It's an easier format in which to absorb the information and therefore has a better chance of influencing potential franchisees to make more considered business decisions.

Who pays? The cost of public information seminars on franchising should be government-funded. A user-pays model will only attract those few people prepared to pay for advice (see earlier comments), and who are at an advanced stage in their decision-making process. An industry-pays model (which would potentially result in a user-pays fee for participants anyway, thus massively reducing attendances) may lead to a sales pitch where only the positive aspects of franchising are promoted, and not provide the balanced content needed for potential franchisees to make truly objective decisions.

Franchisee rights in the event of Franchisor Failure

The collapse of the 165-store Kleins retail fashion jewellery franchise this year – the largest retail franchise collapse in 12 years – highlights the helplessness of franchisees in the event of franchisor insolvency. The Franchise Advisory Centre has commenced a study of the causes of this system collapse, and surveyed ex-franchisees to determine how the collapse of the franchisor has impacted the franchisees' businesses. While this research is still ongoing, the following are worth noting:

- Because all shop leases were held by the franchisor entity, franchisees in some cases did not learn that the franchisor was in trouble until they were locked out of their stores by landlords. This was despite franchisees making regular rent payments to the franchisor, which did not pass these on to the landlords;
- Franchisees in some instances were debtors of the franchisor due to income guarantees;
- Leases on franchisee premises were terminated and franchisees forced to vacate when the administrators determined that there was no option but to liquidate the franchisor's business. Franchisees were forced out without the opportunity to sell their businesses. Some have negotiated new leases with landlords to continue trading, but at least half have lost all prospect of continuing to trade.
- Where franchisees were owed money by the franchisor, as well as owed money to the franchisor for goods purchased, the administrator did not allow the debts to be set off against each other, and pursued franchisees (whose businesses had been forced to close by the termination of their leases) for outstanding debts, while those same franchisees might

eventually receive just a few cents in the dollar for the money owed to them as creditors. This situation compounds the suffering and losses of franchisees in collapsed systems;

- Losses suffered by franchisees range from \$145,000 to \$170,000 each;
- Some survey respondents fear that they will never financially recover from their loss, and face the prospect of losing their homes.

The 2006 study *When the Franchisor Fails* by University of New South Wales academic Jenny Buchan (**Appendix 8**) highlighted the helplessness of franchisees in the event of a franchisor insolvency, and noted that a franchisee's business was also likely to fail if the franchisor collapsed. In two separate articles for online news service www.SmartCompany.com.au addressed the issue and likened the experience of a franchisee in an insolvent system as being a passenger on the Titanic. (**See Appendix X and Y**)

Unless specifically owed money by the franchisor at the time of its collapse, franchisees are powerless to have any influence over the administration or liquidation of an insolvent franchisor, despite the fact that the businesses they operate are the most tangible evidence of the franchisor's existence. This helplessness of franchisees during franchisor insolvencies can be addressed by the following recommendations:

1. Recognise franchisees as non-financial creditors, (which won't entitle them to a share of proceeds from the winding up of a franchisor) but will entitle them to vote alongside creditors of insolvent franchisors; or alternatively
2. Introduce a tax ruling that treats upfront franchise fees paid to franchisors as prepayments to be amortised over the term of the franchise, and which secures for the franchisee the position of creditor throughout the term of the franchise (albeit at a diminishing rate over the life of the agreement)

Additionally franchisees as both debtors and creditors of the franchisor should be entitled to offset relief, and not be pressured to repay debts when at the same time they are also owed money by the franchisor.

Inquiry Reference Item #2:

Whether an obligation for franchisors, franchisees and prospective franchisees to act in good faith should be explicitly incorporated into the Code (having regard to its presence as an element in paragraph 51AC(4)(k) of the Trade Practices Act 1974:

We offer no response to this term of reference, other than to recommend consultation with the Franchising Legal Committee of the Queensland Law Society and similar committees of other state Law Societies.

Inquiry Reference Item #3:

Interaction between the Code and Part IVA and Part V Division 1 of the Trade Practices Act 1974, particularly with regard to the obligations in section 51AC of the Act;

We offer no response to this term of reference, other than to recommend consultation with the Franchising Legal Committee of the Queensland Law Society and similar committees of other state Law Societies.

Inquiry Reference Item #4:

The operation of the dispute resolution provisions under Part 4 of the Code;

Government subsidy to assist franchisees with Mediation / Ombudsman

The Franchise Advisory Centre supports the role of mediation under the Franchising Code of Conduct and the work of the Office of the Mediation Advisor (OMA), which is able to achieve a negotiated settlement on average in three out of every four cases. These processes would appear adequate and reasonably cost-effective for each party.

However government financial support for the franchisee party may be necessary to assist those franchisees whose businesses are failing (or have already failed) to pay for their half of the mediation costs. This could enhance franchisee participation rates in mediations, and potentially lead to even greater numbers of negotiated settlements of franchise disputes.

Subsidised mediations of this nature may be of great assistance to financially-distressed, cash-strapped franchisees, as well as lead to mediations in a wider range of business sectors served by franchising (for example, mobile service and other low capital cost of entry businesses where mediation and litigation in franchising is rare, mostly due to their costs when compared against the overall value of the business investment).

We are also open to the idea of a national **franchising ombudsman**, which has been floated in previous inquiries and the media, but would need to see the details of such a role before offering comment.

Inquiry Reference Item #5:

Any other related matters;

A requirement for franchisors to disclose ongoing professional development

Overseas studies have shown that failure rates among start-up franchisors (ie. NOT franchisees) can be as high as 75% over 10 years – a business mortality rate not too dissimilar from commonly understood failure rates for independent small businesses (approx. 85% in five years). See *Unravelling the Evidence on Franchise System Survivability*, **Appendix 7** attached.

This potential failure rate, combined with the usually severe consequences of system failure on its franchisees (See *When the Franchisors Fails*, **Appendix 8**) would suggest that education on sound franchising principles and techniques is necessary for franchisors prior to and during the use of franchising to expand. It also supports the need for pre-entry education for potential franchisees to help them better assess the long-term prospects of franchises they may consider buying.

Currently there are no barriers to entry for franchisors in Australia. The Franchising Code of Conduct is retroactive in its adherence to new entrants to the sector, rather like speed limits on a highway. In other words, franchisors are considered to be complying with the Code unless found otherwise, in much the same way that motorists are considered to be driving under the speed limit until proven otherwise by a speed camera or radar trap.

In other words, any business owner, regardless of their qualifications, experience, knowledge of franchising or track record of success (or lack thereof) can become a franchisor. In the absence of a requirement to register franchise systems, someone with no experience can conceivably become a franchisor.

In this regard, it is recommended that Item 2.6 (Franchisor Details) of the Disclosure Document be amended to require each franchisor officer to disclose what business and franchising professional development they have undertaken in the previous 12 months, and a new item 2.7 to outline the franchisor's policy regarding the business and professional development of the rest of its staff. In turn, this will help a potential franchisee better assess a franchisor's preparedness for franchising, and their commitment to long-term sustainability.

An assessment of Licenses, Distributorships & businesses that may be franchises in disguise

Maintaining a current disclosure document is a requirement for all franchisors. It is a breach of the Code to fail to disclose the prescribed information in the manner and timeframe required.

However, we are concerned at the deliberate avoidance of disclosure by those franchises that hold themselves out to be "licenses" or "distributorships" but which to all intents and purposes fall under the definition of a franchise under the Code. These operators may call themselves anything they like, but if they satisfy the four criteria for a franchise agreement under the Code, then it is vitally important they are identified for what they are – a franchise.

Again, pre-entry education for potential franchisees plays an important role in raising the awareness necessary to differentiate between bona-fide franchise offerings, and those disguised to subvert the Code.

We firmly believe that many businesses calling themselves "licenses" or "distributorships" are acting deceptively by refusing to acknowledge their obligations under the Franchising Code of Conduct, and their failure to provide disclosure, cooling off, recourse to mediation, etc should be the subject of close ACCC scrutiny. In this regard, the ACCC should be resourced and encouraged to proactively seek out such businesses at every opportunity to prevent them from subverting the Code and causing harm to unwary franchisees.

Registration of Franchisors / Disclosure Document audits

Recommendation 23 of the Matthews Report in 2006 (See **Appendix 5** attached) to the federal government included a requirement to register all franchisors (ie. businesses that offer franchises for sale). The government's response was that registration would prove an unnecessary regulatory burden on the franchise sector and so this was not accepted when those Code changes came into effect on March 1 this year.

Despite the initial rejection of this suggestion, it is worth revisiting. The registration of franchisors would provide a definitive understanding of the number of participants in the sector, as well as the rate at which franchisors emerge and cease franchising (assuming registration must be renewed on a regular basis). A requirement for registration would provide valuable statistical evidence to determine future policies for the franchise sector. Furthermore, if the requirement was extended to the annual lodgment of updated disclosure documents, it would provide a vital research opportunity to further improve knowledge of the franchise sector unrivalled elsewhere in the world.

However, if concerns about the costs or practicality of such a task prevent its implementation, at the very least it is suggested that a sample number of franchisor disclosure documents are audited by the ACCC each year to test for Code compliance, and that the prospect of being audited will provide incentive to franchisors to keep their disclosure documents accurate and up to date at all times.

Timeliness of franchise investigations

Remedies through the court system via civil actions, and via the ACCC as administrators of the Code are not viewed by disaffected franchisees as sufficiently timely to satisfy their needs for redress. On the one hand, the merits of each case need to be fully considered. On the other, a financially-distressed franchisee will be driven by self interest and press their cause through whatever means necessary (eg. Media, political lobbying) to expedite an outcome.

We believe that existing remedies are adequate, but not delivered in a sufficiently timely manner to satisfy disaffected franchisees. Financially distressed and disaffected franchisees do not need to have their emotional and financial suffering exacerbated by slow and drawn-out investigative processes.

In this regard, we recommend the provision of additional resources to the ACCC to support its compliance activities. But primarily, we see a need to improve the awareness of the rights and obligations of both franchisees and franchisors, prior to entering a franchise agreement.

We support the existing legislative and enforcement framework in place for the Franchising Code of Conduct. We are supportive of the ACCC in its work to administer the Code, but are critical of its lack of resources to apply to franchising, and the length of time required for it to adequately respond to complaints or conclude investigations. Greater awareness of dispute resolution procedures, as well as the role of the Code in general, is needed among potential franchisees. (We estimate that only 10% of potential franchisees are aware of the existence of the Code prior to receiving a copy of it with their disclosure documentation when buying a franchise).

We firmly believe that accessible pre-entry education is the best way to improve dispute resolution through understanding how and why disputes may occur during a franchise relationship.

See also our comments in relation to pre-entry education for potential franchisees in Inquiry Reference Item #1.

Information Overview:

Jason Gehrke MBA
Director, Franchise Advisory Centre



Jason has a passion for franchising and has been involved in the sector for 17 years.

He has worked at franchisee level, launched a franchise system, provided PR and marketing services to more than 30 leading Australian franchise systems, and spoken to literally thousands of potential franchisees and potential franchisors over the years. He is a director of the **Franchise Advisory Centre**, a consultancy that assists start-up and emerging franchisors, and is the immediate past CEO of automotive paint and plastic repair franchise, **Kwik Fix International**, a 2004 Australian Franchise System of the Year winner.

Jason's franchising achievements and skills include:

- Publisher & editor of **Franchise News & Events**, a franchise sector fortnightly electronic news bulletin;
- Authored submissions for Retail Leasing Inquiry (2007) and Franchising Code (disclosure review 2006);
- Seminar presenter for ACCC "What you should know before buying a franchise" seminars (2007) and seminars for Inside Franchising (a 2006 TV show on franchising);
- CEO of **FCA Franchise System of the Year 2004** winner (*Home-based & mobile 21-100 outlets*);
- Winner, Franchise Council of Australia (FCA) "**Contribution to Franchising Award**" 2004;
- Program & Promotions chairman, **2004 Franchise Council National Franchising Conference**, the largest held in Australia to date (700 delegates). Also organizer of the 1999 FCA National Conference.
- Member, **ACCC Franchising Consultative Panel (2004-current)**;
- Member, **Australian Bankers Association Small Business Forum** (advising banks on how to improve their service delivery to Australian small businesses) (2004-2005);
- Accredited franchise mediator with the **Office of the Mediation Adviser**;
- FCA Queensland committee member (current) vice president (2003-2005) & secretary from 1994-2002.
- Australian delegate and co-founder of the **Asia Pacific Franchise Confederation (Malaysia, 1998)**;
- Australian delegate to World Franchise Council events in Malaysia (1999), Melbourne (2000), & France (2001). Also Australian delegate to International Franchise Association (United States, 2004);
- Franchising guest speaker at national franchising conferences in Adelaide (2001), Melbourne (1995, 2003, 2007), Sydney (1997, 2002), and the Gold Coast (2004, 2006);
- Guest speaker Franchise Association of New Zealand seminar (2007) and at franchise conferences in Kuala Lumpur (1999, 2000 & 2004) & Paris (2001);
- Published in **Franchising & Own Your Own Business Magazine** (Australia), **Franchising New Zealand** magazine, and **Retail Asia & Business Opportunities Magazine** (Singapore);
- Organiser of more than 250 franchise events attended by more than 8500 people (1994-2007);
- Conducted Australia's first-ever franchising export trade mission (**Destination: Malaysia, 1995**);
- Obtained Australia's first government funding for public education seminars to promote the benefits of franchising, and delivered 31 seminars & workshops during a 13-month period (2001-2002);
- **Publisher and editor** of FCA national and Queensland member newsletters (1994-2001);
- Original content author (launch version) of official franchising website, www.franchise.org.au;
- Contracted to FCA national office for marketing, PR and event management services; (1997-2001);
- Undergraduate & postgraduate guest speaker, QLD University of Technology and Griffith University;

Other achievements:

- **Master of Business Administration** (MBA), University of Southern QLD (Studied part-time 2002-2007)
- Founder and principal of WordWerx, a public relations, marketing and events consultancy.
- **Queensland Branch Manager, Australian Marketing Institute (1996-2002)**;
- Collector & researcher of military antiquities, specializing in World War I & II German militaria;

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Why franchisors fail (Lessons from the Titanic)

The collapse of Kleins and several other insolvencies of both small and large franchisors so far this year has thrown the issue of franchisor failure into a rarely illuminated spotlight.

Franchisor failure is an unsavoury topic which participants in the sector rarely discuss publicly.

Like a sinking ship, a franchisor failure often creates a suction that drags surviving franchisees down with it, leaving only a small amount of wreckage on the surface to identify that the system ever existed (such as a vacant store, a painted-over sign, or a Yellow Pages ad). But this flotsam associated with the tragedy of a system collapse is rarely visible years or even months after the event.

The Titanic, an “unsinkable” passenger liner which became the greatest maritime disaster of all time, sank with its lights on and engines running. Franchisors can also sink in a similar fashion. Up until a just a few days ago, the website for Kleins was still touting the franchise’s virtues as a business opportunity.

In comparing franchisor failure with the sinking of the Titanic, there are some surprising similarities. Here a just three:

The Myth of Invulnerability

The Titanic was designed, built and promoted to be unsinkable, yet sank on its first encounter with an iceberg. Franchisors create for themselves an equal myth of unsinkability. A common appeal in almost all franchise recruitment advertising is that a system is “proven”, but rarely is there any substance to this claim. What exactly has been proven? How has it been proved? Who proved it? When?

The notion that a system is proven simply because it exists ignores the possibility that it may have been on life support from the outset, or is sailing directly into the path of an iceberg.

This Myth of Invulnerability is shared by both franchisors and franchisees. Franchisors, like any other entrepreneur, do not set out to go broke. Nor do franchisees, who buy into a system on the expectation that the brand, systems, marketing and support provided by the franchisor will substantially reduce their chance of failure compared to an independent operator.

However studies in both the United Kingdom and the United States indicate that up to three out of four new franchisors will fail in their first 10 years*. These tracking studies, conducted independently of one another, both come up with roughly the same figure for franchisor failure. My own preliminary research in Australia shows this figure to be closer to one in three franchisors here will fail in their first 10 years**, but more research is required to determine if the rate of franchisor failure overseas is reflected in the local market.

The Myth of Manoeuvrability

Like the Myth of Invulnerability, the Myth of Manoeuvrability originates with the franchisor. Prior to franchising, a business is often quite small and agile, and able to make changes rapidly to reflect a dynamic marketplace. In this regard, it is a bit like a jet ski – highly manoeuvrable, light, fast and responsive, but with only the driver and maybe a single passenger on board.

Even when franchising commences, a franchisor’s business may still feel like a highly manoeuvrable craft because of the rapid changes introduced to the system as it grows, but most of this perceived manoeuvrability will come from an increase in the size of the engine (due to the number of passengers on board), rather than any real improvement in steering or navigation abilities.

The more passengers (franchisees) the bigger the ship must become, until inevitability it loses the agility and manoeuvrability that made it successful in the first place. So now when travelling at speed, rather than comfortably steering around the iceberg, it may be impossible to prevent the ship from sailing into it, as with the Titanic all those years ago.

The Myth of Wealth

The Titanic was a luxury cruise liner which represented the best of everything on offer in the year it sailed. Many passengers were rich, or aspired to be rich by rubbing shoulders with rich people and doing the things rich people do. Those who weren't rich were travelling to a better life across the sea, and had staked everything on a journey that would take them there.

Similarly franchisees aspire to a better life in the hope of wealth and prosperity through their investment in a franchise, and are often persuaded by the perceived success stories of others already "on board". Many are not fully aware of the work and commitment involved in running a successful small business until they are already in, and the glamour of self-employment soon wears off when the reality of turning a profit kicks in.

Like passengers on a ship, there are few opportunities for franchisees to disembark once the journey has begun. They have little choice but to put blind faith in their captain and crew that the ship is heading in the right direction. For many the journey is truly worthwhile.

Both franchisors and franchisees should be aware from the outset that the journey is not without risk. No ship is unsinkable, and the bigger it becomes the more difficult it is to steer. Furthermore, icebergs and other risks can appear from anywhere at any time, and both franchisees and franchisors should maintain a constant watch and be prepared to act at the first sign of danger.

Had the Titanic and Kleins followed this advice, two tragedies could have been averted.

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- ** Content analysis: *Franchising and Own Your Own Business Magazine*, vol. 9, no. 5, Advertiser Index p. 136, HH&M Media, Sydney.

Jason Gehrke is a director of the [Franchise Advisory Centre](#) and has been involved in franchising for 18 years at franchisee, franchisor and advisor level. He provides consulting services to both franchisors and franchisees, and conducts franchise education programs throughout Australia. He has been awarded for his franchise achievements, and publishes [Franchise News & Events](#), Australia's only fortnightly electronic news bulletin on franchising issues. In his spare time, Jason is also passionate collector of military antiques. For more information about Franchise Advisory Centre services and education programs, visit www.franchiseadvice.com.au.

All aboard a sinking ship...

(Title changed from this to *When the Franchisor fails* when published)

The current implosion of the retail jeweller Kleins has again brought into sharp focus the tied destinies of franchisees with their franchisor.

Despite being around for 26 years, despite its large number of stores, and despite its wholesale and international operations, Kleins is now in its final death throes after the company's administrators last week announced that out of 36 expressions of interest, none were prepared to buy the business.

In other words, it was too far gone to be rescued, and needed to be put out of its misery. And because the franchisor held the head leases on all of its franchised locations, it means the end of the line for its franchisees too.

For those franchisees who had staked all or part of their future prosperity on a Kleins franchise, this outcome must be devastating. In the main they will be left with next to nothing (or worse) from their franchising experience – no capital gain on the business asset they worked to build, a shop fitout that is now effectively worthless, and the prospect of hawking unsold products on the cheap at markets or on Ebay to recover some of their stock outlays.

In the 2006 report "*When the Franchisor Fails*", University of New South Wales academic Jenny Buchan looked at the critical issue of franchisee survival in the event that a franchisor collapses. The result was not good. Buchan found that 13 out of 14 franchisees involved in a system collapse lost money – a staggering 93%. Most were unable to continue their businesses directly or indirectly as a result of the franchisor's failure, and in addition to losing their own livelihoods, also had no option but to terminate the employment of their staff. Thus begins a ripple effect that is yet to be felt to its full degree in the Kleins collapse. This collateral damage to those franchisees, their families, employees and communities is substantial, and forgotten amid the confusion around the demise of a high-profile brand.

At the time Buchan's report was released, it was widely criticised by some high-profile participants in the franchise sector as scaremongering, and casting a shadow over the sustainability of the entire sector. Their interpretation of the report was completely at odds with the report's underlying issues, and indicated that the franchise sector was only interested in good news about itself, and not prepared to consider potential downsides to franchising.

Buchan's report found that 40 franchise systems had failed between 1990 and 2005, with the largest of these being the Traveland chain of travel agents, a subsidiary of Ansett. (Most of the Traveland franchisees were able to continue operating as independents or by joining another chain, but this is not an option for Kleins.) The difficulty of finding details of failed systems meant those which had sunk without trace were not able to be included in the survey. The 40 systems that were included had an average size of 27 outlets. How many more systems that failed with far fewer outlets and which did not make it onto the research's radar during the survey period may never be known, it is more correct to say that at least 40 systems failed between 1990 and 2005, but the number could be higher.

My own research analysing the advertiser list of a 1996 edition of *Franchising Magazine* indicated that of 113 franchisors then advertising for franchisees, 34 could no longer be found to exist just 10 years later – an attrition rate of 30%. Many of these were very small, start-up systems with a handful of outlets, but the consequences of their failure are equally devastating to their franchisees nonetheless.

Kleins and many other businesses today are sailing in murky economic waters. Not only are the conditions becoming unpredictable, but icebergs can appear from nowhere to sink a system, and with it, the dreams of its franchisees. An ever-vigilant franchisor captain and crew, plus a ship nimble enough to avoid disaster is essential for successful franchising.

Calls for an ACCC investigation of the Kleins franchisor may give its franchisees some hope of a future reckoning, but for many, the sinking feeling of being a passenger on the Titanic must be quickly becoming a reality.

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New disclosure requirements give power to past franchisees

By Jason Gehrke, Director, Franchise Advisory Centre

Changes to the disclosure provisions of the Franchising Code of Conduct which come into effect from March 1 should have franchisors rethinking how they deal with former franchisees.

Under the new provisions, franchisors will be required to disclose a list of former franchisees, and their contact details (subject to privacy considerations for individuals) for the last three years.

The impact of this additional disclosure requirement can have a profound effect on the future success of a franchise brand, but in itself, this is not necessarily a bad thing.

Most discussion about the changes to the Code have been centred around the cost or effort required to comply and update documents, but little has been said about introducing management practices that are conducive to maintaining positive relationships with former franchisees, who from March 1 will have the ability to influence potential new franchisees.

There is an old cliché about franchising which compares it to a marriage. However differences between a franchise relationship and a marriage are stark. The franchise relationship is highly documented and defined by the franchise agreement and system operations manuals, whereas a marriage is based on a few short vows. Moreover, marriage is still a “till death us do part” arrangement (even if more than 30% now end in divorce), but franchising has always been a “marriage” which exists for a defined period of time, and subject to both parties holding up their end of the deal along the way.

The point is that when a franchise ends through a term coming to a close and not being renewed, or through a franchisee selling-up and moving on to something else, the relationship need not come to an abrupt end. Anyone who has dedicated several years of their life to running a business under the brand and systems of a franchisor will still be engaged by the brand, even if they are no longer part of it. So what then, are franchisors doing to maintain that engagement by past franchisees?

For many franchisors focused on growing their networks, this question remains unanswered. Alternatively it goes in the “too-hard” basket perhaps because non-compliant, underperforming or unprofitable franchisees have made the franchisor’s life difficult during the relationship when the two parties had to work together, and after the relationship the franchisor is relieved just to be left alone.

But rather than neglect past franchisees, franchisors should seek to actively maintain an involvement, through an alumni (for want of a better term), the purpose of which is to allow franchisees to continue to enjoy their association with the brand, as well as each other, and act as mentors for new franchisees, as well as provide more strategic and objective franchisee-centric input to the system’s development. In such an alumni environment, a past franchisee could well be elected to a system’s internal Franchise Advisory Council, marketing committee or both.

There would be many other ways that franchisors could engage with and harness the energy and passion of past franchisees if they really put their mind to it – and perhaps this change to the Code is the catalyst that was needed. A past franchisee has more power than ever before to impact the future growth and expansion of a system by positively or negatively influencing the perceptions of future franchisees. Recognition of this represents great opportunities - and some challenges - to the sector that astute franchisors will embrace.

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**REVIEW OF THE DISCLOSURE PROVISIONS OF THE
FRANCHISING CODE OF CONDUCT**

**Report to the Hon Fran Bailey MP
Minister for Small Business and Tourism**

October 2006

Terms of Reference

The Terms of Reference for the review were:

- The Committee is to review the current operation of *Part 2 - Disclosure* of the Franchising Code of Conduct¹.
- The Committee is to identify, where justified, possible amendments that could improve the disclosure provisions of the Franchising Code of Conduct.

In performing its functions, the Committee is to advertise nationally, consult with key stakeholders, receive public submissions, take into account overseas experiences, and seek the views of State and Territory Governments.

The Committee is to protect the confidentiality of the affairs of individuals and companies in the course of its deliberations, to the extent not inconsistent with its legal or accountability obligations.

The Committee was required to report by 30 September 2006.

NOTE: The Minister for Small Business and Tourism extended the report date for the review to 31 October 2006 to allow the Committee sufficient time to consider the 75 submissions received, to consult with stakeholders, and to frame its recommendations.

¹ The Franchising Code of Conduct is a mandatory code and it is contained in the Trade Practices (Industry Codes – Franchising) Regulations 1998 made under the Commonwealth's *Trade Practices Act 1974*.

Membership of the Franchising Code Review Committee

Period of the Review – 28 June 2006 to 31 October 2006

Chairman:

Mr Graeme Matthews National Managing Partner, KPMG Middle Market
Advisory

Advisers to the Committee:

A Corrs Chambers Westgarth team, led by Ms Alexandra Wedutenko, Partner

Secretariat:

Provided by the Office of Small Business and led by Dr Peter Tucker, General
Manager

Foreword

Franchising is a major part of the Australian economy and day to day life.

The mandatory Franchising Code of Conduct was introduced under the Commonwealth's *Trade Practices Act 1974* in 1998 by the Australian Government.

A review of the Code was commenced in 1999 with the report and recommendations being delivered to the Australian Government in 2000.

This present Review was announced on 28 June 2006 by the Minister for Small Business and Tourism, the Hon Fran Bailey MP. I am grateful for all the time and careful thought contributed to the Review by industry, academia, and the Government.

While the Committee's Terms of Reference were, *inter alia* to review the current operation of *Part 2 - Disclosure* of the Franchising Code of Conduct it is clear that Annexures 1 and 2 of the Code are integral to the operation of disclosure and Parts 1 and 3 are also important and relevant. Many submissions to the Review dealt with Parts 1, 2 and 3 and Annexures 1 and 2 of the Code. In order to provide a comprehensive review of disclosure the Committee has chosen to comment on and make recommendations that relate principally to Part 2 and Annexures 1 and 2. Additionally, where considered appropriate the committee has included comment and recommendations that relate to Parts 1 and 3 of the Code.

The Committee was greatly assisted by the high quality of written submissions.

Strong support for the Code has been registered throughout the review process. It is widely seen as pivotal to the continued success of the franchising industry.

I am also thankful for the strong support provided by Corrs Chambers Westgarth and the secretariat from the Office of Small Business within the Department of Industry, Tourism and Resources.

I am pleased to bring this report and its recommendations to the Government.

Mr Graeme Matthews - Chairman
National Managing Partner, KPMG Middle Market Advisory,
31 October 2006

Abbreviations

2001 Regulations	<i>Trade Practices (Industry Codes – Franchising) Amendment Regulations 2001</i>
ACCC	Australian Competition and Consumer Commission
AWA	<i>Arthur Wishart Act (Franchise Disclosure) 2000</i>
CCC	California Commercial Code
ECE	European Code of Ethics for Franchising
FCC	Franchise Code Council,
FCP	Franchising Code of Practice
FPC	Franchising Policy Council
FTC Rule	Code of Federal Regulations
Cth	Commonwealth
ECE	European Code of Ethics for Franchising
FPC	Franchising Policy Council
UNIDROIT	International Institute for the Unification of Private Law
OMA	Office of the Mediation Adviser
TPA	<i>Trade Practices Act 1974</i>
The Code	<i>Trade Practices (Industry Codes – Franchising) Regulations 1998</i>
UFOC	Uniform Franchise Offering Circular
UCC	<i>Uniform Commercial Code</i>

Report of the 2nd Review of the Franchising Code of Conduct - October 2006

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EXECUTIVE SUMMARY – THE RECOMMENDATIONS

NOTE:

- When applicable changes to Annexure 1 also relate to Annexure 2.
- At least some of the recommendations will have consequential changes to other provisions.
- The Committee recommends that sufficient time be allocated for franchisors to update disclosure documents to meet these recommendations.
- Recommendations included in the Appendix which relate to inconsistencies and areas for clarification in the Code, have not been reproduced in this executive summary.

Recommendations directly pertinent to Part 2 and Annexure 1

1. Requirement to include a complete franchise agreement

Clause 10 and item 17 of Annexure 1 of the Code be amended to require the franchisor to provide the franchise agreement in the form it is intended to be executed with the disclosure document.

2. Requirement to include copies of all associated agreements and contracts

Item 18 of Annexure 1 of the Code be modified to require the franchisor to provide copies of all related documents required by the franchise agreement to be signed by the franchisee, in the form they are intended to be signed with the disclosure document, or earlier, which would be at least 14 days before the franchise agreement is expected to be signed.

3. Requirement to include a Risk Statement

The Code be amended to include a requirement for the franchisor to include a Risk Statement with the disclosure document.

The ACCC be tasked with developing a prescribed Risk Statement document with disclosure requirements.

4. Disclosure of section 87B TPA undertakings

Part 3 clause 18(2) of the Code and item 4 of Annexure 1 to the Code be amended to include the requirement to disclose details of section 87B

TPA undertakings within a reasonable time (but not more than 14 days) after the undertaking is given.

5. Rebates and other financial benefits

That item 9.1(j) of Annexure 1 to the Code be extended to include disclosure of the amounts or method of calculation of rebates or other financial benefits to the franchisor or an associate of the franchisor from the supply of goods or services to franchisees.

6. Auditing of marketing and other co-operative funds

The annual financial statement of marketing or other co-operative funds, receipts and expenses prepared pursuant to clause 17 of the Code be subject to compulsory annual audit by a registered company auditor.

7. Provision of audited financial information for the franchisor and the consolidated entity

The ACCC, as part of the registration process (Recommendation 23), collect information on the extent to which franchisors' financial statements are currently audited and provided pursuant to item 20.3 of Annexure 1 of the Code.

The ACCC determine the extent to which any lack of audited financial statements is causing unsatisfactory outcomes for the industry particularly in respect to franchisor solvency disclosures.

The ACCC report to the Government on its findings and provide recommendations by 30 April 2007.

8. More information about past franchises

Subject to compliance by the franchisor with Privacy Laws and the obtaining of relevant consents to disclosure, the Code be amended to require not just the numbers but also names, location and contact details relating to the franchisees corresponding to events listed in item 6.4 of Annexure 1. This could be included as an addendum to the disclosure document.

9. Qualifications of advisors

The Government ask relevant peak industry bodies to raise the level of understanding of their members of the particular requirements connected with advising potential franchisees prior to them entering into franchisee agreements.

10. Disclosure of the business experience of all who have or may have management responsibilities.

That item 3.1 of Annexure 1 be amended to remove the executive officer exemption from the class of persons about which a summary of relevant business experience in the last 10 years must be provided.

That Item 2.6 of Annexure 1 be amended to substitute for the term “executive officer” (which is not defined in the *Corporations Act 2001*), the concept of a person who is concerned in, or takes part in, the management of the franchisor (regardless of the person’s designation and whether or not the person is a director of the franchisor).”

11. Opt out clause from providing information requested from Annexure 1

The opt out provision in Part 2 clause 6C be deleted.

Recommendations directly pertinent to Parts 1 and 3

12. Disclosure of materially relevant facts

Part 3 clause 18(1) of the Code be amended to require franchisors to disclose materially relevant facts within 14 days after the franchisor becomes aware of the facts rather than the present 60 days.

13. Exemption from application of the Code

The exemption to the application of the Code referred to in Part 1 clause 5(3)(a)(i) and (ii) be removed from the Code.

14. Franchises currently excluded from the Code

Delete clause 5(3)(c).

15. Directors to disclose their convictions

Part 3 clause 18(2)(b) and (2)(d) and *Annexure 1 item 4* of the Code be amended to include franchisor directors in the class of persons about which materially relevant facts must be disclosed and the scope of disclosure be extended to criminal convictions for non serious offences.

16. The right of unilateral termination to a franchise agreement

The Risk Statement and ACCC educational material refer to the risks associated with unilateral franchisor termination rights contained in Part 3 clause 22 of the Code.

Consideration also be given to removing or modifying the right of a franchisor to include in a franchise agreement the right to unilaterally terminate a franchise agreement. In the event that the right to unilaterally terminate the agreement is maintained, adequate franchisee compensation should be provided for in the franchise agreement and referred to in the disclosure document.

17. The right of unilateral change to a Franchise Agreement

The Risk Statement and ACCC educational material refer to the risks associated with unilateral franchisor changes to franchise arrangements.

Consideration also be given to prohibiting unilateral changes by franchisors to arrangements with franchisees which have materially adverse effects on the franchisee without franchisee consent. In the event that the right to unilaterally amend financial arrangements with franchisees is maintained, adequate franchisee compensation should be provided for in franchise agreements and referred to in the disclosure document.

18. Prospective franchisees communication with existing franchisees

Part 3 clause 15 of the Code be amended to include a reference to prospective franchisees after the references to franchisees.

Other recommendations and observations relevant to disclosure

19. General waivers of written representations

Consideration be given as to whether or not franchise agreements and disclosure documents should be prohibited by the Code from including any general waivers of written representations made to potential

franchisees or franchisees seeking to extend their franchise agreements.

20. Clarity at the termination, expiry or non-renewal of an agreement

The Risk Statement should, if significant, refer to the risks to the franchisee on termination, expiry or non-renewal of the franchise agreement.

21. Clarity in the event of franchisor failure

The Risk Statement and ACCC educational material should clearly describe the risks and consequences associated with franchisor failure.

22. Financial Details

The requirement under item 20 of Annexure 1, to disclose financial details be extended, where applicable, to include the consolidated entity to which the franchisor belongs.

23. Registration and Review of Disclosure Documents.

The Government implement a mandatory process of franchisor registration and annual lodgement of the most current disclosure document and other prescribed information. Sample audits of disclosure documents would be undertaken with appropriate enforcement of the Code. The process would be administered by the ACCC.

24. The current level of ACCC action relating to franchising

The Government appraise the ACCC of concerns expressed to the Committee about the level and extent of action by the ACCC in dealing with claims of breaches of the Code by franchisors.

25. Implementation of the principle of good faith and fair dealing

A statement obligating franchisors, franchisees and prospective franchisees to act towards each other fairly and in good faith be developed for inclusion in Part1 of the Code.

26. Standardisation of the audit period

The audit period referred to in Part 2 clause 6(1) of the Code be aligned with the *Corporations Act 2001* audit period.

27. Avoidance of providing the details and history of the territory or site to be franchised together with the disclosure documents

Item 11.3 of Annexure 1 of the Code be amended to require the details mentioned in item 11.2 to be in a separate document which is provided with the disclosure document.

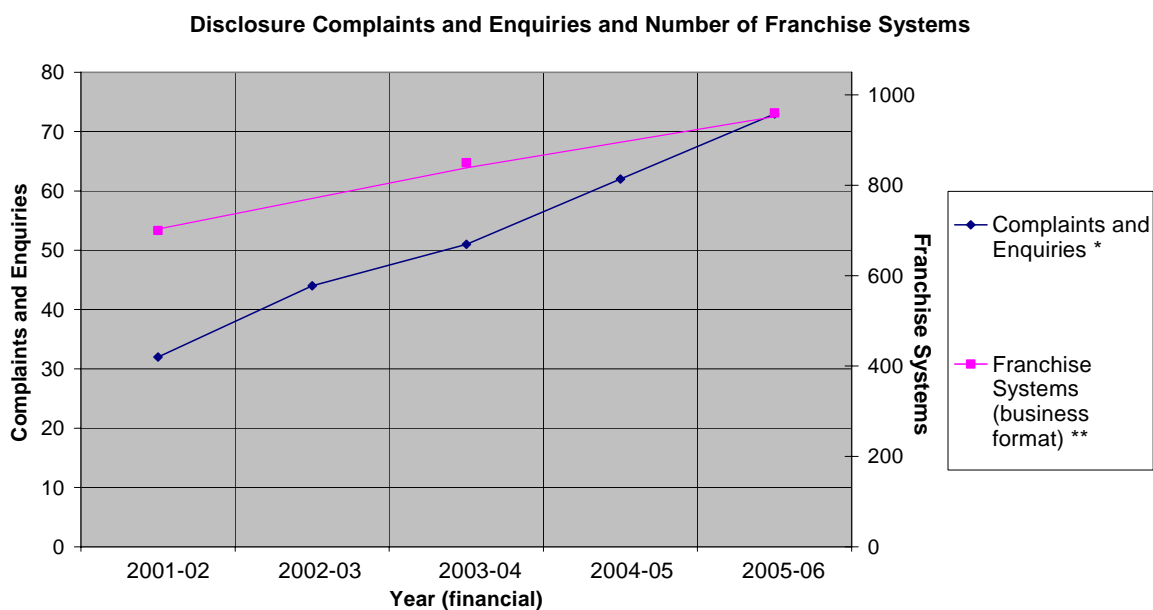
THE EXTENT OF THE PROBLEM

The Committee noted the analysis by the Australian Competition and Consumer Commission (ACCC), in their submission, of complaints data and trends in relation to the Code since July 2001.

The ACCC reported that 252 complaints related to disclosure issues, which represents 19 percent of the total number of complaints and inquiries in the period from July 2001 to June 2006. Further analysis reveals that the *failure to provide the disclosure document* category accounted for 11 percent of matters, or 141 complaints and inquiries, four percent (56) were complaints about *misleading or deceptive* disclosure documents and three percent (42) of complaints alleged that *disclosure documents were inadequate*.

According to ACCC data, disclosure related complaints received by the ACCC were dominated by the *failure to provide* category. The number of complaints relating to *misleading or deceptive* or *inadequate disclosure documents* were somewhat less.

The ACCC's trend analysis of the number of disclosure document complaints shows a steady increase in complaints and inquiries. The number has more than doubled over the past 5 years. Two factors should be noted: that the ACCC's education initiatives have most likely contributed to an increase in the number of inquiries; that there has also been an increase in the number of franchise systems over this same period. These two factors have the effect of inflating the combined number of complaints and inquiries. Nevertheless, the Committee sees this trend as justifying its view that improvements to the disclosure provisions and their operation should be recommended to the Government.



* Data from ACCC Submission to this Review

**Data from Franchising Australia 2006 Survey, Griffith University

The ACCC also noted that according to the *Franchising Australia 2004 Survey*², the number of franchise systems operating in Australia was estimated to be 850 with 50 000 franchising units in operation. It was their contention that the receipt of only 252 disclosure related complaints and inquiries in the last five years indicates that the disclosure regime prescribed by the Code is, overall, highly effective. It provided potential and existing franchisees with a protection mechanism and a means to access relevant information about a franchisor and franchise system.

Figures provided by the Office of the Mediation Advisor (OMA) on the number and results of mediations from August 2004 to June 2006 suggest that approximately 10 per cent of these mediations (293) were related to disclosure issues. Data from the first half of 2006 is provided below.

Mediations by basis of dispute 1 January to 30 June 2006 Data gathered by the OMA from their own activities.	
Alleged Misrepresentations by Franchisor as to Profit/Performance	6
Failure to Provide a Disclosure Document	2
Alleged Multiple Misrepresentations by Franchisor (site/profit/support etc.)	13
Amounts Unpaid by Franchisor	3
Competing with Franchisor	0
Franchisee's failure to Pay Franchise Fees / Other Amounts and Make Financial Reports	4
Franchisee's failure to Comply with Agreement Terms	9
Franchisor's failure to Comply with Agreement Terms	3
Inadequate Support, Training, Assistance	4
Materials/Intellectual Property Rights	1
Poor Franchisor Management / Communication	5
Poor Franchisee Communication	0
Premises and/or Premises Refurbishment	2
Sale of Franchise	3
Territory	1
Terms of Termination/Exit Arrangements	1
Unfair Agreement Terms	0
Unprofitability of Franchise	1
Total	58
NOTE: Mediations usually involve more than 1 issue and since the data was collected prior to mediation, and not necessarily accurately define all the issues these statistics are indicative only.	

² *Franchising Australia 2004 Survey*, Griffith University, Service Industry Research Centre, L. Fraser & S. Weaven.

The Committee noted the finding of the Franchising Australia 2006 Survey that fewer than 2 percent of franchised units ceased to operate in 2005. This, according to Professor Lorelle Frazer, supports the notion that franchising failure rates are low³.

The Committee was made aware of a number of cases where the impact of the failure of a franchise or a franchisor had a major effect on the financial and emotional well being of those involved.

³ Frazer, Lorelle, Weaven, Scott, and Wright, Owen, *Franchising Australia 2006 Survey* (draft) Service Industry Research Centre, Griffith University

CHARACTERISTICS OF FRANCHISING

A franchise agreement is an agreement in which a person (the franchisor) grants to another person (the franchisee) the right to carry on the business of offering, supplying or distributing goods or services in Australia under a system or marketing plan substantially determined, controlled or suggested by the franchisor or an associate of the franchisor. Under the arrangement the operation of the business will be substantially or materially associated with a trade mark, advertising or a commercial symbol and before starting business or continuing the business, the franchisee must pay or agree to pay to the franchisor or an associate of the franchisor an amount.⁴ This fee may relate to the initial capital investment, goods or services, training or royalties of the business. The amount of any franchise fee can be specified in the franchise agreement, or incorporated into the price for goods sold to the business.⁵

Franchises generally share the following elements:

- a contractual business agreement which can be written, oral or implied;
- the franchisor granting to the franchisee the right to carry on a business under a system or marketing plan that is provided and controlled by the franchisor;
- the business is conducted under a trade mark, advertising or symbol owned or licensed (or specified) by the franchisor; and
- the franchisee pays the franchisor, often by way of an initial license fee and in ongoing royalties.

There are different types of franchises: product plus tradename franchises, where franchisees are granted the right to distribute a manufacturer's product within a specified territory or at a specific location, usually under the manufacturer's trademark (examples are fuel depots and new car sales yards); and the business format franchise, which is the most common type, and generally involves each individual outlet operating under a common trademark according to a standard system of management, appearance and quality of goods (for example food outlets). Franchising is most intensive in the retail non-food industry followed by the property and business services sector.⁶

About two thirds of franchisors have adopted master franchising (also known as sub-franchising) arrangements in their Australian operations.⁷

Franchisees operate from diverse locations, including home, retail site or mobile operations.⁸

Slightly more than one quarter of Australian based systems are currently franchising internationally.⁹

⁴ Trade Practices (Industry Codes – Franchising) Regulations 1998

⁵ ACCC The franchisees guide November 2001

⁶ Lorelle Frazer, *Franchising Australia 2006 Survey*, p10

⁷ Lorelle Frazer, *Franchising Australia 2006 Survey*, p11

⁸ Lorelle Frazer, *Franchising Australia 2006 Survey*, p11

⁹ Lorelle Frazer, *Franchising Australia 2006 Survey*, p11

INTRODUCTION

The Franchising Code of Conduct – Historical information

Draft Franchise Agreements Bills were developed in 1986 but subsequently lapsed. In response to continuing calls for Government intervention, a voluntary Franchising Code of Practice (FCP) was developed in 1993. The FCP was designed to improve standards of behaviour in the franchising industry by providing standards of disclosure, cooling off periods and access to dispute resolution mechanisms. It was administered by a company limited by guarantee, the Franchise Code Council (FCC), which was also responsible for developing modifications to the FCP.

The FCP was widely viewed as ineffective. Even where franchisors did register as agreeing to comply with the FCP, there was no assurance that they complied with all of its provisions. Government funding for the FCC was removed and the FCP lapsed in 1996 as a result.

In May 1997 the House of Representatives Committee on Industry, Science and Technology delivered a report on fair trading in Australia. The report, *Finding a Balance*, dealt with franchising problems in detail.

The Committee identified numerous problems experienced by small business. Problems in the franchising sector related to:

- unfair contract terms arising from a refusal of big business to negotiate the terms and conditions of contracts;
- complexity of documentation;
- lack of pre-contract disclosure, resulting in an inability to make informed decisions about the viability of an enterprise;
- the inadequacy of advice and education for small business; and
- the prohibitive costs of, and the long delays involved in, legal action, inhibiting small business access to justice.

The Committee recommended the development of specific franchising legislation, and argued that the legislation should provide for adequate disclosure documentation, the establishment of appropriate independent code administration bodies, and dispute resolution procedures.

The task of preparing and advising on the content of the new Code was given to the Franchising Policy Council (FPC) comprising three franchisors, three franchisees, two advisers and an independent Chair. In its September 1997 *New Deal: Fair Deal* statement the Government announced a mandatory Franchising Code of Conduct, prescribed under the *Trade Practices Act 1974* (TPA).

The Code was prescribed on 1 July 1998 under the TPA and as such has the force of law. It became fully operative from 1 October 1998. It is administered by the Australian Competition and Consumer Commission (ACCC) with the Minister for Small Business and Tourism, the Hon Fran Bailey MP, having Ministerial responsibility for the Code.

The Code is designed to ensure that franchisees are given information that is material to the running of the franchised business, and provide access to a fast and relatively inexpensive way to resolve any disputes. Broadly, it achieves this by requiring franchisors to disclose specific facts to franchisees and to follow set procedures in their dealings with franchisees. For instance, if a dispute arises, either party can require the other to attend mediation.

To support the dispute resolution aspects of the Code the Government established the Office of the Mediation Adviser (OMA) in 1998 to assist with the mediation of disputes between franchisees and franchisors. The OMA appoints qualified and experienced mediators to help franchisors and franchisees resolve their problems and disputes without going to court. While the OMA provides an initial free and confidential discussion, the parties to the mediation are responsible for their own costs.

The First Review – December 1999 to May 2000

In the Budget Statements for 1999-2000, the Government announced that it would conduct a review of the Code. On 26 August 1999, the then Minister for Employment, Workplace Relations and Small Business, the Hon Peter Reith MP, announced that the FPC had accepted the task to review the Code. This review was conducted during the period 1 December 1999 to 31 May 2000.

The FPC was required to report on:

- the effectiveness of the Code in meeting its objectives;
- the success of the Code in raising standards of conduct within the franchising sector; and
- the costs of compliance with the Code and how these costs might be minimised.

The FPC made a number of recommendations for amendments to the Code.¹⁰ In relation to the disclosure provisions of the Code, the recommendations included:

- that the original Annexure 2 (mainly used for disclosure of information by a vendor franchisee to a prospective purchaser franchisee) be repealed;
- that a short form disclosure document for franchisees with an annual turnover of less than \$50,000 per annum be prescribed; and
- that international franchisors should be exempt from the disclosure requirements of the Code (only in situations where the franchisor has appointed an Australian master franchisee to make the necessary disclosures on its behalf).

The Government responded to the FPC's Report in October 2000. It agreed with the recommendations outlined above in relation to repealing Annexure 2 and introducing a short form disclosure document for small franchises. These amendments were effected by the *Trade Practices (Industry Codes – Franchising) Amendment Regulations 2001* (the 2001 Regulations). The short form disclosure document is now contained in a new Annexure 2.

¹⁰ See *Review of the Franchising Code of Conduct*, Report by the Franchising Policy Council (May 2000).

The 2001 Regulations also clarified the position of master franchisees in relation to disclosure requirements: before a master franchisee grants a sub franchise, both the franchisor and master franchisee must disclose the information required by the Code. A joint disclosure document is permitted.

Other amendments made by the 2001 Regulations in relation to disclosure include:

- the requirement for the franchisor to maintain a current disclosure document;
- an extension of the stated purpose of disclosure documents – the purpose of such documents is now not only to provide information about the franchise to prospective franchisees, but to give the franchisee “current information that is material to the running of the franchised business” (clause 6A of the Code); and
- the inclusion of additional “materially relevant facts” that must be disclosed by franchisors to franchisees (see clause 18 in Part 3 of the Code).

The operations of the Franchising Policy Council ceased over the period June to August 2002. The Office of Small Business established arrangements to accommodate any necessary industry consultative meetings. Consultation was held under these arrangements in the lead up to the current review.

THE CURRENT REVIEW

Establishment

It is important that businesses at both ends of the franchising system are able to operate with confidence and certainty. While the franchising industry is generally satisfied with the operation of the Franchising Code of Conduct (the Code), concerns have been raised with the Government about whether the disclosure provisions covered in Part 2 of the Code are working effectively. The Government has also received representations, particularly from franchisees, about the enforcement of the Code by the ACCC.

On 28 June 2006 the Minister for Small Business and Tourism, the Hon Fran Bailey MP, announced that the Australian Government would review the current operation of *Part 2 - Disclosure* of the Code. Mr Graeme Matthews, National Managing Partner, KPMG Middle Market Advisory, agreed to lead the review which was required to focus on the disclosure provision of the Code and to identify, where justified, possible amendments that could improve the disclosure provisions of the Code. Mr Matthews was supported by a team from Corrs Chambers Westgarth and a secretariat from the Office of Small Business within the Department of Industry, Tourism and Resources.

Terms of Reference for the Review

The Terms of Reference for the review were:

1. The Committee is to review the current operation of *Part 2 - Disclosure* of the Franchising Code of Conduct.
2. The Committee is to identify, where justified, possible amendments that could improve the disclosure provisions of the Franchising Code of Conduct.

In performing its functions, the Committee is to advertise nationally, consult with key stakeholders, receive public submissions, take into account overseas experiences, and seek the views of State and Territory Governments.

The Committee is to protect the confidentiality of the affairs of individuals and companies in the course of its deliberations, to the extent not inconsistent with its legal or accountability obligations.

The Committee was required to report by 30 September 2006. The Minister subsequently extended the reporting date to 31 October 2006.

Methodology

The Committee advertised the Review nationally, (**Attachment A**), consulted with a range of stakeholders, including the ACCC and the OMA, representative organisations and individual franchisees and franchisors, (**Attachment B**), considered overseas experience and regulatory regimes and sought the views of State and Territory government agencies.

Respondents were asked to confine their comments to issues relevant to the terms of reference and focus on providing:

- factual information regarding the operation of the disclosure section of the Code;
- views about the current form of the disclosure section of the Code.

Submissions closed on Tuesday 15 August 2006 with final submissions accepted up to Tuesday, 22 August 2006. To assist in obtaining the most relevant information authors of submissions were asked to clearly mark any material that they wished to be treated as confidential.

Seventy five submissions were received. Details of those submissions, except for those who requested that their submissions be treated in confidence, are at **Attachment C**.

THE CODE - CONTENT

The *Part 2 – Disclosure* provisions are an integral part of the Franchising Code of Conduct. Although this review is focused on Part 2, it is important to understand the role of each part of the Code and their relationship to Part 2. The following sections seek to explain the purpose of each of the four parts of the Code.

Part 1 – Preliminary

This Part sets out the name and purpose of the Code as well as its application. It also sets out all definitions, including the meaning of a "franchise agreement".

Part 2 – Disclosure

Franchisors are obliged to create and maintain a disclosure document (see clause 6 of the Code), in accordance with either Annexure 1 (long form) or Annexure 2 (short form). The short form disclosure document contains only 11 categories of prescribed information that must be disclosed to franchisees, rather than the 23 categories listed in the long form document (see **Attachment D**).

However, a franchisor who is entitled to provide a short form disclosure document in accordance with Annexure 2 may be asked by a prospective franchisee to provide any information from the remaining Annexure 1 items.

The Committee was provided with anecdotal evidence that suggests that the short form disclosure document is very rarely used.

Some of the matters required to be disclosed, pursuant to Annexure 1, include:

- current and past proceedings (including litigation and arbitration) against the franchisor and directors of the franchisor;
- information about the franchise site or territory;
- information about the supply of goods or services to and from a franchisee;
- information about marketing or cooperative funds to which the franchisee may be required to contribute;

- payments that will have to be made by the franchisee in relation to the franchise;
- a summary of some of the significant provisions of the franchise agreement (or references to those provisions if the franchise agreement is attached); and
- financial details of the franchisor.

The appropriate disclosure document and a copy of the Code must be provided to prospective franchisees and to franchisees proposing to renew or extend an existing franchise agreement at least 14 days before the prospective franchisee enters into, renews or extends the relevant franchise agreement or makes a non-refundable payment to the franchisor or an associate of the franchisor in connection with the proposed franchise agreement. A new disclosure document must be produced within three months after the end of each financial year after entering a franchise agreement.

The franchisor is not permitted to enter into, renew or extend a franchise agreement unless the franchisee or prospective franchisee gives the franchisor a statement to the effect that they have received, read and had the opportunity to understand the disclosure document and the Code. Further, before a new franchise agreement is entered into, the prospective franchisee must provide the franchisor with a signed statement that it has received independent advice about the proposed franchise agreement or franchise business, or alternatively that they acknowledge that such advice should be sought but have decided not to seek it.

Part 3 – Conditions of Franchise Agreement

This part of the Code provides for a number of other measures to be followed. Those that relate to the disclosure of information by franchisors include:

- the prohibition of a general release of the franchisor from liability to the franchisee;
- the imposition of obligations on the franchisor in relation to money paid for marketing or to another cooperative fund;
- the requirement for the franchisor to provide copies of lease documents to the franchisee (if relevant);
- the requirement for the franchisor to disclose “materially relevant facts” not mentioned in the disclosure document; and
- the requirement for the franchisor to give a franchisee a current disclosure document within 14 days of receiving a request from the franchisee.

Other non-disclosure aspects of **Part 3** of the Code include:

- a 7 day cooling off period following the signing of a franchise agreement;
- a prohibition of franchisor behaviour that would induce a franchisee not to form an association or not to associate with other franchisees for a lawful purpose;
- the regulation of the circumstances in which a franchisor may withhold consent to a franchise transfer; and
- the regulation of how and when termination of the franchise agreement is permitted. If the franchisee breaches the franchise agreement and the franchisor intends to terminate the agreement as a result, the franchisor must

notify the franchisee and allow a reasonable time for the franchisee to remedy the breach.

Part 4 – Resolving Disputes

This part of the Code mandates various aspects of the disputes resolution process including definitions, the appointment of a mediation adviser and procedures to be followed, including the inclusion of particular dispute resolution processes in franchise agreements.

THE CODE – CONSEQUENCES OF BREACHING PART 2

The Franchising Code of Conduct is a mandatory industry code prescribed under the *Trade Practices Act 1974* (TPA) and thus has the force of law. The ACCC is responsible for:

- investigating possible breaches of the competition and consumer protection provisions of the and, where appropriate, bringing proceedings against those suspected of breaching the Act;
- considering applications for immunity from the Act on a range of public interest grounds;
- arbitrating on disputes over access to essential facilities and in the telecommunications industry;
- assisting consumers who have suffered as a result of breaches of the Act to obtain compensation or redress;
- generally ensuring a culture of compliance with the Act through education and research.¹¹

This part of the report explains the consequences of breaching Part 2.

General

A breach of Part 2 of the Franchising Code of Conduct constitutes a breach of section 51AD of the *Trade Practices Act 1974* (Cth) (TPA) which reads:

“A corporation must not, in trade or commerce, contravene an applicable industry code.”

This section prohibits corporations from contravening mandatory industry codes, and voluntary codes where a corporation has bound itself to accepting that code, provided that such codes are prescribed under regulations made under section 51AE of the TPA.

Consequences of Breaches

Any person who suffers loss or damage as a consequence of a breach of section 51AD may:

- seek injunctions under section 80 of the TPA;
- seek remedial orders under section 87 of the TPA; and /or
- recover damages under section 82 of the TPA

There are no criminal sanctions for a breach of section 51AD.

Injunctions – section 80

¹¹ Miller, Russel V. Miller's Annotated Trade Practices Act. 2001/22nd Edition, 2001

On application from the ACCC or any other person, the Court may grant an injunction on such terms as the Court determines to be appropriate where it is satisfied that a person has engaged in, or proposes to engage in, conduct that contravenes, among others, section 51AD or where a person has:

- aided, abetted, counselled or procured such a contravention;
- induced, or attempted to induce, whether by threats, promises or otherwise, such a contravention;
- conspired with others to engage in conduct that would constitute such a contravention; or
- been in any way, directly or indirectly, knowingly concerned in, or party to such a contravention.

Damages – section 82

A person who suffers loss or damage by the conduct of another person that was done in contravention of section 51AD, may recover the amount of the loss or damage by action against that other person or any person involved in the contravention. The ACCC cannot bring an action for damages under section 82 on its own behalf, as it is not a person who suffers loss and damage by reason of a contravention of the TPA. Actions for damages pursuant to section 82, for breach of section 51AD must be brought within six years of the date on which the applicant suffered loss or damage.

Compensatory Orders – section 87

Where the Court finds that a person who is a party to proceedings for breach of section 51AD has suffered, or is likely to suffer loss or damage by conduct of the person being sued for that breach, the Court may make such orders as it thinks appropriate to compensate the first mentioned person in whole or in part for the loss or to otherwise prevent or reduce the loss or damage. The ACCC can make an application pursuant to section 87 for orders on behalf of individuals who have suffered loss or damage as a consequence of another person's breach of section 51AD. Actions for compensatory orders pursuant to section 87, for breach of section 51AD must be brought within six years of the date on which the cause of action accrues.

ACCC Enforcement Action

In its submission the ACCC indicated that, in its view, there were significant benefits to resolving franchisor/franchisee issues through alternative dispute resolution mechanisms. This approach facilitates ongoing business relationships and is not likely to damage the franchise in the way that court proceedings may.

The next stage if this option does not result in a resolution to the problem, is the appointment of an ACCC Investigation Officer. This officer's task is to seek further information from the complainant to substantiate their allegations. If adequate substantiation is received, the view of the other party involved in the dispute is sought.

Once information from both parties is received the ACCC considers if there may have been a breach of the Code. The ACCC then carefully considers the detriment caused by the conduct, whether:

- the conduct involves a blatant disregard of the law;
- the person, business or industry has a history of previous contraventions of competition or consumer laws;
- the conduct is of major public interest or concern;
- the conduct is 'industry wide' or is likely to become widespread if the ACCC does not intervene; and/or
- there is potential for action to educate and deter future conduct.

The ACCC can resolve enforcement matters through agreeing to an administrative resolution, accepting a court enforceable undertaking and/or litigation. See "Consequences of Breaches" above.

Since the introduction of the Code, the ACCC has commenced and successfully concluded litigation in 15 cases. All cases were found to be in breach of the TPA and the Code, and a variety of remedies were ordered by the courts including injunctions, court orders and the implementation of a trade practices compliance program.

Of these 15 cases, 14 involved a failure by the franchisor to fully comply with the disclosure provisions of the Code. Most cases involved situations where the franchisor did not provide disclosure documents to potential franchisees or, if the disclosure documents were provided, they were misleading or inadequate. Some of these cases also involved franchise systems that wrongly represented themselves as distributorships or licence agreements, to avoid the stringent requirements of the Code.

RELATED AUSTRALIAN LAW

In addition to any rights that may exist under the Code, franchisees' available legal remedies for a franchisor's inadequate or inaccurate disclosure may include:

- the prohibitions on misleading and deceptive conduct and on false and misleading representations in sections 52 and 53, respectively, of the TPA and in the equivalent State and Territory *Fair Trading Acts*;
- the common law and, in the Australian Capital Territory and South Australia, the legislation relating to innocent misrepresentations;
- the common law of tortious misrepresentation;
- the common law of fraudulent misrepresentation;
- the prohibition on unconscionable conduct at law and as contained in sections 51AA and 51AC of the TPA;
- the doctrine of equitable estoppel;
- the equitable doctrine of undue influence; and
- the express written terms and any pre-contractual statement by the franchisor in the nature of a term.

The rights and remedies described above are not necessarily mutually exclusive and there will be instances where a franchisee may be entitled to rely on several rights of action.

AN INTERNATIONAL PERSPECTIVE

By way of background, the Committee considered the regulation of the franchising industry in a number of overseas jurisdictions. Jurisdictions considered by way of example included the USA (Federal, State and the Uniform Franchise Offering Circular), a number of European systems including France, Italy and voluntary codes of conduct prescribed by the British Franchise Association and the European Franchise Federation. Vietnam and Malaysia were considered as a sample from South East Asia. The Canadian province of Ontario and a model franchising law proposed by the International Institute for the Unification of Private Law (UNIDROIT) were also considered. These examples were considered to be an adequate sample of current regulation of the franchise industry.

Disclosure is a key issue in all of the examples reviewed, as it is in Australia. However, the approaches taken and the degree of regulation and compliance monitoring vary considerably between jurisdictions.

By way of comparative example, US jurisdictions generally require quarterly revisions, fully audited financial statements and more information on franchisees that have been terminated, cancelled or not renewed. In Europe, under the European Code of Ethics for Franchising (ECE), the disclosure requirements are much less stringent while in Italy, failure to disclose by either party can result in annulment of the franchise agreement.

Malaysia prohibits unfair discrimination between franchisees, including when supplying goods to different franchises. Both Malaysia and Vietnam provide for a system of registration.

Under the model law proposed by UNIDROIT the franchisee only has to acknowledge receipt of the disclosure documentation if the franchisor asks for it and in Ontario (Canada) the franchisor has to certify that they have provided all the information required by the legislation.

Further details of the features of each of the jurisdictions reviewed by the Committee is provided at **Attachment E**. This attachment compares how each jurisdiction treats disclosure and issues such as registration requirements, good faith and fair dealing, requirements to obtain advice, termination and renewal, payments to franchisors and advertising of franchises and promotional funds.

DISCLOSURE – OPERATION AND RECOMMENDATIONS

Introduction

Many respondents considered that there was a high level of awareness of the Code in the franchising industry and that the Code has had a positive impact on that industry. However suggestions ranged from recommendations for no alterations to those for significant changes.

A number of submissions related to incomplete or inaccurate information in disclosure documents. It was also suggested that there did not appear to be any process for the administrator of the Code to ensure that disclosure documents complied with the Code until after a complaint was lodged. There was some suggestion that even when problems with the disclosure process were identified and either went to mediation or were referred to the ACCC, limited follow up action was taken to address the concerns of the franchisee. In the case of mediation conducted by the OMA, due to confidentiality issues, there is no system in place to monitor or review the implementation of the results of the mediation. However in the majority of resolutions the two parties sign an agreement.

The Committee considers that a number of changes could be implemented to augment the level and extent of disclosure and oversight of this aspect of the Code. These options and subsequent recommendations are provided below. Where possible specific recommendations are provided for amendments to the Code to achieve these recommendations.

The recommendations are divided into three parts:

- Recommendations directly pertinent to Part 2 and Annexure 1;
- Recommendations directly pertinent to Parts 1 and 3; and
- Other recommendations and observations pertinent to disclosure.

An appendix contains recommendations that the Committee made regarding some inconsistencies that it observes in the Code.

NOTE:

- When applicable changes to Annexure 1 also relate to Annexure 2.
- At least some of the recommendations will have consequential changes to other provisions.
- The Committee recommends that sufficient time be allocated for franchisors to update disclosure documents to meet these recommendations.

Recommendations directly pertinent to Part 2 and Annexure 1

1. Requirement to include a complete franchise agreement

The Code requires a franchisor to give a current disclosure document to a prospective franchisee. According to Annexure 1 of the Code this must include summary conditions of the franchise agreement (see items 15,16 and 17). Some submissions reported that franchisors provided incomplete franchise agreements at the time the disclosure document was provided. In some instances the franchisee was given the complete document at the time of signing the franchise agreement and consequently insufficient time was allowed for them to consider the document. It was reported that in some cases the document provided for signing may have included additional provisions or changed provisions from those in the original draft. The Committee considers that whilst the 7 day cooling off period does provide some protection, the protection afforded is not adequate.

The Committee considers that it is appropriate for prospective franchisees to receive the franchise agreement in the form in which it is intended to be executed at the same time as they receive the disclosure document. The franchise agreement could be provided on the basis that it is commercial and in confidence.

The Committee noted that such a requirement is consistent with a number of the foreign franchising disclosure laws reviewed (Italy, France and United States – Federal being examples).

Recommendation 1

Clause 10 and item 17 of Annexure 1 of the Code be amended to require the franchisor to provide the franchise agreement in the form it is intended to be executed with the disclosure document.

2. Requirement to include copies of all associated agreements and contracts

Item 18 of Annexure 1 requires the franchisor to provide a summary of any requirements under the franchise agreement for the franchisee to enter into other agreements as a result of signing the franchise agreement. These include leases and sub-leases for premises, chattel leases or hire purchase agreements, guarantees, mortgage security deposits, confidentiality agreements and agreements not to carry out business in the area for a time after the franchise agreement is terminated.

The Committee was advised that the final form of such documents is sometimes not provided until after the franchise agreement is signed and their existence is only alluded to briefly during preliminary meetings or brushed off as not being of any significance. However, such agreements often have a major impact on the viability of the franchise and therefore need to be treated appropriately.

The Committee noted that the 7 day cooling off period does not provide adequate protection as the signing of these documents in their final form, under the current arrangement, may take place some time beyond the expiration of cooling off period.

In the interest of full disclosure and to allow the franchisee to seek advice on these agreements and their ramifications, the Committee considers that complete copies of such documents should be provided to the franchisee at least fourteen days before they are expected to sign the franchise agreement. This would provide the franchisee sufficient time to assess these documents before making a commitment.

It is noted that a similar provision is a requirement of the *Federal Trade Commission Rule on Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures*¹² in the USA.

Recommendation 2

Item 18 of Annexure 1 of the Code be modified to require the franchisor to provide copies of all related documents required by the franchise agreement to be signed by the franchisee, in the form they are intended to be signed with the disclosure document, or earlier, which would be at least 14 days before the franchise agreement is expected to be signed.

3. Requirement to include a Risk Statement

The Committee noted that some of the problems identified by the submissions may have been avoided if the prospective franchisee had a clearer understanding of the significant risks that were involved in becoming a franchisee. Significant risks may include decisions made by third parties relevant to the business (such as landlords, franchisor and franchisee associates), earnings projections, changing competition, franchisor rights to unilaterally amend the franchise agreement, franchisee rights and obligations on termination or expiration of the franchise agreement, economic cycles, legislative change, franchisor solvency, franchisor rights to unilaterally terminate the franchise agreement and a decision by the prospective franchisee not to take advice before entering into a franchise agreement.

The Committee considers that, if prospective franchisees are made aware of significant risks, such as those identified above, then they should be better informed in making their decision about entering a franchise agreement and will be better equipped to manage the risks.

In the Risk Statement the franchisor should identify known significant risks that could have a material impact on the franchisee. In recognition of the Committee's desire to keep the disclosure focused, relevant and concise, it is recommended that the ACCC be tasked with developing a prescribed Risk Statement format with disclosure requirements.

¹² *Federal Trade Commission Rule on Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures (FTC Rule) §436.*

In addition the committee notes that Clause 11 of the Code enables prospective franchisees to opt out of taking advice from an independent legal advisor, an independent business advisor or an independent accountant. The Committee is of the view that prospective franchisees are well advised to obtain as much information and advice as possible before entering a franchise agreement. Many submissions supported this view and noted the disadvantages to prospective franchisees who opted not to take such advice.

Whilst the Committee agreed that the taking of advice would, generally, be in the best interest of the prospective franchisee, it did not consider that the taking of advice should be mandated by the Code. Some franchisees, for example, have existing knowledge about franchises and franchising. The Committee recognised the importance of education in this regard and recommends that the risks of not taking advice be included in the Risk Statement and augmented in ACCC educational material.

Recommendation 3

The Code be amended to include a requirement for the franchisor to include a Risk Statement with the disclosure document.

The ACCC be tasked with developing a prescribed Risk Statement document with disclosure requirements.

4. Disclosure of section 87B TPA undertakings

Undertakings given by a party under TPA section 87B are voluntary and legally enforceable undertakings that the party may give to the ACCC in many different circumstances, including to settle or avoid proceedings alleging that the party has breached the TPA.

The Code in item 4.3 Annexure 1 requires the franchisor to disclose, in their disclosure document, the date of order or undertaking under section 87B of the TPA. However the franchisor is not required to advise franchisees of subsequent undertakings as they are for other proceedings by way of Part 3 clause 18(2) requirements. Since timely knowledge of the existence and content of 87B undertakings may be material to the ability of the franchisees to make informed decisions (whether prior to or after the franchise agreement is entered into), the Committee considers that such information should be included in the disclosure document and should also be disclosed within a reasonable time (but not more than 14 days) after the undertaking is given.

Recommendation 4

Part 3 clause 18(2) of the Code and item 4 of Annexure 1 to the Code be amended to include the requirement to disclose details of section 87B TPA undertakings within a reasonable time (but not more than 14 days) after the undertaking is given.

5. Rebates and other financial benefits

Item 9.1(j) of Annexure 1 of the Code requires franchisors to disclose whether the franchisor or an associate of the franchisor, will receive a rebate or other financial benefit from the supply of goods or services to franchisees, and whether any rebate or financial benefit is shared, directly or indirectly, with franchisees.

The Committee received submissions requesting that this clause be extended to include details of the amounts of the rebate or other financial benefit. The Committee considers that this extension should be made, as disclosure of this information would provide greater transparency to the relationships between the franchisor, franchisee and suppliers to the franchisee.

Recommendation 5

That item 9.1(j) of Annexure 1 to the Code be extended to include disclosure of the amounts or method of calculation of rebates or other financial benefits to the franchisor or an associate of the franchisor from the supply of goods or services to franchisees.

6. Auditing of marketing and other co-operative funds

The Committee noted concerns expressed in submissions about the operation and management of marketing and other co-operative funds. The concerns related to the lack of transparency in the management and application of such funds and the fate of the franchisees' contributions in the event of franchisor failure.

The Committee noted that franchisors have an option to seek approval from 75 per cent of their franchisees to avoid the requirement to have such funds audited. It was considered that this option sent the wrong messages to industry participants and that this option should be removed by deleting clause 17(2) of the Code. This would also require a consequent amendment to item 12.1(e) of Annexure 1.

Some submissions suggested that these funds should be placed in a trust account. This would ensure that these funds were not subsumed into the working capital of a franchisor and not lost in the case of franchisor failure. However requiring these funds to be placed in a trust account would potentially result in increased expense and require increased administration. This may adversely impact on funds available for marketing and other purposes.

As a compromise, the Committee proposes that the audit of marketing and other co-operative funds should be mandatory.

Recommendation 6

The annual financial statement of marketing or other co-operative funds, receipts and expenses prepared pursuant to clause 17 of the

Code be subject to compulsory annual audit by a registered company auditor.

7. Provision of audited financial information for the franchisor and the consolidated entity

The Committee considers that the provision of audited financial information for the franchisor, and if applicable, the consolidated entity to which it belongs could be important for a prospective franchisee in assessing the structure and financial viability of the franchisor (See also Recommendation 24). The Committee noted that several overseas jurisdictions mandate audited financial statements; these jurisdictions include the United States, Malaysia and the Province of Ontario in Canada. However the Committee also recognised that an obligation to provide audited financial information would impose additional cost burdens on franchisors and consequently, on franchisees and consumers through cost recovery.

There is currently insufficient evidence to fully evaluate the costs and benefits of mandating audits for the franchise sector. To better understand the extent to which financial statements are currently being audited and the degree to which this affects outcomes in the franchising sector, the Committee recommends that the ACCC collect and analyse further information, and reports and provides its recommendations in this area.

Recommendation 7

The ACCC, as part of the registration process (Recommendation 23), collect information on the extent to which franchisors' financial statements are currently audited and provided pursuant to item 20.3 of Annexure 1 of the Code.

The ACCC determine the extent to which any lack of audited financial statements is causing unsatisfactory outcomes for the industry particularly in respect to franchisor solvency disclosures.

The ACCC report to the Government on its findings and provide recommendations by 30 April 2007.

8. More information about past franchises

Concern about the availability of information regarding past franchises was expressed in a number of submissions.

The Committee considers that such information is an important element in the disclosure process because it may assist a prospective franchisee to obtain information regarding the viability of the franchise, practical issues in running the franchise business, and assistance provided by the franchisor. Further, the level of movement in and out of the franchise system and the reason for that movement is also likely to be relevant to a prospective franchisee.

In disclosing past franchisee details it is vital that the privacy of those franchisees who did not want their details disclosed be protected. The disclosure of information about past franchisees will need to comply with the *Privacy Act 1988* and confidentiality obligations.

The Committee considers that the onus should be on the franchisor to seek the approval of past franchisees to release their contact details to prospective franchisees. Where consent was not forthcoming, the franchisor would disclose the number of franchisees that declined to give consent.

Recommendation 8

Subject to compliance by the franchisor with Privacy Laws and the obtaining of relevant consents to disclosure, the Code be amended to require not just the numbers but also names, location and contact details relating to the franchisees corresponding to events listed in item 6.4 of Annexure 1. This could be included as an addendum to the disclosure document.

9. Qualifications of advisors

It was submitted to the Committee that the independent advisors referred to in clause 11 of the Code should be subject to a certification process about their franchising qualifications. The Committee recognises the importance of taking advice from a suitably qualified and competent person but did not form the view that this should necessarily require a certification process at this time.

The ACCC and peak industry associations undertake an important role in providing education and information resources for franchisees and franchisors. These resources should strengthen the message to prospective franchisees in particular that they should seek advice from suitable and independent franchise sector advisors.

Recommendation 9

The Government ask relevant peak industry bodies to raise the level of understanding of their members of the particular requirements connected with advising potential franchisees prior to them entering into franchisee agreements.

10. Disclosure of the business experience of all who have or may have management responsibilities.

Item 3.1 of Annexure 1 of the Code specifically excludes an executive officer from the class of persons about which a summary of relevant business experience in the last 10 years must be provided. The Committee is of the view that knowledge about the business experience of an executive officer is relevant to prospective and

existing franchisees and consequently that the executive officer exemption should be deleted from item 3.1 of Annexure 1.

The *Corporations Act 2001* does not define the term “executive officer” but the previous definition of that term (as used in the Corporations Law) referred to the concept of a person who is concerned in, or takes part in, the management of a body (regardless of the person’s designation and whether or not the person is a director of the body). Notwithstanding the omission of the definition of “executive officer” from the *Corporations Act 2001*, the previous definition as was used in the Corporations Law is appropriate.

Recommendation 10

That item 3.1 of Annexure 1 be amended to remove the executive officer exemption from the class of persons about which a summary of relevant business experience in the last 10 years must be provided.

That Item 2.6 of Annexure 1 be amended to substitute for the term “executive officer” (which is not defined in the *Corporations Act 2001*), the concept of a person who is concerned in, or takes part in, the management of the franchisor (regardless of the person’s designation and whether or not the person is a director of the franchisor).”

11. Opt out clause from providing information requested from Annexure 1

In accordance with item 11.1(a) of Annexure 2 of the Code, franchisors are required to give a statement to the effect that the prospective franchisee may ask for information referred to in various sections of Annexure 1.

Clause 6C of Part 2 obliges franchisors to provide this information "unless, in the circumstances, it is reasonable to withhold the information". It is the Committee’s view that if any of the additional information required under Annexure 1 is requested in accordance with clause 6C, then it should be provided.

The Committee’s view is that the opt out provision in clause 6C, as described above, should be deleted.

Recommendation 11

The opt out provision in Part 2 clause 6C be deleted.

Recommendations directly pertinent to Parts 1 and 3

There are clauses in Part 1 and Part 3 and that have a strong bearing on the disclosure provisions. The Committee considers it appropriate to submit its recommendations concerning these disclosure related sections.

12. Disclosure of materially relevant facts

The Committee received a number of submissions in relation to the time given to a franchisor to disclose "materially relevant facts" under the provisions of Part 3 clause 18(1) of the Code. The Committee understood that a change from 60 days to 14 days had been recommended by the first review in 2000. The Committee agrees with that recommendation.

Recommendation 12

Part 3 clause 18(1) of the Code be amended to require franchisors to disclose materially relevant facts within 14 days after the franchisor becomes aware of the facts rather than the present 60 days.

13. Exemption from application of the Code

The following exemption to the application of the Code is provided at clause 5(3)(a)(i) and (ii) of the Code:

"5 (3) However, this code does not apply to the franchise agreement:

(a) if the franchisor:

- (i) is resident, domiciled or incorporated outside Australia; and*
- (ii) grants only 1 franchise or master franchise to be operated in Australia".*

It was suggested to the Committee that this exemption should be removed from the Code because of problems that have arisen from foreign franchisors reselling the one franchise. As the Committee is of the opinion that franchise arrangements referred to in clause 5(3)(a)(i) and (ii) should be subject to the same disclosure requirements as other franchise arrangements, the Committee agrees with the suggestion.

Recommendation 13

The exemption to the application of the Code referred to in Part 1 clause 5(3)(a)(i) and (ii) be removed from the Code.

14. Franchises currently excluded from the Code

The following exemption to the application of the Code is provided at clause 5(3)(c) of the Code:

“5 (3) However, this code does not apply to the franchise agreement:

...

(c) if:

(i) the franchise agreement is for goods or services that are substantially the same as those supplied by the franchisee before entering into the franchise agreement; and

(ii) the franchisee has supplied those goods or services for at least 2 years immediately before entering into the franchise agreement; and

(iii) sales under the franchise are likely to provide no more than 20% of the franchisee's gross turnover for goods or services of that kind for the first year of the franchise.

The Committee's view is that the protection provided by the disclosure provisions should be afforded to all prospective and existing franchisees. The Committee sees no sufficient reason to exclude franchise agreements within the description of clause 5(3)(c).

Recommendation 14

Delete clause 5(3)(c).

15. Directors to disclose their convictions

The Committee was made aware of a recent ACCC investigation that indicated a need to consider a greater level of disclosure of prior criminal convictions for offences under the *Corporations Act 2001*. The relevant matter involved allegations of unconscionable conduct and complaints concerning the non-disclosure of the director's prior conviction for a criminal offence under the *Corporations Act 2001*.

As awareness that a director of a franchisor company has been convicted of an offence under corporate law may be relevant to existing and potential franchisees making informed business decisions, the Committee considers that the Code should be amended to require disclosure of this information.

Recommendation 15

Part 3 clause 18(2)(b) and (2)(d) and Annexure 1 item 4 of the Code be amended to include franchisor directors in the class of persons about which materially relevant facts must be disclosed and the scope of disclosure be extended to criminal convictions for non serious offences.

16. The right of unilateral termination to a franchise agreement

A number of submissions expressed concern about the unequal nature of a business relationship that allows a franchisor to unilaterally terminate a franchise agreement without any breach by the franchisee (a unilateral termination). Amongst the submissions there were calls for a guaranteed buy-back of franchise or other compensation or a prohibition on the right of unilateral termination.

Part 3 clause 22 contemplates franchise agreements that permit the unilateral termination of an agreement by a franchisor.

The Committee's view is that in many circumstances it would be unreasonable for a franchisor to unilaterally terminate a franchise agreement where there has been no breach by the franchisee.

If unilateral termination rights are to be held by a franchisor, the Committee considers that the franchisee's risks associated with these rights should be covered in the Risk Statement. In addition, it is important that the ACCC ensure that such risks are clearly spelt out in the educational material that they provide to prospective franchisees.

The Committee also sees merit in the franchise agreement providing for adequate franchisee compensation if unilateral termination rights are exercised, and in referring to such compensation in the disclosure document.

Recommendation 16

The Risk Statement and ACCC educational material refer to the risks associated with unilateral franchisor termination rights contained in Part 3 clause 22 of the Code.

Consideration also be given to removing or modifying the right of a franchisor to include in a franchise agreement the right to unilaterally terminate a franchise agreement. In the event that the right to unilaterally terminate the agreement is maintained, adequate franchisee compensation should be provided for in the franchise agreement and referred to in the disclosure document.

17. The right of unilateral change to a Franchise Agreement

Franchisors are currently able to include in the franchise agreement the right to unilaterally amend arrangements between themselves and franchisees.

The original Franchise Bills proposed that such clauses in a franchise agreement should be null and void.¹³

¹³Clause 22 of the original *Franchise Agreements Bill 1986* (Cth) declared void any provision in a franchise agreement or related agreement which permits a party to unilaterally vary provision in the franchise agreement or related agreement. See, Business Affairs Division of the Commonwealth Attorney-General's Department, *Consultative Paper and Franchise Agreements Bill 1986* (Cth), 62.

Franchise agreements which contain clauses enabling a franchisor to unilaterally amend arrangements with franchisees have the potential to adversely impact a franchisee. If rights of unilateral change are to be held by a franchisor, the Committee considers that the franchisee's risks associated with these rights should be covered in the Risk Statement. In addition, it is important that the ACCC ensure that such risks are clearly spelt out in the educational material they provide to prospective franchisees.

The Committee received submissions supporting the view that changes to a franchise agreement that have a materially adverse effect on a franchisee should not be allowed without the consent of the franchisee or at the least not without some form of appropriate compensation being paid to the franchisee. The terms and conditions of any such payment of compensation would necessarily have to be clearly spelt out in the disclosure document and the franchise agreement.

Recommendation 17

The Risk Statement and ACCC educational material refer to the risks associated with unilateral franchisor changes to franchise arrangements.

Consideration also be given to prohibiting unilateral changes by franchisors to arrangements with franchisees which have materially adverse effects on the franchisee without franchisee consent. In the event that the right to unilaterally amend financial arrangements with franchisees is maintained, adequate franchisee compensation should be provided for in franchise agreements and referred to in the disclosure document.

18. Prospective franchisees communication with existing franchisees

A number of submissions indicated that there are occasions when franchisors exert pressure on prospective franchisees not to communicate with past franchisees.

Clause 15 of the Code prohibits franchisors from inducing franchisees not to associate with other franchisees for a lawful purpose. However this clause does not expressly prohibit franchisors from inducing prospective franchisees not to associate with current or past franchisees. Thus the interests of prospective franchisees are not currently protected by clause 15.

The Committee considers that as the interests of current or past franchisees cannot be distinguished from those of prospective franchisees in this respect, clause 15 should also protect prospective franchisees.

Recommendation 18

Part 3 clause 15 of the Code be amended to include a reference to prospective franchisees after the references to franchisees.

Other recommendations and observations relevant to disclosure

In addition to the core recommendations appearing in the sections "Recommendations directly pertinent to Part 2, Annexure 1" and "Recommendations directly pertinent to Parts 1 and 3", the Committee considers it appropriate to submit other recommendations and observations which are relevant to disclosure under the Code.

19. General waivers of written representations

In its submission the ACCC referred the Committee to a recent Full Federal Court decision¹⁴ where the disclaimers, exclusion clauses and requirement to seek independent advice were sufficient to place the franchisees on notice that further investigation and qualification was required of representations regarding sales, profitability, site quality and other matters.

The ACCC was of the view that this determination may place franchisees in a vulnerable and disadvantageous position, as it was in the ACCC's experience that the decision of many prospective franchisees to purchase a franchise is influenced by prior written representations.

In its submission the ACCC suggested that this decision may encourage franchisors to use broad disclaimers in franchise sales literature to seek avoiding liability under the Code and the TPA, while placing a stronger onus and obligation on franchisees to verify information provided. The ACCC stated that this onus appears disproportionate considering that franchisors should be able to provide accurate and detailed information about a potential and existing franchise.

Accordingly, the ACCC recommended that the Committee consider a possible amendment to the Code to provide that franchise agreements contain no general waiver of written representations made to potential franchisees.

The Committee notes that it is not uncommon in business-to-consumer and business-to-business transactions for one or both parties to seek waivers, disclaimers and limitations or exclusions of liability in order to allocate risks. Moreover, it is possible that such a change may discourage franchisors who would normally make written representations as to sales, profitability, site quality and other matters (albeit with disclaimers) from providing any such written representations at all.

Recommendation 19

Consideration be given as to whether or not franchise agreements and disclosure documents should be prohibited by the Code from including any general waivers of written representations made to potential franchisees or franchisees seeking to extend their franchise agreements.

¹⁴ *Poulet Frais Pty Ltd v The Silver Fox Company Pty Ltd* (2005)ATPR 42-075

20. Clarity at the termination, expiry or non-renewal of an agreement

A number of submissions from franchisees and ex-franchisees expressed concern about the consequences to them on termination, expiry or non-renewal of the franchise agreement. Other stakeholders also suggested that further clarity on this matter would be beneficial. Clause 17 of the Code requires a summary of the conditions of the franchise agreement (or a reference to the relevant conditions of the franchise agreement) that deal with franchisee obligations when a franchise agreement is terminated, expires or is not renewed. Recommendation 1, if adopted, will require the franchisor to provide the franchise agreement in the form it is intended to be signed with the disclosure document.

Consequently, compliance by the franchisor, in the franchise agreement, to the requirements of clause 17 of the Code, will provide franchisees with the conditions dealing with termination, expiration or non-renewal of the franchise agreement. To further highlight the importance of this issue the Risk Statement should, if significant, also refer to the risks to the franchisee on termination, expiring or non-renewal.

Recommendation 20

The Risk Statement should, if significant, refer to the risks to the franchisee on termination, expiry or non-renewal of the franchise agreement.

21. Clarity in the event of franchisor failure

Concerns were expressed about the sufficiency of franchisor disclosure regarding franchisee rights and obligations if the franchisor fails. The Committee considers that these concerns can be addressed through the Risk Statement and ACCC educational material.

Recommendation 21

The Risk Statement and ACCC educational material should clearly describe the risks and consequences associated with franchisor failure.

22. Financial Details

In some instances the franchisor belongs to a consolidated entity comprising a number of legal entities. Clause 20 requires disclosure of financial details in respect of the franchisor but not, where applicable, the financial details of the consolidated entity to which it belongs.

The Committee considers that as financial information in respect of both the franchisor and, where applicable, the consolidated entity is relevant to prospective

and existing franchisees, this information should be disclosed as part of the requirements under item 20 of Annexure 1.

Recommendation 22

The requirement under item 20 of Annexure 1, to disclose financial details be extended, where applicable, to include the consolidated entity to which the franchisor belongs.

23. Registration and Review of Disclosure Documents.

A number of franchisees advised the Committee that they had not been given disclosure documents at all whilst some others advised that the disclosure document they had received was not in accordance with the Code. Additionally many of the concerns raised in the submissions may have been overcome if the degree of compliance with the disclosure provisions of the Code was improved. The Committee formed the view that to address this issue, the registration of franchisors and review of a sample of disclosure documents should be introduced. The committee noted that recommendations for Registration and review of disclosure documents were received from a cross section of stakeholders. By comparison, in the USA the UFOC¹⁵ does not require registration but 14 states, which include California, require the disclosure document to be registered with their regulatory body. Registration is required before entering into a franchise agreement in Vietnam¹⁶ and before making an offer to sell a franchise in Malaysia.¹⁷

The Committee considers that franchisors should be required to register with the ACCC and annually provide the most current disclosure document and other minimum prescribed information (to be determined by the ACCC). The ACCC should be tasked with performing representative sample audits of disclosure documents each year and addressing any failures to comply with the disclosure provisions of the Code. The Code should be amended to allow the ACCC to ask for a copy of a disclosure document for assessment outside the provisions of Section 155(1) of the TPA.¹⁸

The ACCC should also be tasked to perform an active enforcement role including vetting disclosure documents and addressing failure to comply with the Code.

Recommendation 23

The Government implement a mandatory process of franchisor registration and annual lodgement of the most current disclosure document and other prescribed information. Sample audits of disclosure documents would be undertaken with appropriate

¹⁵ United Franchise Offering Circular (UFOC).

¹⁶ Investment and Trade Promotion Centre, *Trade Ministry Circular n° 9-2006-TT-BTM dated May 25, Article 17-23.*

¹⁷ Malaysian Parliament, *Act 590 - Franchise Act 1998 (section 6(1)).*

¹⁸ Clause 155(1) Grants power to the ACCC to obtain information documents and evidence if they believe that there has been a contravention of the TPA.

enforcement of the Code. The process would be administered by the ACCC.

24. The current level of ACCC action relating to franchising

The administration of the Code by the ACCC is a key element in ensuring that franchisors are complying with the disclosure provisions of the Code.

A number of submissions from franchisees expressed concern about the level and extent of action by the ACCC to deal with claims of breaches of the Code by franchisors. Some submissions, from franchisees and ex-franchisees expressed disappointment that the ACCC did not launch investigations into their cases.

Notwithstanding the concerns expressed by a number of franchisees who made submissions, the Committee notes that the ACCC demonstrated that it has been active in promoting the Code. In its submission, the ACCC advised that their Small Business Team provides regular information to national and state industry bodies and business service providers about trade practices issues. In addition to general liaison the ACCC has established a Franchising Consultative Panel which meets twice a year and provides a forum to identify emerging industry issues, and a mechanism for developing specific compliance tools to assist franchisors and franchisees in understanding their rights and obligations under the TPA and the Code. Since 2001-02 the ACCC has received approximately 1300 complaints and inquiries relating to the Code; approximately 260 of these have concerned disclosure documents. Since the introduction of the Code, the ACCC has commenced and successfully concluded litigation in 15 cases, where 14 related to the disclosure provisions of the Code.

Recommendation 24

The Government appraise the ACCC of concerns expressed to the Committee about the level and extent of action by the ACCC in dealing with claims of breaches of the Code by franchisors.

25. Implementation of the principle of good faith and fair dealing

A number of the reviewed foreign jurisdictions have either a general concept of good faith in commercial contracts or a specific concept of good faith which applies to franchise agreements, e.g. in the context of pre-contractual negotiations and in mediation of disputes. (See Attachment E)

In Australia, some courts have accepted, to some degree, the implication of obligations of good faith in contractual dealings. For instance, it has been suggested that good faith embraces three notions: an obligation on the parties to cooperate in achieving their contractual objects, compliance with honest standards of conduct and compliance with standards of conduct which are reasonable having regard to the interests of the parties. However, uniform acceptance and

understanding of concepts, content and implications of good faith obligations has not emerged in the Australian jurisdictions.¹⁹ (See Attachment F)

The concept has been included in the voluntary Motor Vehicle Insurance and Repair Industry Code of Conduct 2006. In this case insurers and repairers have agreed to "*observe high standards of honesty, integrity and good faith in conducting their business with each other and in the provision of services to claimants*".²⁰

The interdependency between franchisors and franchisees is fundamental to the franchise sector. Notwithstanding the various legal remedies already available to both franchisors and franchisees under various laws including the *Trade Practices Act 1974* (see Attachment F), the Committee considers that recognition in the Code of a concept of good faith and fair dealing would provide positive reinforcement to the development of improved relationships and dealings between franchisors, franchisees and prospective franchisees.

Recommendation 25

A statement obligating franchisors, franchisees and prospective franchisees to act towards each other fairly and in good faith be developed for inclusion in Part1 of the Code.

26. Standardisation of the audit period

The Committee is of the view that the audit period referred to in clause 6(1) should align with *Corporations Act 2001* audit period. This will improve consistency with other statutory requirements.

Recommendation 26

The audit period referred to in Part 2 clause 6(1) of the Code be aligned with the *Corporations Act 2001* audit period.

27. Avoidance of providing the details and history of the territory or site to be franchised together with the disclosure documents

Annexure 1 item 11.2 requires details and history of the territory or site to be franchised to be provided in the disclosure document. Annexure 1 item 11.3 states that "The details mentioned in item 11.2 may be in a separate document and may be made available for inspection at a time and place mentioned in the disclosure document."

¹⁹ The Hon Justice James Douglas "Exploring the Recent Uncertainty Surrounding the Implied Duty of Good Faith in Australian Contract Law: the Duty to Act Reasonably - Its Existence, Ambit and Operation" <http://www.cisq.law.pace.edu/cisq/biblio/douglas1.html> (accessed 12 October 2006)

²⁰ *Motor Vehicle Insurance and Repair Industry Code of Conduct (June 2006)*; page 7.

Whilst accepting that the required information may be provided by way of a separate document the Committee's view is that the information should be provided with the disclosure document.

Recommendation 27

Item 11.3 of Annexure 1 of the Code be amended to require the details mentioned in item 11.2 to be in a separate document which is provided with the disclosure document.

Appendix

During the review of the disclosure provision of the Code, the Committee made the following additional observations regarding inconsistencies and areas for clarification.

28. Clarification of "other payments"

Property payments can be major expenses to franchisees. A number of submissions commented on the failure to provide adequate information about rental and other property expenses.

The Committee therefore sees the need to clarify that the "other payments", which must be disclosed pursuant to Annexure 1 item 13.6, include lease related payments. This should be done by stating that the definition of "associate" in clause 3(1)(b) also applies to persons who supply real property to franchisees.

Recommendation 28

Part 1 clause 3(1)(b) include the words "real property" so that it reads:

**"associate, for a franchisor, means a person...
(b) whose relationship with the franchisor is relevant to the franchise system, including supplying goods, real property or services to a franchisee."**

29. Consistency with regard to attaching a copy of the Code to the disclosure document

As a result of its study of the Code, the Committee noted an inconsistency with regard to instructions for a copy of the Code to be supplied together with the disclosure document. Item 22.2 of Annexure 1 currently reads "Copy of the Code may be attached." This is inconsistent with clause 10 of the Code, which requires that a copy of the Code "must" be attached.

Recommendation 29

That Item 22.2 of Annexure 1 be deleted.

30. Clarification of "extend"

A number of submissions sought clarification as to whether the word "extend" in this clause refers to an extension in "term" only or term and "scope". Part 2 clause 6B (1) currently uses the phrase "a franchisee proposing to renew or extend a franchise agreement." The Committee formed the view that this should be clarified because "extend" is used in a number of clauses, eg, clauses 10 and 11. The Committee favours the inclusion of "scope" in order to define the provision in a

broader sense than “term”, however, suspects that the original intention was that clause 6B is limited to “term”.

Recommendation 30

Part 2 clause 6B (1) be amended to read:

"(1) A franchisor must give a current disclosure document to:

- (a) a prospective franchisee; or**
- (b) a franchisee proposing to renew a franchise agreement or extend the scope or term of a franchise agreement".**

31. Clarification of the time frame for the measure used to determine the use of the Annexure 1 or Annexure 2 disclosure documents

Concern was raised about the meaning of the time frame in Part 2 clause 6(2) of the Code. The Committee saw the need to make clear the time frame that is used to determine the scale of franchised business according to which the required disclosure document is determined.

Recommendation 31

That in Part 2 clause 6(2) of the Code “at any time during the term of the franchise agreement” be added after “turnover” to clarify the time frame.

32. Definitions of "executive officer" and "officer"

Part 1 clause 3(2) directs the reader to consult "the *Corporations Law*" for a definition of the term "executive officer" and other terms is dated since the *Corporations Law* has been repealed and replaced by the *Corporations Act 2001*. The *Corporations Act 2001* does not use or consider the term "executive officer" nor does it provide a definition for this term.

Recommendation 32

That, in view of the repeal of the definition of “executive officer under the *Corporations Law*:

- (a) clause 6(2)(c) of the Code be amended to replace the term “executive officer” with the term “officer”;**
- (b) Item 2.6 of Annexure 1 be amended in accordance with Recommendation 10; and**
- (c) clause 3(2) of the Code be amended to delete the term “executive officer”, and the usage of that term in the rest of the Code and the Annexures be reviewed.**

33. Termination of the agreement and costs within the 'cooling off' period.

The Code is inconsistent regarding the cost to a prospective franchisee who terminates the agreement within the 'cooling off' period. Item 1.1 (d) of Annexure 1 and item 1.1 (e) of Annexure 2 both allow for the prospective franchisee to "terminate the agreement without cost" if this is within the "7 day 'cooling off' period after signing the agreement" while Part 3 clause 13 (4) states that "the franchisor may deduct from the amount paid under subclause (3) the franchisor's reasonable expenses if the expenses or their method of calculation have been set out in the agreement".

Recommendation 33

Add the intention of Part 3 clause 13 (4) to items 1.1 (d) of Annexure 1 and item 1.1 (e) of Annexure 2.

34. Relevance of "site" and "premises"

Some confusion has arisen in relation to inconsistent language in the Code. The Committee is of the view that the scope and clarity in Annexure 1 item 16.1(a) and 1.61 (j) should be improved in relation to the terms "site" and "premises".

Recommendation 34


Add a reference to "and premises" after "site" in Annexure 1 item 16.1(a), so that it reads:

"site and premises selection and acquisition"

Add a reference to "site and" before "premises" in Annexure 1 item 16.1(j), so that it reads:

"maintenance and appearance of site and premises, vehicles and equipment"

ATTACHMENT A – ADVERTISING



Australian Government
Department of Industry
Tourism and Resources

Review of the Disclosure Provisions of the Franchising Code of Conduct Call for Submissions

The Franchising Code of Conduct began operation in October 1998. It is a mandatory code under the *Trade Practices Act 1974*. The Australian Government is undertaking a review of *Part 2 - Disclosure* of the Code which covers the information that franchisors must disclose to franchisees and prospective franchisees.

Industry participants and interested parties are invited to provide submissions to the review by close of business on Tuesday, 15 August 2006. Submissions should be confined to issues relevant to the terms of reference and should focus on providing factual information regarding the operation of the disclosure section of the Code and views about the current form of the disclosure section. Further information about the review, including the terms of reference may be obtained by following the small business link on the Department of Industry, Tourism and Resources' web site at www.industry.gov.au.

Submissions can be sent to:

Secretary
Review of the Franchising Code of Conduct
Office of Small Business
Department of Industry, Tourism and Resources
GPO Box 9839
CANBERRA ACT 2600

Or by email to Franchise.Review@industry.gov.au

hwaCD4951

WWW.INDUSTRY.GOV.AU

Publications Used

26 July 2006

Australian Financial Review
The Australian
Adelaide Advertiser
Brisbane Courier Mail
Sydney Morning Herald
The Melbourne Age
West Australian
Hobart Mercury
NT News
Canberra Times

ATTACHMENT B – LIST OF STAKEHOLDERS CONSULTED

List of stakeholders with whom the Committee held direct consultation

ACCC (Mr John Martin, Commissioner)

Office of the Mediation Adviser (Mr David Newton (OMA) and Ms Bianca Keys)

Franchise Council of Australia (Mr Richard Evans, Chief Executive Officer)

Baker & McKenzie (Ms Penny Ward)

National Retail Association (Mr Gary Black)

Yum group (Ms Michelle Davies, Legal Counsel and Craig Kaywood)

Michael and Benjamin Morris (ex-Danoz franchisees)

National Federation of Independent Business (Mr John Farrell and Ms Pamela Ayson)

University of New South Wales (Professor Andrew Terry)

Mr Tony Melham (Gloria Jeans franchisee)

BCI Business Brokers (Mr Tony Arena, Managing Director)

ATTACHMENT C – LIST OF SUBMISSIONS

No.	Company
1	Spectrum Analysis
2	Former Donut King franchisee
3	Former franchisee
4	Former Midas franchisee
5	Permac Pty Ltd (Lenard's master franchisor)
6	Baker's Delight
7	Baskin Robbins franchisee
8	Former Midas franchisee
9	Former franchisee (chicken industry)
10	Former Michel's <u>Patisserie</u>
11	Northvue
12	Just Cuts
13	Lenard's
14	Aussie Pooch Mobile
15	United Franchisees Inc. (Victorian 7-Eleven Franchisees Association)
16	Jim's Group
17	Bill Winter Business Development
18	Franchisees Association of Australia
19	Former Baker's Delight franchisee
20	Foodco Group Pty Ltd
21	Midas franchisee
22	Federal Chamber of Automotive Industries
23	Baskin Robbins franchisee
24	Australian Retailers Association
25	Spinner's Building Services franchisees
26	Former Power Loan franchisee
27	Former franchisees
28	Former Thrifty franchisee
29	Australian Couriers
30	Bond University
31	Youth and Enterprise Legal Centre
32	IF International Group
33	Franchisee (chicken industry)
34	Former Lenard's franchisee
35	Mortgage Choice
36	Former Michel's <u>Patisserie</u> franchisee (additional to submission no. 10)
37	Former Lenard's franchisee
38	Former franchisee
39	The Iceberg Corporation Pty Ltd
40	Confidential
41	Baker's Delight franchisee
42	Franchisee (travel industry)
43	Doxa International
44	Cartridge World

No.	Company
45	University of NSW (Faculty of Commerce and Economics)
46	Motor Trades Association of Australia
47	Former franchisees
48	Former franchisee
49	Robert James Lawyers
50	Hertz Licensee Council
51	Confidential
52	National Retail Association
53	GHB Property Services
54	Franchise Council of Australia
55	Post Office Agents Association Limited
56	Acheson Franchise Advisors
57	Former franchisees Danoz Directions Pty Ltd
58	Baker McKenzie
59	Queensland Law Society
60	Former Midas franchisee
61	Former Jani-King franchisee
62	US Attorney at Law
63	Former Lenard's franchisee
64	CPA Australia
65	ACCC
66	National Federation of Independent Business Inc
67	Phillips Fox
68	Small Business Development Corporation (Western Australia)
69	Department of State Development, Trade and Innovation, (Queensland)
70	Department of Trade and Economic Development(South Australia)
71	Chairman, Farm & Industrial Dealers Association (Victoria)
72	Northcoats Pty Ltd
73	Quindar Pty Ltd formally trading as Jim's Antennas Central Coast.
74	Il Gianfornaio, franchisee
75	Il Gianfornaio, former franchisee

ATTACHMENT D – LONG AND SHORT DISCLOSURE

Differences between the Long Form and Short Form Disclosure Documents are evident from the following table.

Long Form	Short Form
1. First Page	1. First Page
2. Franchisor's Details	2. Franchisor's Details
3. Business Experience	
4. Litigation	3. Litigation
5. Payment to agents	
6. Existing franchises	
7. Intellectual property	4. Intellectual property
8. Franchise site or territory	5. Franchise site or territory
9. Supply of goods or services to a franchisee	
10. Supply of goods or services by a franchisee	
11. Sites or Territories	
12. Marketing or other cooperative funds	6. Marketing or other cooperative funds
13. Payments	7. Payments
14. Financing	
15. Franchisor's obligations	8. Franchisor's obligations
16. Franchisee's obligations	9. Franchisee's obligations
17. Summary of other conditions of agreement	
18. Obligation to sign related agreements	
19. Earnings information	
20. Financial details	10. Financial details
21. Updates	
22. Other relevant disclosure information	
23. Receipt	11. Receipt

The prospective franchisee may ask the franchisor for all of the information in the Long Form that is not listed in the Short Form (i.e. items 3, 5, 6, 9, 10, 11, 14, 17, 18, 19, 21 and 22)

ATTACHMENT E – FOREIGN FRANCHISING LAWS

The Committee considered publicly available material for a number of foreign jurisdictions (including model laws established by particular organisations) as background information:

- The USA (Federal);
- The USA (Uniform Franchise Offering Circular);
- The USA (California);
- European Franchising Federation;
- The United Kingdom;
- Italy;
- France;
- Malaysia;
- Vietnam; and
- UNIDROIT (Model Franchise Disclosure Law)

The summary of these jurisdictions provided below is not intended to be a comprehensive analysis or description of the franchising laws for each jurisdiction. Rather, it seeks to highlight some similarities and differences between the selected jurisdictions in relation to disclosure and associated requirements for franchises. The experiences of the reviewed jurisdictions and their varying approaches to franchise regulation provide a helpful guide to considering issues relevant to the review.

Disclosure in the Reviewed Jurisdictions

Disclosure is a key issue in all of the jurisdictions reviewed; however, it has been approached in a number of different ways, ranging from minimal disclosure regulation through to the requirement that a disclosure document be registered and vetted before a franchise can be offered for sale. The summary set out below highlights some of the key disclosure requirements in the reviewed jurisdictions.

The USA has both Federal and State franchising laws, the State laws can either be unique to a State or as is the case with the Uniform Franchise Offering Circular (UFOC) adopted by a group of States.

USA (Federal)

In 1979 the USA introduced the *Federal Trade Commission Rule on Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures (Title 16, Part 436 of the Code of Federal Regulations)* (FTC Rule).²¹

The FTC requires that a franchisor provide a prospective franchisee with a disclosure statement either at the first personal meeting²², or 10 business days

²¹ Federal Trade Commission, *Federal Trade Commission Rule on Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures* (1979) <<http://www.ftc.gov/bcp/franchise/16cfr436.htm>> last accessed 7 September 2006.

prior to the execution of the franchise agreement or any other agreement imposing a binding legal obligation on the prospective franchisee, or the payment by the prospective franchisee, about which the franchisor²³ knows or should know, of any consideration in connection with the proposed sale of a franchise (which ever occurs first). The franchisor is also to prepare quarterly revisions to reflect any material change in the franchisor or relating to the franchise business which are to be attached to the disclosure document.

It is also noted that the *Uniform Commercial Code (UCC)* imposes an obligation of good faith on the performance and enforcement of all contracts.²⁴

The FTC Rule requires franchisors to include a wide range of items in the disclosure statement. Some items worth highlighting include:

- details of which, if any, directors and executive officers are subject to any currently effective injunctive or restrictive orders or are parties to currently pending proceedings where such orders are sought, relating to franchise activities, the franchisor-franchisee relationship or involving fraud, embezzlement, fraudulent conversion, misappropriation of property or restraint of trade;
- the names, addresses and phone numbers of the 10 nearest franchised outlets of the same franchise;
- general categorisation of the reasons for franchisor re-acquisition, refusal to renew or termination of franchises in the relevant franchise network;
- the business experience of the franchisor and the franchisor's parent firm (if any) in relation to the franchise;
- a statement of the total funds which must be paid by the franchisee to the franchisor or to a person affiliated with the franchisor or collected by a franchisor or affiliate for a third party;
- financial statements which have been examined in accordance with generally accepted accounting standards by an independent certified or licensed public accountant. Further, the FTC Rule only allows for the disclosure of unaudited financial statements in limited circumstances. Where unaudited statements are used they must be accompanied by a clear and conspicuous disclosure that they are unaudited and that final statements prepared on an audited basis will be made available as soon as practicable.

Along with the disclosure document, the FTC Rule requires that a franchisor must also provide a prospective franchisee with a copy of the franchise agreement and all related agreements to be executed by the parties at least 5 business days prior to the expected date of execution.

²² A "personal meeting" is a face to face meeting between a franchisor or franchise broker (or any agent, representative, or employee thereof) and a prospective franchisee which is held for the purpose of discussing the sale or possible sale of a franchise.

²³ This will include any franchise broker, or agent, representative or employee of the franchisor.

²⁴ See §1-304 of the UCC. Further, §1-201(b)20 defines good faith as "honesty in fact and observance of reasonable commercial standards of fair dealing." Also note, the UCC only has the force of law if enacted by States. See Cornell Law School, *Uniform Commercial Code* (2003) < www.law.cornell.edu/ucc/ucc.table.html > last accessed on 27 September 2006.

USA (Uniform Franchise Offering Circular (UFOC)).²⁵

Franchisors in the USA have a choice of formats for making the disclosures required by the FTC Rule. They may use either the format provided by the FTC Rule or the UFOC format. State franchising laws may also require disclosure documents to be in the form of the UFOC (see comments on California below).

The UFOC is a model disclosure document. The circumstances under which it is necessary to create a disclosure document in the form of the UFOC will vary depending on whether the FTC Rule or a particular state law is being applied. The UFOC also provides example clauses for agreements. The UFOC provides for a copy of all agreements regarding the offering of a franchise to be attached. This includes the franchise agreement and related agreements such as any leases, options and/or purchase agreements. However as is the case in Australia the UFOC does not require franchisors to include an earnings claim.

USA (California)

Corporations Code §§31100-31516²⁶ and *California Code of Regulations, Title 10 Chapter 3, Subchapter 2.6* (Regulations)²⁷

The *Corporations Code* provides for a franchise registration system in California. It is unlawful for any person to offer or sell any franchise in California unless the offer is registered with the California Corporations Commissioner or alternatively deems to fall into one of the categories of exemption set out in the *Corporations Code*.²⁸ Where registration is required a franchisor must create a disclosure document consistent with the UFOC. Thus, the content of a disclosure document will be the 23 items required by the UFOC.²⁹ A franchise which is exempt from registration on the other hand is only required to disclose 16 items set out in §31101(c)(3)(1) of the *Corporations Code*.

Set out below are a number of noteworthy features of the Californian disclosure regime:

- If there is a failure to comply with the *Corporations Code*, registration can be revoked or suspended;
- It is unlawful for any person wilfully to make any untrue statements or omissions of a material fact in any application, notice or report filed with the Commissioner;³⁰
- Franchisees are not required to seek legal and financial advice regarding the disclosure document;

²⁵ The UFOC was created and adopted by the North American Securities Administration Association (NASAA). NASAA is an association of 67 state, provincial and territorial securities administrations in the 50 states of the United States of America, the District of Columbia, the U.S. Virgin Islands, Puerto Rico, Canada and Mexico. See North American Securities Administrators Association, *Uniform Franchise Offering Circular Guidelines* (1993) <http://www.nasaa.org/Industry___Regulatory_Resources/Uniform_Forms/3697.cfm> last accessed on 7 September 2006.

²⁶ Official California Legislation Information, *California Corporations Code* <<http://www.leginfo.ca.gov/>> last accessed on 6 September 2006.

²⁷ California Office of Administrative Law, *California Code of Regulations* <<http://www.calregs.com>> last accessed on 7 September 2006.

²⁸ Various exemption categories are set out in Chapter 1 of the Corporations Code (see §§31110-31109.1).

²⁹ State specific regulations may amend the UFOC to require further disclosures or allow for exemptions. The Californian Regulations, for example amend the UFOC in a number ways.

³⁰ See California Corporations Code, §§31200 -31203.

- Franchisees can sue for damages or rescission of the franchise agreement in cases when franchisors violate specified parts of the *Corporations Code*.
- Except for in a number of defined circumstances³¹, it is unlawful to solicit the agreement of a franchisee to a proposed material modification of an existing franchise without first delivering to the franchisee a disclosure document in a form and containing information required by the Commissioner;
- Annual disclosures are not required; however, notification of any material change is required;
- Financial statements should be audited except where the particular form (i.e., UFOC) permits the use of unaudited statements for interim periods or generally. In extraordinary cases the Commissioner may waive the requirement for audited statements if the statements have been prepared by an independent certified public accountant or independent public accountant and the Commissioner is otherwise satisfied as to the reliability of such statements and as to the ability of the franchisor to perform future commitments. It is unlawful to sell a franchise which is subject to registration without first providing a prospective franchisee at least 10 business days prior to the execution of a binding franchise agreement, or payment of any consideration by the prospective franchisee, with a copy of the disclosure document and a copy of all proposed agreements relating to the sale of the franchise;
- Registration of a franchise offering is to occur annually; and
- Franchisor must promptly notify the commissioner of any material change in the disclosure document.

France

*Law No. 89-100 of December 31, 1989 (the Loi Doubin) and Decree No 91-337 Implementing Law No. 89-100 of December 31, 1989 (1991) (the Decree)*³²

The Loi Doubin requires that any person who grants another person a licence to use a trade name, a trade mark or logo subject to exclusivity or quasi-exclusivity for the exercise of the latter's activities shall, prior to the execution of any agreement, furnish a document on the other party which gives honest information which would permit them to make an informed decision.

While a definition of "franchise" is not used, a franchisor/ franchisee relationship is covered by the type of licensing agreement contemplated by the Loi Doubin.

Disclosure must be made at least 20 days before the execution of the franchise agreement or before the payment of any monies.³³

Disclosure requirements under the Loi Doubin worth noting include:

- the number of franchisees who ceased to be members of the network during the preceding year; and

³¹ See above, §§31125(c) and 31125(d).

³² European Franchise Federation, *The Loi Doubin on Pre-contractual Disclosure* (1986) < http://www.eff-franchise.com/france_franchise_legislation_loi_oubin_english.pdf > last accessed on 7 September 2006.

³³ See above, Article 1.

- notification of presence in the same area of establishments which have the express permission of the franchisor to offer the same goods and services subject of the franchise agreement.

Italy³⁴

*Law on “commercial affiliation” (Franchising) Approved by the Senate of the Italian Republic on April 21, 2004 (the Law)*³⁵

Under the Law a franchisor is required to provide a complete copy of the franchise agreement and a series of annexures to a prospective franchisee at least 30 days before the signing of the franchise agreement. Some of disclosures are required to be in the body of the franchise agreement and others are required to be in the form of the annexures. Essentially, the franchise agreement and the annexures together form the disclosure document. Noteworthy disclosure provisions include:

- the requirement that the franchisor provide an indication of the variation in franchisees from year to year;
- the requirement that the franchisor provide information required by the franchisee or otherwise justify non disclosure;
- franchisees are obliged to disclose to the franchisor, promptly and in a complete and correct manner, any information necessary or appropriate for the signing of the franchise agreement;
- if one party provides false information, the other may ask for an annulment of the franchise agreement and damages (if due);
- If the franchise agreement (and required annexures) is not in writing it is null and void;
- In the pre-contract time-frame each party must behave towards the other “with loyalty, fairness and good faith” and disclose the information useful or necessary for the purposes of signing the franchise agreement.

Vietnam

*Decree of the Government No 35-2006-ND-CP dated March 31 2006 – Detailing the provision of the Commercial Law on commercial franchising (the Decree)*³⁶; and *Trade Ministry Circular n° 9-2006-TT-BTM dated May 25, 2006 Guiding the Commercial Franchising Registration (the Circular)*³⁷

The Decree provides for a system of registration of franchisors. Before a franchisor can grant commercial rights to a franchisee, the franchisor must lodge a dossier of application with a competent state agency. This dossier must include:

³⁴ Note that franchise businesses in European countries may also be bound by the *European Code of Ethics for Franchising* (ECE). The ECE applies to the member companies of the 17 national franchise associations that form the European Franchise Federation’s (EFF) membership. The EFF is a non-profit international organisation that represents, promotes and defends the interests and development of franchising in Europe. A condition of membership of the EFF is that the national franchise associations require their members to accept and comply with the ECE. The ECE does not regulate the form and content of franchisor disclosure in detail but rather requires “full and accurate written disclosure” of information material to the franchise relationship in order to allow a prospective franchisee to enter into any binding document with full knowledge. See European Franchise Federation, *European Code of Ethics* (last amended 2003) < <http://www.eff-franchise.com/codeofethics0.html>> last accessed on 7 September 2006.

³⁵ European Franchise Federation, *Law on Commercial Affiliation* (2004) < http://www.eff-franchise.com/Italy_%202004%2021%20April%20Commercial%20Affiliation_Franchsie%20Law%20_english.pdf> last accessed on 7 September 2006.

³⁶ Ministry of Trade, *Decree of the Government No 35-2006-ND-CP dated March 31 2006* <<http://www.mot.gov.vn>> last accessed on 7 September 2006.

³⁷ Investment and Trade Promotion Centre, *Trade Ministry Circular n° 9-2006-TT-BTM dated May 25, 2006* < http://www.itpc.hochiminhcity.gov.vn/en/search?SearchableText=circular+25+May+2006&image1.x=20&image1.y=10_> last accessed on 7 September 2006.

- an application for registration, made according to a set form;
- a written description of the franchise, made according to a set form;
- a notarized copy of the business registration certificate or investment certificate;
- papers proving the approval of the primary franchisor's permission of franchise in the case the trader applying for registration is the secondary franchisor; and
- a copy of the foreign trader's business registration certificate or paper of equivalent validity, certified by a competent agency of the place where the foreign trader is set up (in case of commercial franchises from overseas into Vietnam).

The Circular provides the set forms in its appendices. Once the competent authority has approved the application for registration, the franchisor must provide a prospective franchisee with Appendix III, a "written introduction" and the franchise agreement at least 15 working days before the signing of the franchise agreement. The Decree requires a prospective franchisee to disclose information to the franchisor when the franchisor reasonably requests information needed in order to decide whether or not to grant commercial rights to the franchisee. There are other conditions that must be met before a franchisor can grant commercial rights. For example, the business system intended for franchise must have been in operation for at least one year.

The franchisor is also required to promptly notify all franchisees of all important changes in the commercial franchise system which may affect franchisees' franchise business activities. The responsibility to supply information is also extended to the prospective franchisees where the franchisor reasonably requests information before deciding whether or not to grant commercial rights to the prospective franchisee.

Malaysia

Act 590 - Franchise Act 1998 (the Act)³⁸; and;
Franchise (Forms and Fees) Regulations 1999. (Regulation)³⁹.

The Malaysian Act also provides for a system of registration. Before a franchisor can make an offer to sell a franchise, the franchisor must apply to register its franchise with the Registrar of Franchises. The application must include, among other things, a complete disclosure document with all the necessary particulars filled in. The form and content of the disclosure document has been prescribed by regulation. The Regulation sets out 20 items which must be contained in the disclosure document. Items worth noting include:

- an organisational chart (of the franchisor company) to be included with the details of the franchisor's personnel;
- audited financial statements for the last three financial years;
- financial forecasts for three years; and
- the actual amount of franchise fees or royalty rates (if applicable);

Other noteworthy disclosure related issues considered by the Act and Regulation include:

³⁸ Malaysian Parliament, *Act 590 - Franchise Act 1998* < <http://www.parlimen.gov.my/actindexbi/pdf/ACT%20590.pdf>> last accessed on 8 September 2006.

³⁹ CCH, *Business Franchise Guide*, vol 1 (at 241-11-99) 10,111-10,014. Note, the Act did not come into force until the Regulations were finalised and published on 8 October 1999.

- The disclosure document provided to a prospective franchisee must be in the same form as the document submitted to the Registrar;
- The Registrar may allow the public inspection of any disclosure documents filed with the Registrar unless, in his or her opinion, the inspection may bring harm to a franchisor or franchisee or any person involved in the franchise business or that it is not in the public interest;
- If there is any material change to the disclosure document, the disclosure document must be amended to the form prescribed by the Act; and
- The franchisor is required to submit the disclosure document to a prospective franchisee at least 10 days before the franchise agreement is signed

UNIDROIT

The International Institute for the Unification of Private Law (UNIDROIT) is an independent intergovernmental organisation. Its purpose is to study needs and methods for modernising, harmonising and co-ordinating private and, in particular, commercial law as between States and groups of States.

The UNIDROIT's model law dealing with franchise disclosure law is the *Model Franchise Disclosure Law (2002)* (the MFDL)⁴⁰. The MFDL is a model law upon which jurisdictions that have decided to adopt franchise specific legislation may choose to base their national law.

The MFDL sets out 16 items that must be contained in a disclosure document. It sets out a further 12 items that must be disclosed, however, notes that these 12 items may be contained in the franchise agreement and therefore may only require a reference in the disclosure document. Items of note include:

- *Audited* financial statements are only required to be provided to the prospective franchisee "when available";
- A description of the state of the general market of the relevant goods and/ or services and the prospects for development in that market; and
- Information is required on franchisees that have ceased to be franchisees during the previous three fiscal years.

Further, a confirmation of receipt of the disclosure document is only required if the franchisor requests such confirmation.

Canada (Ontario)

*Arthur Wishart Act (Franchise Disclosure) 2000 (AWA)*⁴¹; and *Regulations made under the Arthur Wishart Act (Franchise Disclosure) 2000 Ontario Regulation 581/00. (Regulation)*⁴²

The AWA and the Regulation apply in the Canadian province of Ontario. It was reviewed as an example of the type of regulation that applies in Canadian Provinces.⁴³

⁴⁰ International Institute for the Unification of Private Law, *Model Franchise Disclosure Law* <<http://www.unidroit.org/english/modellaws/2002franchise/main.htm>> last accessed on 7 September 2006.

⁴¹ Canadian Legal Information Institute, *Arthur Wishart Act (Franchise Disclosure) 2000* <<http://www.canlii.org/on/laws/sta/2000c.3/20060614/whole.html>> last accessed on 7 September 2006.

⁴² Canadian Legal Information Institute, *Ontario Regulation 581/00* <<http://www.canlii.org/on/laws/regu/2000r.581/20060614/whole.html>> last accessed on 7 September 2006.

⁴³ Other Canadian provinces with franchise specific legislation include Alberta and Prince Edward Island.

The Act requires that a franchisor provide a prospective franchisee with a disclosure document not less than 14 days before the earlier of the signing of the franchise agreement and the payment of any consideration by or on behalf of the prospective franchisee.

The AWA requires that all material facts, including those prescribed by the Regulation, are contained in a disclosure document. The Regulation prescribes the items that must be disclosed. Items of note include:

- disclosure of all costs to the franchisee;
- the amount a franchisee is required to contribute to an advertising fund;
- a description of every licence, registration, authorisation or permission that a prospective franchisee will be required to obtain in order to operate the franchise business;
- the degree to which a prospective franchisee must participate personally and directly in the operation of the franchise or if the franchise is a corporation, whether its principals are so required;
- contact details for each franchisee in Ontario who operated franchise of the type being offered that has been terminated or cancelled in the preceding fiscal year;
- reasons for the closure of each franchise of the type being offered in the previous three fiscal years; and
- a financial statement and an audited financial statement for the most recently completed fiscal year, prepared in accordance with generally accepted auditing standards that are at least equivalent to those set out in the *Canadian Institute of Chartered Accountants Handbook*⁴⁴; and
- Disclosure of all material changes to a potential franchisee is required.

Other noteworthy disclosure related issues considered by the AWA and Regulation include:

- a certificate must be included in the disclosure document which certifies that every material fact required by the AWA and its regulations is included; and
- a franchisee may rescind the franchise agreement without penalty or obligation no later than 60 days after receiving the disclosure document if the franchisor failed to provide the disclosure document with the prescribed time or if the contents of the disclosure document did not meet the requirements.

Non Disclosure Related Issues in the Reviewed Jurisdictions

In each of the jurisdictions reviewed non-disclosure related issues such as the application of franchising laws, registration, good faith, the requirement to obtain advice, termination/ renewal of franchise agreements, payments to franchisors and advertising have been approached in a number of different ways.

The summary set out below is not an analysis of these issues but rather identifies notable approaches from the various jurisdictions.

⁴⁴ A regulation made under section 13(1) or (2) of the AWA may exempt a franchisor from providing either the financial statement or the unaudited financial statement as long as the disclosure document contains a declaration to that effect. See Ontario Regulation 581/00, section 3(1)(c).

Application of the law

USA (Federal)

The FTC Rule does not apply when:

- the total payments made by the franchisee to the franchisor as a condition of obtaining or commencing the franchise, in the period between any time before, to 6 months after commencing operation of the franchise, is less than US\$500, or
- when the agreement is not in writing.

USA (UFOC)

The UFOC is a model disclosure document. The circumstances under which it is necessary to create a disclosure document in the form of the UFOC will vary depending on the law that governs the particular franchise relationship. The FTC Rule allows for the use of the UFOC as well as state franchising laws.

France

The Loi Doubin applies to specific types of licensing activity such as the exclusive use of trade names and trademarks rather than strictly between franchisors and franchisees.

Vietnam

Where a Vietnamese trader is the primary franchisee of a foreign franchisor, the Vietnamese trader must conduct business by the mode of company operated franchising for at least one year in Vietnam before sub-franchising.

Malaysia

In Malaysia a foreign franchisor's application to the Registrar which is approved, may be subject to any conditions the Registrar may impose and the term of a franchise agreement shall not be less than five years.

Further, the Act requires the parties to a franchise agreement to act in an honest and lawful matter and also prohibits a franchisor from refusing to renew a franchise agreement without compensating the franchisee.

Registration requirements

USA (California)

Unless the franchise is deemed to be exempt from the registration requirements under the Corporations Code, it is unlawful to offer or sell a franchise unless the offer is registered with the Commissioner. A disclosure document in the form UFOC must be filed with the application for registration. Further, all applications, reports and other papers or documents filed with the Commissioner are open to public inspection unless the Commissioner withholds from the documents from public inspection on public interest grounds or for the protection of investors.

Malaysia

In Malaysia a franchisor must register the disclosure document, a sample franchise agreement and an operations manual with the Registrar of Franchises before a franchise can be offered or sold to any person. Any advertisement which offers to

sell or buy a franchise must also be filed with the Registrar and can be prohibited if it is deemed misleading or deceptive. Further, franchise brokers wishing to work in Malaysia are also required to be registered with the Registrar of Franchises.

Good faith and fair dealing.

A number of the reviewed jurisdictions have express good faith provisions in their franchising legislation. Alternatively, some have express good faith provisions in their civil codes which may apply to franchise agreements as a class of contract. The various approaches to good faith are set out below:

USA

§1-304 of the Uniform Commercial Code (**UCC**) states that “[e]very contract...imposes an obligation of good faith in its performance and enforcement.” The UCC only has force of law if enacted by the states.⁴⁵

USA (California)

The UCC has been enacted in California as the California Commercial Code (CCC). §1203 of the CCC states that “...[e]very contract or duty within this code imposes an obligation of good faith in its performance or enforcement.”⁴⁶

Italy

The Law requires the franchisor and prospective franchisee to behave towards each other with loyalty, fairness and good faith in pre-contractual negotiations.⁴⁷ Both parties must promptly provide each other with any information which is necessary for the purpose of signing the franchise agreement. The Law’s limitation of the good faith concept to pre-contractual behaviour and focus on the sharing of information means that the disclosure process must be undertaken in good faith.

Further, while not considered by the good faith clause in the Law, it is a contravention of the Law to act unreasonably or materially discriminate between franchisees operating a franchise business in terms of franchise fees, royalties, goods, services, equipments, rentals or advertising services if such discrimination will cause competitive harm to a franchisee.

European Franchise Federation

The European Code of Ethics for Franchising (ECE) is meant to be a practical ensemble of essential provisions of fair behaviour for franchise practitioners in Europe. Clause 2.4 of the ECE states that the parties to a franchise agreement shall exercise fairness in their dealings with each other. Further, it requires that the parties resolve complaints, grievances and disputes with good faith and good will through fair and reasonable direct communication and negotiation.

Malaysia

The Act does not make an express reference to the concept of “good faith” in respect to dealings between franchisors and franchisees but does prescribe a

⁴⁵ All states except for Louisiana have implemented the UCC. See Cornell Law School, *Uniform Laws* (2004) <<http://www.law.cornell.edu/uniform/ucc.html#a1>> last accessed on 28 September 2006.

⁴⁶ Official California Legislative Information, *Californian Commercial Code* <<http://www.leginfo.ca.gov/cgi-bin/calawquery?codesection=com&codebody=1203&hits=20>> last accessed on 28 September 2006.

⁴⁷ Article 1337 of the Italian Civil Code also states that “parties, in the conduct of negotiation and the formation of the contract, shall conduct themselves according to good faith...”

particular standard of conduct that the parties must adhere to in their dealings with one another.⁴⁸ The Act requires both franchisors and franchisees to act in an honest and lawful manner and shall endeavour to pursue the best franchise business practice of the time and place.

In particular the Act requires a franchisor and a franchisee in their dealings with one another to avoid the following conduct:

- substantial and unreasonable overvaluation of fees and prices;
- conduct which is unnecessary and unreasonable in relation to the risks to be incurred by one party; and
- conduct that is not reasonably necessary for the protection of the legitimate business interests of the franchisor, franchisee or franchise system.

Canada (Ontario)

Section 3 of the AWA imposes on each party to a franchise agreement a duty of fair dealing in its performance and enforcement, where the duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards.

European Union

Some EU member countries rely solely on good faith -fair dealing provisions to govern the relationship between franchisor and franchisee. In Germany, for example, section 242 of the *Civil Code* requires all agreements to be negotiated and conducted according to the principle of *Treu & Glauben* (good faith), together with section 9 of the *Law to Regulate General Terms of Trade* which voids any disproportionately disadvantageous contract provision between contracting parties. These provisions have been interpreted by the German Courts to require a franchisor “to give full advice to the franchisee and to protect him from business mistakes.”⁴⁹

Requirement to obtain advice.

USA

The FTC Rule (§436.1(a)(21)) requires that a recommendation to seek advice is included on the cover sheet of the disclosure document.

Canada (Ontario)

Section 5(4)(d) of the AWA and Regulations 4(2) and (3) require that the franchisor include at the beginning of every disclosure document a series of statements recommending that the prospective franchisee seek advice. Statements such as:

- Independent legal and financial advice in relation to the franchise agreement should be sought prior to entering into the franchise agreement; and
- A prospective franchisee is strongly recommended to contact any current or previous franchisee prior to entering into the franchise agreement.

Termination and renewal

⁴⁸ See above Act 590, section 29(1) and (2).

⁴⁹ Albrecht Schulz in *Franchising in Germany, Franchising in Europe* (Martin Mendelsohn, ed.) Cassell Plc 2000, 156-157.

Vietnam

Article 16(1) of the Decree gives the franchisee the right to unilaterally terminate the franchise agreement when the franchisor breaches its obligations set out in the Vietnamese Commercial Law.

Article 16(2) of the Decree considers the franchisor's right to unilaterally terminate a franchise agreement. This can occur in a number of circumstances. For example when the franchisee:

- no longer holds the necessary licences or authorisations to carry on the business;
- is dissolved;
- goes bankrupt;
- commits a serious violation of the law which may harm the reputation of the franchise system; and
- where the franchisee fails to remedy its immaterial breaches of the franchise agreement within a reasonable time after having been advised in writing to do so.

Malaysia

Section 31 of the Act prohibits a franchisor from terminating a franchise agreement before its expiry date without good cause. It is also an offence under section 32 of the Act for the franchisor to refuse to renew a franchise agreement without compensating the franchisee. Where the franchisee requests an extension to the terms of a previous franchise agreement, the franchisor must grant the extension unless the franchisee has breached the terms of the previous agreement.

Payments to franchisors

France

The Loi Doubin requires the details of any payment to be made by a franchisee prior to the execution of a franchise agreement to be in writing.

USA (California)

Where a franchisor applies for registration and the Commissioner finds that the disclosure document contains insufficient evidence that adequate financial arrangements have been made to fulfil the franchisor's obligations to provide real estate, improvements, equipment, inventory, training and other items set out in the disclosure document, then the Commissioner may require the escrow or impoundment of any payments made by the franchisee until such obligations have been satisfied;

Advertising of Franchises and Promotional Funds

USA (California)

The Corporations Code prohibits the publication of an advertisement concerning any franchise in California if the Commissioner finds that the advertisement contains any statement that is false or misleading or fails to make a necessary statement.⁵⁰

⁵⁰ See above California Corporations Code, §31157.

Malaysia

Section 57 of the Act requires that an advertisement to sell a franchise must be filed with the Registrar and may be prohibited if it is deemed to be false, fraudulent, misleading or deceptive. Further, sections 22 and 23 of the Act states that where a franchisee is required to make any payment for the purpose of promotion, the franchisor shall establish a promotion fund which is to be managed under a *separate* account and shall only be used to promote the franchise. If a franchisee is required to contribute to such a fund then the payment will be at the rate provided in the disclosure document.

ATTACHMENT F – GOOD FAITH AND FAIR DEALING

There is no express good faith provision in the *Franchising Code of Conduct*. A number of the submissions to the current review have suggested that franchisors and franchisees should be required to act in good faith in the execution of their agreements and in mediation. These requests arose in response to specific issues of concern about franchisor conduct.

A number of overseas jurisdictions particularly those based on Roman civil law have either a general concept of good faith in commercial contracts or a specific concept of good faith applying in franchise agreements, including in the context of pre-contractual negotiations and in mediation of disputes.

In Australia, some courts in some jurisdictions have accepted, to some degree, the implication of obligations of good faith in contractual dealings.⁵¹ Nonetheless, uniform acceptance has not emerged in the Australian jurisdictions of a coherent, separate legal concept of good faith or fair dealing in contract law.

Specifically with reference to franchising situations, several Australian decisions (in Victoria and NSW) have found that good faith obligations were implied into the franchise agreements in those cases.⁵² However, at least one Australian decision (in Queensland) has declined to imply good faith obligations into a franchise agreement.⁵³

Further, some eminent Australian academics and commentators continue to dispute that good faith exists as such a coherent, separate legal concept in Australian contract law.⁵⁴

To date, the High Court of Australia has not addressed the general issue of good faith in contracts, and several judges of the current High Court have previously expressed scepticism regarding the concept.⁵⁵

⁵¹ In the NSW decision in *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, Priestley JA made comments suggesting that Australian law was ready to recognise an implied duty of good faith under Australian contracts. Those comments were taken in several later cases in NSW and other Australian jurisdictions as indicating an acceptance of the existence of an implied obligation of good faith in commercial contracts. See The Honourable Justice Robert McDougall, *The Implied Duty of Good Faith in Australian Contract Law* (2006) <http://www.lawlink.nsw.gov.au/lawlink/Supreme_Court/ll_sc.nsf/pages/SCO_mcdougall210206> last accessed on 26 October 2006.

⁵² *Bamco Villa Pty Ltd v Montedeen Pty Ltd; Delta Car Rentals Aust Pty Ltd v Bamco Villa Pty Ltd* [2001] VSC 192; *Far Horizons Pty Ltd v McDonald's Australia Ltd* [2000] VSC 310 and *Burger King Corp v Hungry Jack's Pty Ltd* [2001] NSWCA 187 at paragraphs 477-480 and 534. See also *Luce Optical v Budget Specs (Franchising)* [2005] FCA 1486 (Federal Court acceptance, in interlocutory proceedings, of good faith obligations in a franchise agreement).

⁵³ *Laurelmont Pty Ltd v Stockdale & Leggo (QLD) Pty Ltd* [2001] QCA 212.

⁵⁴ For instance, Carter, J & Peden, E, 'Good Faith in Australian Contract Law' (2003) 19 *Journal of Contract Law* 155-172.

⁵⁵ See Gummow J's comments in *Service Station Association Ltd v Berg Bennett & Associates Pty Ltd* (1993) 117 ALR 393 at 406 and Kirby J's comments in *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 186 ALR 289 at 311-312.

In the Australian jurisdictions that have accepted the existence of the concept of good faith in contract law, there does not appear to be a clear consensus regarding:

(a) whether good faith obligations are to be imposed on franchise agreements:

(i) because good faith obligations are to be found in all commercial contracts, and franchise agreements are a species of commercial contracts;

(ii) because franchise agreements are a category of contracts in which good faith obligations are to be imposed; or

(iii) on a case by case basis, depending on the particular circumstances in which the franchise agreement was formed;

(b) what the precise content of good faith or fair dealing obligations might be in franchise agreements, and what might constitute a breach of such obligations; and

(c) what the consequences of a breach of good faith or fair dealing obligations are.

Recent cases in NSW and Victoria appear to indicate a trend towards limiting the application of good faith obligations to case by case instances arising under particular fact scenarios.⁵⁶ In any case, the recognition of good faith or fair dealing obligations in Australian law extends only to recognition of them arising when and after the contract is formed, and does not include any acceptance of pre-contractual obligations on negotiating parties to act in good faith towards each other in their pre-contractual dealings.

However, there are applicable legal principles under existing Australian law that apply to provide analogous remedies for injured parties even if principles of good faith and fair dealing are not accepted or recognized, whether in pre-contractual scenarios or post-contract formation scenarios.

Obligation to act in good faith pre-contractually

In Australia there is no obligation to act in good faith in pre-contractual stages per se. There has been some Australian consideration of whether an agreement to negotiate is enforceable (and whether such an agreement might include an obligation to negotiate in good faith), but no consensus has emerged as to either the enforceability of such an agreement or the implication of such an obligation.⁵⁷

The *Trade Practices Act 1974* (Cth) (TPA), contains comprehensive provisions of wide impact that prohibit misrepresentations or misleading and deceptive conduct during the formation of a contract. Section 52 of the TPA, for example, can be

⁵⁶ See e.g., The Honourable Justice James Douglas, *Exploring the Recent Uncertainty Surrounding the Implied Duty of Good Faith in Australian Contract Law: the Duty to Act Reasonably – Its Existence, Ambit and Operation* (paper presented at the LexisNexis Contract Law Master Class, 24 August 2006) <http://www.cisq.law.pace.edu/cisq/biblio/douglas1.html> - last accessed on 26 October 2006.

⁵⁷ See e.g. *Coal Cliff Collieries Pty Ltd v Sijehama Pty Ltd* (1991)24 NSWLR 1.

applied to prohibit franchisors from making misleading statements with regard to, among other things, projected turnover or profitability. Relevantly:

(a) section 52 applies to all ordinary or reasonable people who come within the relevant section of the public alleged to have been misled or deceived by the conduct in question. In this case, the relevant section of the public will be actual and prospective franchisees and will include astute and gullible, intelligent and not so intelligent, and well-educated and poorly educated franchisees.⁵⁸ However, franchisees who are “extraordinarily stupid” or gullible, or whose reactions are “extreme or fanciful” are unlikely to be used as the standard against which a franchisor’s conduct will be judged;⁵⁹

(b) a franchisor’s statement which is literally true can still be held to be in breach of section 52 if it misleads or deceives or is likely to mislead or deceive; similarly, reasonable and honest conduct by a franchisor can still be misleading or deceptive conduct that contravenes section 52;⁶⁰

(c) although a franchisor is permitted by section 52 to bargain “hard”,⁶¹ silence by a franchisor may, in all of the circumstances constituted by its acts, omissions and representations, constitute conduct likely to mislead or deceive a franchisee within the meaning of section 52;⁶²

(d) section 52 applies to both statements made publicly and in private negotiations by the franchisor,⁶³ and

(e) by section 51A, representations and opinions by a franchisor, as to future matters, will be taken to be misleading for the purposes of section 52 unless the franchisor can prove that it had reasonable grounds for making the representation.

A failure to observe the standard of conduct required by section 52 has its consequences under Part VI of the TPA (enforcement and remedies), including both remedies available at common law (such as injunctions and damages) and other compensatory remedies under section 87 which apply when loss or damage is likely to be suffered by a franchisee (e.g., orders declaring the franchise agreement void or varied, for specific performance of the franchise agreement, accounting for profits made by the franchisor, payment of other compensation, or refunds or returns of property).

The above features of liability under section 52 make this section a powerful mechanism for dealing with issues relating to franchisor conduct both before and during the course of the franchise arrangement.

Similarly, the general law doctrine of unconscionability, as extended under Part IVA of the TPA, can also be readily applied to many franchise scenarios that may arise. We note that although the concept of unconscionable conduct is not defined in the TPA, section 51 AC (which applies the concept of unconscionable conduct to

⁵⁸ *Campomar Sociedad, Limitada v Nike International Ltd* (2000) 202 CLR 45.

⁵⁹ *Ibid.* See also *Telstra Corp Ltd v Cable & Wireless Optus Ltd* [2001] FCA 1478 and *Taco Co of Australia Inc v Taco Bell Pty Ltd* (1982) 42 ALR 177.

⁶⁰ *Hornsby Building Information Centre Pty Ltd v Sydney Building Information Centre Ltd* (1978) 140 CLR 216.

⁶¹ *Poseidon Ltd v Adelaide Petroleum NL* (1991) 105 ALR 25.

⁶² *Demagogue Pty Ltd v Ramensky* (1992) 39 FCR 31 and *Fraser v NRMA Holdings Ltd* (1995) 55 FCR 452.

⁶³ *Bevanere Pty Ltd v Lubidineuse* (1985) 7 FCR 325.

business transactions with small business consumers including franchisees) expressly requires the Court to have regard to (amongst other things) the extent to which the supplier and the small business consumer acted in good faith: section 51 AC(4)(k). Several Australian cases have since found that section 51AC has been breached by a franchisor's conduct that included a lack of good faith within the meaning of section 51 AC(4)(k).⁶⁴ In one of these cases, the judge suggested that conduct which is held to be unconscionable within the meaning of s 51AC of the *Trade Practices Act 1974* "will probably be sufficient" to constitute a breach of an express term providing for absolute good faith between the parties.⁶⁵

⁶⁴ For instance, *ACCC v Simply No-Knead (Franchising) Pty Ltd* [2000] FCA 1365 and *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286.

⁶⁵ *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286 at paragraph 388 (Hasluck J).

An Overview of the Franchise Sector in Australia

A summary of key features and data relating
to the Australian franchise sector (2008).

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Jason publishes Franchise News & Events, a national franchising news bulletin, writes a fortnightly franchise column, frequently presents at franchise and business conferences, and comments about franchising in the media. He has provided input to state and federal government franchise policy and legislation, and in late 2007 was reappointed by the Australian Competition & Consumer Commission (ACCC) to its national 12-member Franchise Consultative Panel.

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What is Franchising?

Franchising is a business concept that has been around in one form or another for centuries, but today is commonly identified as the business format model, where a franchisor grants the right (under certain conditions) to a franchisee to use a business name and trademark, operating systems and know how to operate their own business. In turn, the franchisor usually receives initial and ongoing fees for the use of the brand, and the provision of ongoing business guidance and support to the franchisee.

Franchising in Australia is regulated nationally by the Franchising Code of Conduct (1998), a mandatory code under the Trade Practices Act which is administered by the Australian Competition and Consumer Commission (ACCC). Among other things, the Code specifies the nature and extent of information that should be provided to a franchisee prior to investing in the franchise (mandatory disclosure), as well as a timeframe for the provision of the information, and a cooling-off period once a franchise contract is signed. The Code does not require any pre-registration by franchisors with the ACCC. Rather, franchisors are deemed to be operating in compliance with the Code until such time as the ACCC have cause to launch an investigation, or are prompted by a complaint from the public. Consequently, statistics on the size and scope of franchising, particularly in relation to the number of franchisors in Australia, are not available from the very body which is responsible regulating the sector.

The Entrepreneurial Alliance of Franchising

Franchising is, at its core, a large-scale entrepreneurial growth strategy for the franchisor. (Spinelli, Rosenberg & Birley, p.5).

According to the Australian Federal Government's AusIndustry website, entrepreneurialism is defined as:

"...proactive and innovative business management aimed at identifying and exploiting new commercial opportunities for the growth and/or sustainability of the business."
(AusIndustry 2007).

When looking at the franchisor, the term entrepreneur readily comes to mind. The franchisor has developed a business over time, proven its profitability and systems, then granted franchises for its successful and rapid duplication to exploit market potential while minimizing capital outlays. Entrepreneurs are innovators and risk-takers (Schaper & Volery, p.32) though are not always creative in themselves.

But what is often neglected is that the franchisee is also an entrepreneur, risking their cash and labour on a business model they plan to operate for themselves, and often with no prior experience in business. Spinelli et al draw the link clearly by stating that franchising is an "entrepreneurial alliance" between franchisor and franchisee, and that their book on franchising is as much about entrepreneurship (p.2).

Legislative Framework

In addition to the Trade Practices Act 1974 (TPA), the franchise sector is regulated by the Franchising Code of Conduct (the Code), a mandatory industry code prescribed under the TPA and introduced on July 1, 1998 and is applicable to all franchises granted or renewed after that date. The mandatory Code replaced an earlier and voluntary Franchising Code of Practice. It is administered by the Australian Competition and Consumer Commission (ACCC), a federal statutory authority formed in 1995 to promote competition and fair trade in the marketplace to benefit consumers, businesses and the community (ACCC).

The Code arose from the Howard Government's New Deal Fair Deal business reforms 1997, with an initial exposure draft released in September 1997, followed by another in April 1998, both of which were substantially different (and badly drafted according to observers at the time) from the version introduced on July 1, 1998. The Code's key purpose was "*to regulate the conduct of participants in franchising to other participants in franchising*", with its principal innovations being the requirement to provide specified information in a disclosure document to prospective franchisees prior to purchase, a cooling-off period, and dispute resolution via a mediation process.

Despite international franchisors who grant just one franchise in Australia (such as a master franchise) being exempt from the requirement to provide disclosure information (since introduced on March 1, 2008), international observers including respected Canadian franchise attorney and author Alex Konigsberg declared in 1998 that the introduction of the Code would actively dissuade foreign franchisors from entering the Australian market (Konigsberg).

International concerns that the introduction of the Franchising Code of Conduct would stymie franchise growth in Australia may have been initially vindicated due to the steady number of franchisors from 1998 to 2002 (See Table 1, page 6), but has not been supported in the long run when compared against the significant growth of franchise system numbers since 2002.

There have been two revisions to the Code, introduced on the following dates:

October 1, 2001

Minor drafting changes, as well as the deletion of the requirement for unit franchisees to provide a disclosure document to prospective purchasers of their businesses (in addition to the disclosure document provided by the franchisor);

March 1, 2008

These changes were adopted following the Matthews Report, instigated by the then Federal Small Business Minister in late 2006. Changes were made to the disclosure provisions of the Code, affecting the nature and timing of information to be included in disclosure documents for the granting or renewal of franchises. Significant changes included the requirement to include a contact of past franchisees for the previous three years, as well as a list of suppliers who pay rebates to the franchisor.

Both of these requirements were met with concern by many franchisors, fearing a scenario where just one disaffected ex-franchisee could unduly influence all future prospects against buying a franchise. Furthermore, the requirement to disclose the names of suppliers which pay rebates was viewed as a loss of competitive advantage, with the likelihood that disclosure information would find its way into the hands of competitors.

Another significant change introduced on March 1, 2008 was the requirement to provide a copy of the franchise agreement for disclosure in its final form, creating the potential for multiple disclosure for the same agreement where relatively minor changes occur (eg. changes of commencement date, etc).

Background to Franchising in Australia

Franchising in Australia is widely regarded as a highly successful way of doing business, providing new business entrants the opportunity to be in business for themselves, but not by themselves. The Franchise Council of Australia compares the success of franchising against the high level of failure of independent small business, with its website quoting an 85% failure rate for small businesses in their first five years compared to 85% of franchised businesses (ie. those operated by franchisees) still operating after five years.

The Franchising Australia 2006 Survey (Frazer, Weaven & Wright) revealed there were 960 franchise systems operating in Australia with a combined turnover in excess of \$128 billion through more than 60,000 outlets. Franchisees are in the main believed to be satisfied with the performance of their businesses, with the Survey revealing less than one percent of franchisees were in serious dispute with their franchisor. Similarly, a study by the Franchise Relationships Institute (Nathan, p.203) showed that 93% of franchisees were satisfied with their business investment.

Sector Size – By Franchisors

Establishing the number of franchisors operating in Australia is an inexact science. The Australian Bureau of Statistics 2001 Small Business in Australia (Trewin) survey estimated there to be 1.23 million private sector small businesses in operation, but did not distinguish between those which were franchised and those which were not, let alone further distinguish between numbers of franchisors and franchisees.

The Franchising Australia 2006 Survey (Frazer, Weaven & Wright) identified 960 franchisors operating in Australia as at June 30 that year. Conducted by Griffith University academics and sponsored by the Franchise Council of Australia, the survey is conducted approximately every two years. It gathers franchisor contact information by monitoring newspaper and magazine advertisements to identify those businesses offering franchises.

Other sources provide different figures for franchisors operating in Australia. The printed 2006 Franchise Directory published by Reed Business lists 612 franchise opportunities, while the online version of the directory (www.franchisebusiness.com.au - produced by the same company) lists 1,143 franchisors as at August 27, 2008. New South Wales-based consultancy, the Franchise Counselling Centre, estimates the true figure of franchisors in Australia is in excess of 1,500, however the most accurate number is that available from the Franchising Australia surveys.

The number of franchisors operating in Australia has increased by approximately 58% in 10 years from 693 in 1998 to an estimated number of 1,100 in 2008. This number of franchisors serves a national population estimated at 21,400,000 at August 25, 2008, or one franchise system for every 19,454 Australians.

This compares with a franchisor count in the United States of approximately 3,000 franchise brands, against a national population of 293,000,000, or one franchise system for every 97,666 Americans – a system density nearly five times less than Australia.

Franchising Australia (year)	Total Business Format Franchisors	Average Number of franchise outlets	Average Number of company owned outlets	Average number of years franchising	Average number of years in business	Franchisor increase from one survey to the next	Av. number of years franchising increase from one survey to next
1998	693	17	1	7	11.5		
1999	708	22	1	8	11	2.16%	14.28%
2000	No survey						
2001	No survey						
2002	700	24	1	9	15	-1.14%	12.50%
2003	No survey						
2004	850	26	1	11	14	21.43%	22.22%
2005	No survey						
2006	960	22	1	10	16	12.94%	-9.09%
2008	1,100*	*2008 Franchising Australia Survey due for release in October 2008					

Table 1: The Population of Australian Franchisors & Related data
(Sourced from the Franchising Australia Surveys, 1998-2006)

The 10 largest franchise systems in Australia account for approximately 12,225 outlets. In other words, less than 1% of the total number of franchise systems account for 17.4% of total franchised outlets, and employ on average just under 11 people per outlet (including franchisees).

	System	No. of Aust. outlets	Estimated no. of jobs (incl f'sees)*
1	Australia Post	2,969	6,200
2	Jims Group	2,635	3,600
3	Subway	1,035	10,000
4	VIP Home Services	1,000	1,500
5	Ray White Real Estate	1,000	10,000
6	Retail Food Group^	998	9,000
7	McDonald's	760	75,000
8	LJ Hooker Real Estate	700	7,000
9	Bakers Delight	625	5,400
10	Video Ezy	503	5,000
	TOTAL:	12,225 outlets	132,700 jobs
	^ Retail Food Group consists of four franchise brands: Donut King, Café BB's, Michel's Patisserie & Brumbys Bakeries.		
	* Figures estimated by Franchise Advisory Centre, or distilled from reported amounts.		

Table 2: The 10 Largest Franchise Systems in Australia (by outlet numbers)
(Sourced from franchisor websites)

Franchisor entries and exits – Australian figures

The continual growth in the number of franchisors shown in Table 1 shows ongoing net increases, but does not provide any indication as to franchisor exits during the same period. (For the purposes of this report, a franchisor exit is defined as a system which ceases to franchise). When releasing the Franchising Australia 2006 survey findings at the Franchise Council national conference on October 21 that year, the authors specifically commented on the number of entrants and exits when compared with the previous survey. While the overall number of franchise systems in Australia had increased by approximately 100 from 2004 to 2006, this increase was made up of 200 new entrants and 100 franchisors that had ceased franchising since the 2004 survey. In other words, for every two new franchisors, one franchisor exited over a two-year period, accounting for a loss of almost 12% of the 850 franchisors identified in the 2004 survey.

A content analysis of a 10-year-old issue of *Franchising Magazine* by the author of this report reveals further evidence of franchisor exits (see Appendix 1). Of the 113 franchisors listed in the magazine's index as advertising in the December 2006 / January 2007 issue of the magazine, only 78 (ie. 69%) could be identified as still franchising today by comparing against the Franchise Advisory Centre's database, internet and telephone directory searches. The remaining 30% had ceased to franchise, and in most cases, could not be found at all, suggesting that not only had those franchisors exited from franchising, but that they may have ceased operating altogether. (The remaining 1% could not be determined as to whether the business was still franchising or not).

Few statistics on franchisor exit or failure, are available. The Franchise Council of Australia has no information on franchisor exit numbers, and is critical of explorations of franchisor failure. A 2006 research report titled "*When the Franchisor Fails*" (Buchan, 2006) was condemned both publicly and privately by the FCA (author interviews, 2006).

Franchisor exit data from overseas

Overseas statistics also indicate that franchisors do cease to franchise at rates equal to, if not substantially higher than the limited Australian statistics currently available.

In the United States, often considered the home of modern franchising due to the profile of its fast food chains, there are an estimated 3,000 franchise systems with a combined total of more than three quarters of a million outlets. However system exit rates are high, reaching 75% over 10 years and 85% over 17 years (Shane, p.211).

Accurate data remains a problem – the United States does not have a central registry of franchisors, although some states require registration. Research conducted by the International Franchise Association in 1997 identified 1,156 franchisors operating in those states requiring registration, which rose by just 22 franchisors the following year. On comparing the registration lists from one year to the next, only 834 of the franchisors registered in 1996 were still registered the following year. The remaining 322 (28%) were absent (Stanworth, Purdy, English & Williams, p.60).

A tracking study conducted by Lafontaine and Shaw (reproduced in *Franchising: An International Perspective*) of franchisor start-ups in the United States from 1980 to 1992 showed a survival rate for the period of just 28.6%. Similarly, Shane tracked 138 US franchisors which commenced franchising in 1983, and found only a 24.6% survival rate after 10 years. In the United Kingdom, University of Westminster researchers analysed the database of franchisors listed as advertisers in the UK's two annual franchise directories in 1996 and found that in the 18 to 24 months since the directories were compiled that almost one third of the 704 franchisors identified had ceased franchising. Furthermore, of the 237 franchisors that had ceased franchising, 150 of these had ceased to trade altogether, or could not be traced despite the researcher's best efforts, and therefore presumed to have failed (Stanworth et al, p.58).

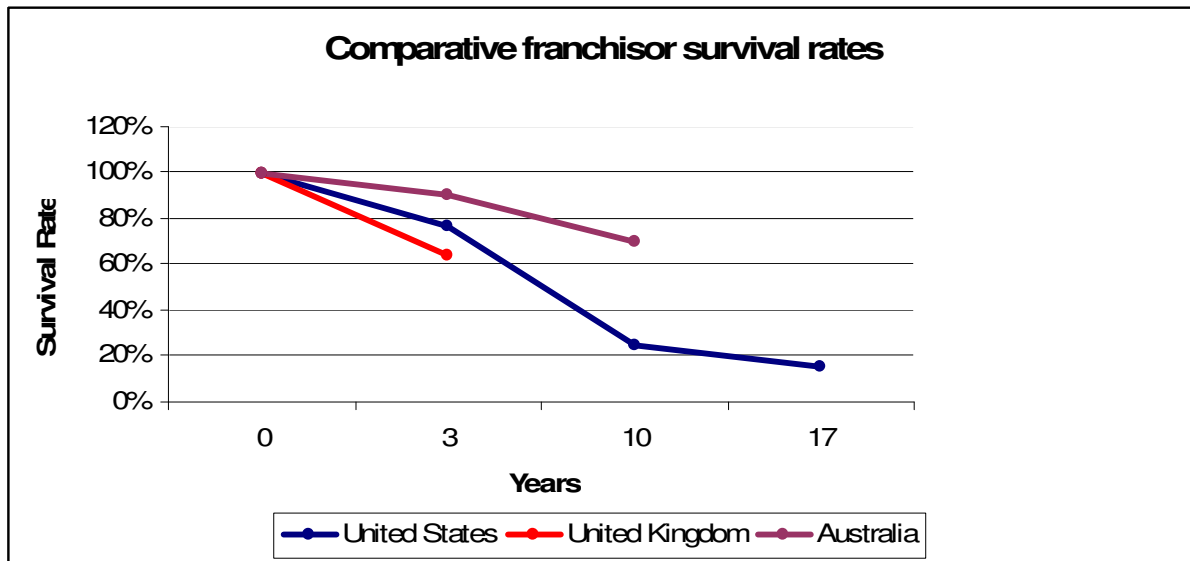


Figure 2: Comparative franchisor survival rates
 (Compiled from Shane, Lafontaine & Shaw, Frazer et al, and Gehrke)

Reasons cited for franchisor failure in the international literature include inadequate piloting and testing of systems prior to offering them as franchises (Stanworth et al, p.63). Lafontaine and Shaw cite factors contributing to franchisor exit include the nature of the product or service offering itself, the financial and support capabilities of the franchisor's principals, franchisee selection and finally, the franchisor's prior business experience and level of education.

Consequences of franchisor failure

The groundbreaking work by Buchan (2006) on franchisor failure which specifically examined issues arising from the insolvency of the franchisor, found that the failure of 40 franchisors between 1990 and 2005 in Australia affected 1,090 franchisees and their families (many of whom lost their businesses), up to 11,500 employees, and also affected landlords, financiers and other suppliers. The economic consequences of failure were not calculated, however it was noted that when franchisors become insolvent, current Australian law gives franchisees no rights as creditors despite their significant stake in the franchisor's business.

Little, if any, other formal research into the consequences of franchisor failure has been conducted in Australia. A case study of the legal battles and subsequent demise of the Cut Price Deli chain (Tarling, Franchising Magazine January/February 1999) identified that at least 65 of the franchise's original 165 stores were forced to close following the collapse of the franchisor, with the remainder continuing to trade as best they could (either as independents or by joining a rival chain) or otherwise meeting an unknown fate. The emotional and economic cost for those involved in closures of stores that cost up to \$400,000 to establish would have been substantial (Tarling).

Franchisees cut adrift from their franchisors have greatly reduced prospects of survival. Buchan's research linked the collapse of franchisee businesses with the demise of their franchisor, with franchisees subsequently suffering major financial and emotional distress resulting (in some cases) in bankruptcy and relationship breakdowns. Additionally, failed franchises are often the subject of media reports and the source of complaints to the ACCC and other government bodies, thereby consuming valuable public sector resources.

Sector Size – By Franchisees

A summary of the last five Franchising Australia surveys indicates that the total number of outlets in the franchise sector increased by 40% from 50,100 in 1998 to 70,250 in 2006, compared to a population increase of 8.43% for the same period (Australian Bureau of Statistics). In particular, the number of business format franchised outlets increased by 46% for the same period. While anomalies appear in the reported figures for company-owned outlets, motor vehicle and fuel retail outlets, the growth trend of franchised outlets, and all outlets overall, is relatively consistent.

With a total number of 70,250 franchise branded outlets in Australia in 2006, there was one outlet for every 304 Australians.

Franchising Australia (year)	Number of Business Format Franchised outlets	Number of company-owned outlets	Motor vehicle retail outlets	Fuel retail outlets	Total Outlets	Franchisor increase from one survey to the next
1998	38,500	5,300	3,400	2,900	50,100	
1999	40,900	5,200	5,900	2,600	54,600	8.98%
2000	No survey					
2001	No survey					
2002	44,400	6,700	3,300	2,000	56,400	3.29%
2003	No survey					
2004	50,600	3,400	2,400	8,000	64,400	14.18%
2005	No survey					
2006	56,200	5,660	2,690	5,700	70,250	9.08%

Table 3: The Population of Australian Franchised Outlets & Related data
(Sourced from the Franchising Australia Surveys, 1998-2006)

Typically, franchises are operated by males (68.6%) who also own the business outright or in partnership with a spouse or partner. Male franchise operators are likely to be aged 41-50 years (42%) or 31-40 years (28.1%).

Franchisee entry & exits

Unlike the franchisor population where exits may be more noticeable, establishing the number of franchisee exits in any given period is guesswork to say the least. An outlet may change hands once or more during a 12-month period, but to an external observer it would appear that because the outlet continues to trade it is being operated by the same franchisee, when this would not be the case. New

Franchisor obligations to report closed outlets in their disclosure documents provides little useful information without examining the disclosure document for each of the estimated 1,100 systems operating in 2008. Media claims by current or former franchisees about high numbers of closures, or allegations of churning, are unable to be validated by statistically relevant data, but only because such data does not currently exist.

Representative Bodies

Franchise Council of Australia (FCA)

The **Franchise Council of Australia** (FCA) describes itself as the peak body representing the franchise sector, including franchisors, franchisees and service providers. Formed in 1983 by a small group of franchisors who recognised a common interest in their method of doing business, the FCA was known at the time as the Franchisors Association of Australia (FAA), with a membership comprising of only franchisors, and later service providers (such as accountants, lawyers and banks) (Bell 2003).

During the following years, it established state chapters first in Queensland, and then progressively to the other mainland states. A New Zealand chapter was also established, and the name changed to Franchisors Association of Australasia in 1990, and later to the Franchisors Association of Australia & New Zealand (FAANZ) (Bell 2003).

In 1994, the association opened its membership to include franchisees, and changed its name to Franchise Association of Australia & New Zealand (FAANZ). In 1998 (the same year in which the Franchising Code of Conduct was introduced and in response to the New Zealand chapter wishing to form its own body), the association changed its name for the last time to Franchise Council of Australia (Bell 2003).

The FCA is a nationally-incorporated not-for-profit association headquartered in Melbourne with a staff of 12 people. Each of the five mainland state chapter committees elect a president, who is automatically appointed to the FCA national board. A further five board positions are directly elected by the membership, however three of the five must be franchisors, with the other two positions able to be filled from any membership category. A further two board positions may be filled by individuals invited by the FCA board. Since 2007, one of these positions has been occupied by a franchisee representative.

At the time of writing, the FCA website lists 568 members, of which approximately 420 or 74% are franchisors, with the balance comprising mostly of lawyers, accountants, banks and other providers of services to the franchise sector. The number of franchisee members is unknown.

Franchisee Associations

There is no franchisee association of the size and scale of the Franchise Council of Australia.

A number of different organizations have emerged since the mid-1990's to represent franchisees. The first of these was the **Australian Franchisees Association** (AFA), a privately-owned entity based in Brisbane. The AFA ceased operations approximately 18 months later amid concerns that it existed primarily as a for-profit business which benefited from conducting speculative litigation on behalf of franchisees against franchisors.

About two other franchisee associations were known to exist in the mid to late 1990's, none of which achieved any national recognition and lasted more than a few months.

Another and entirely unrelated **Australian Franchisees Association** (AFA) formed several years later based in Sydney, chaired by former Federal Business Minister David Beddall (who presided over an inquiry into franchising in the mid 1990's which resulted in a voluntary Code of Practice for the sector). This AFA was for a while successful in drawing media attention to its aims of representing franchisees. It became involved in several major franchise disputes, and a defamation action arising from one of these resulted in a judgment against the AFA, which unable to pay the damages awarded, was wound up.

In 2007, a new association, the **Franchisees Association of Australia Incorporated** (FAAI) was formed with similar aims to the immediate past AFA, and also involved some of the same office-bearers, including David Beddall as president. Its website (www.faai.com.au) remains largely under

construction but states that the FAAL is pro-franchising. No membership list is available online and the association's contact details are currently listed as care of the Lottery Agents Association of Victoria.

The **National Federation of Independent Business** (NFIB), a registered Australian body headquartered in Canberra has also spoken out on franchisee issues in the media. The NFIB website (www.nfib.com.au) provides scant information on its services and no specific reference to its franchisee representation activities.

Various retail associations (there are known to be eight representing the retail sector in Australia) also comment publicly from time to time on franchising issues as they affect retailing, but none claim to represent franchisees generally or the franchise sector at large.

Brand-specific Franchisee Associations

Where franchisees of a particular brand form their own lobby group or association outside the formal communication channels established by the franchisor, this becomes a brand-specific franchisee association. Unlike the franchise sector in the United States where the individual franchise chains on average are much larger than in Australia and such brand-specific associations are relatively common, only a few examples are known to exist in Australia. These include:

Post Office Agents Association Limited (POAAL) which represents the owner/operators of licensed post offices, mail contractors, sub-contractors and couriers;

National Pizza Association which represents the interests of approximately 130 Pizza Hut franchisees;

Other brand-specific associations may exist but are unlikely to be known outside the franchise systems in which they operate.

Sector Trends

Through constant ongoing interaction with participants in the franchise sector at franchisee, franchisor and advisor level in professional development forums and via feedback from its sector bulletin *Franchise News & Events*, the Franchise Advisory Centre has identified the following current trends:

Recruitment

Economic conditions featuring full or near-full employment and record high wages and salaries due to a shortage of workers has reduced the number of people looking at franchising as a form of self-employment according to many system executives. Inquiry rates from prospective franchisees are low, with marketing costs as high as nearly \$20,000 to add just one new franchisee to a system. Currently 18% of franchisees are 51-60 years old, but as the population continues to age the proportion of franchisees 50 and above is likely to increase.

Retention

With a reduced rate of recruitment, franchisors are placing greater emphasis on retaining existing franchisees. On average, franchisees in Australia are staying seven years in a franchise system (compared to an average franchise term of five years). Retention incentives used by franchisors include additional stores or territories, master franchises, renewal fee waivers or reduced royalties for subsequent terms.

Occupancy Costs

A rapid escalation of rents in shopping centres and other retail locations continues to cause concern among premises-dependent franchisors, who can find that lease renewals often include ratchet-to-market rent increases that can make the difference between a profitable or unviable location. A 2008

report released following the federal government's Productivity Commission inquiry into the Market for Retail Tenancies in Australia recommended greater disclosure and transparency in dealings between landlords and tenants, but has stopped short of calling for specific legislation. Shopping centre occupancy costs in particular are a source of tension, with rents commonly increased by significant amounts on lease renewals according to both franchisors and franchisees, and which in turn can affect the ongoing viability of a site. This in turn has resulted in a greater focus on higher levels of franchisee performance during their first term (when the retail lease is less onerous) in case a second term lease is unviable.

Multiple-Unit Operations

More than a third of Australian franchisors reporting that their franchisees own more than one outlet (Frazer et al, p.65), multiple-unit ownership is a growing trend both in Australia and overseas, particularly in the United States where some franchisees own 100 or more outlets (Sherman, p.184 and Lowell, p.112).

Franchisors increasingly support the concept of multiple-unit ownership as a way of increasing franchisee retention. Multiple-unit ownership also assists the franchisor to meet its system growth targets with fewer franchisees, and can increase efficiencies for the provision of services by the franchisor to its franchisees.

Master Franchising

Commonly used by most franchisors during the 1990's, master franchising (the act of granting the rights to sell and support franchises in a given area in return for a percentage of the royalty fee) has declined in popularity as those systems which used in initially have matured and in some cases, buying back their master franchises. Additionally, franchisors dilute their revenue base by sharing royalties with a master franchisee, and recent litigation by franchisees against franchisors arising from the actions of master franchisees is a further disincentive to use master franchising.

Corporatisation

Corporatisation describes the process where franchisors sell part or all of their systems to extract some capital from the business, and eventually leading to a partial or full sale to new owners who may operate the business under management with little or nor direct owner involvement. It is estimated that 5-10% of Australian franchise systems are corporatized in some way, with many of these as listed entities or subsidiaries of listed entities.

Appendix 1: Australian Franchisor Exit analysis - Franchising Magazine 10 years on.

Franchising Magazine Dec 1996 / January 1997 Edition

Listed Franchisor Advertisers

Franchise System	Still Franchising? (Jan 2007)	
7-Eleven	Yes	
A4 Maths	Yes	
Abacus Bookkeeping	No	
Above All Ceiling Cleaning	No	
Absolute Management	No	
Ampol Road Pantry	Yes	Now Caltex Star Mart
Arnold's Ribs & Pizza	No	
Athlete's Foot	Yes	
Auditel	No	
Aussie Pooch Mobile	Yes	
Australia Post	Yes	
Autobarn	Yes	
Barbarella's	No	
Barry's The Home Improvement Specialists	Yes	
Bartercard	Yes	
Baskin-Robbins	Yes	
Bin Busters	No	
Bob Jane Corporation	Yes	
BP Express	Yes	
Bumpa T Bumpa	No	
Cake It Away	Yes	
Capt'n Snooze	Yes	
Car Care Co.	CND	Could not determine
Cargroomers Australia	Yes	
Cash Converters	Yes	
Chips Away	Yes	
Civic Video	Yes	
Clark Rubber	Yes	
Computer Gym	Yes	
Cookie Man	Yes	
Copperart	No	
Cuddles 'N' Mum	Yes	
Dick Smith	Yes	
Domino's Pizza	Yes	
Donut King	Yes	
Eagle Boys	Yes	
Elite Entertainment	No	
Expense Reduction Analysts	Yes	
Express Bookkeeping	Yes	

Fancy Fillings	Yes	
Fastway Couriers	Yes	
Fernwood Female Fitness	Yes	
Flea Stoppers	Yes	Renamed as Doggywash
Forty Winks	Yes	
Framing Corner	Yes	
Franchise Management Services	No	
Freedom Furniture	Yes	
Furniture Wizard	No	
Glass Art Australia	Yes	
Gobblers	No	
Granny May's	No	
Great Australian Ice Creameries	No	
Hallmark	Yes	
Handy Gardeners At Work	No	
Hire Intelligence	Yes	
Jani King	Yes	
Jim's Mowing	Yes	
Just Comfort	No	
Just Cuts	Yes	
Just Dents	No	
Kenkleen	Yes	
Kenny's Cardiology	Yes	
KFC	Yes	
Kleins	Yes	
Kwik Kerb	Yes	
Kwik Kopy	Yes	
Lenard's	Yes	
LJ Hooker	Yes	
Made in Japan	Yes	
Magna-Dry	Yes	
Mail Boxes Etc	Yes	
McGoo's Spitroast	Yes	
Mend-A-Bathroom	Yes	
Midas	Yes	
Mobil	Yes	
Mobile Car Bath	No	
Modern Roof Restoration	No	
Mostly Movies	No	
Mr Whippy	Yes	

Muffin Break	Yes	
Nectar	Yes	
New Zealand Natural	Yes	
No Complaints Cleaning Service	No	
Optus	Yes	
Oz Design	Yes	
Pack & Send	Yes	
Pix Printing	No	
Pizza Haven	Yes	
PoolWerx	Yes	
Prompt Bookkeeping	No	
Pure & Natural	Yes	
Red Baron	No	
Retireinvest	Yes	
Sign Biz	No	
Snack Systems	Yes	
Snap Printing	Yes	
Solatec	Yes	
Sportsco	Yes	
Stone Seal	No	
Subway	Yes	
Techclean	No	
The Cheesecake Shop	Yes	

The Touch Up Guys	Yes	
The Vinyl Doctor	No	
Think Big Images	No	
Total Building Maintenance	No	
Touch N Go	No	
United Home Services	Yes	
Valuecard	No	
VIP Home Services	Yes	
Wendy's	Yes	
WorldWide Refinishing	Yes	
Xpres Corporation	No	
	Number	Percentage
Total Franchisors listed	113	100%
Total still operating	78	69.02%
Total no longer operating / able to be found	34	30.08%
Could not determine	1	0.90%
<i>Analysed, Brisbane, February 1, 2007 by Jason Gehrke.</i>		

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Unravelling the Evidence on Franchise System Survivability

JOHN STANWORTH, DAVID PURDY, WILKE ENGLISH and JO WILLEMS

ABSTRACT *The underlying hypothesis behind the evidence presented here – some of it drawn from earlier literature and some of it previously unpublished – is that franchise system survival patterns largely mirror those of conventional small businesses, with high attrition rates in the formative years, rather than being a sure-fire recipe for success with low system failure rates. After all, the majority of new franchise systems are in fact themselves small businesses, obliged to construct a front-end infrastructure of managerial support some years ahead of achieving full financial break-even point. In effect, given the demands placed upon an infant franchise system to finance and manage the processes of franchisee recruitment and all that entails, plus induction and field support for franchisees, the new franchise company is, in effect, developing the management and administrative structures normally associated with a medium-sized business, without the income levels normally associated with this scale of business. For a small business intent on developing into a credible franchise operation, the strains normally associated with small business growth are, in fact, likely to be magnified and concentrated, rather than reduced.*

Key words: Failure; Franchise systems; Survival; Withdrawal; UK; USA.

1. Introduction

Two basic defining characteristics underpin the concept of franchising. The first involves the bestowing of a ‘right’ which, in a European context, has historically sometimes involved rights embracing the collection of taxes within defined territories. Today, franchises are granted for a range of activities, including the production of television programmes or the running of rail or air transportation services. In these cases, the granting of a franchise is the outcome of a process of tendering whereby the competing tenders may vary quite considerably in their detail. Once such a franchise is granted for a specified period of time, the franchisee (often a large company) enjoys some autonomy in the delivery of services, subject to

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the meeting of certain minimum standards defined by the franchisor and consumer protection agencies in the case of public utilities.

The second major notion underlying the concept of franchising is that of 'cloning' a supposedly 'tried-and-tested' product or service. This is without doubt the key principle underlying modern 'business-format' franchising where the franchisee is typically a small business (as is also the franchisor quite often in the early days), the relationship between franchisee and franchisor is close and ongoing and, finally, each franchised outlet business approximates to a clone of the franchisor's piloted 'formula for success'. This perhaps begs the question of why a franchisor with a 'proven' and 'tried-and-tested' business formula should find it advantageous to, in effect, spin-off stakes or quasi-equity to others in the exploitation of this business formula via franchising.

Horse-race tipsters purporting to involve the public in access to 'proven formula winning systems' in exchange for money are typically viewed with some suspicion. Such 'tips' (predictions) are sold before the 'off' (start of the race) and there is no come-back in the event of the 'winning system' being found wanting. In essence, rather than invest their own assets in backing their tips, tipsters rent out their system for investment by others. That is not, of course, to say that they may not also invest financially in following their own fancy, just as a franchisor may invest in one or more company-owned outlets. But the fundamental similarity remains – a winning formula is 'sold-on'. So, why does a franchisor dilute his/her ownership of a winning business formula if it has indeed been seriously pre-tested and offers considerable financial potential?

The answer here does not immediately provide fuel for conspiracy theories. After all, the joint stock company itself, the icon of corporate business life, operates very largely on the same principle of raising money for growth from shareholders and, in return, sharing the fruits of a successful business formula. The essential differences are, it would appear, two in number. Firstly, the investor (franchisee)'s risk is not limited to the value of the initial investment, but is compounded by the opportunity cost of their labour since they subsequently work the franchise at no charge to the franchisor. Secondly, many new franchisees already have their own conventional small businesses or otherwise have a history of prior self-employment (Kaufmann and Stanworth, 1995; Stanworth and Kaufmann, 1996) and what, for them, appeals about a franchise over its conventional alternatives is the franchisor's claim to be privy to title of a 'proven business system'. Thus, the notion 'proven' emerges as crucial to the sale of franchises, along with the implied relative certainty of success for investing franchisees. But just how certain is the survival of a new franchise system?

Only America and Britain have been home to work of any substance on the issue of franchise system survivability. Whilst franchisor survival rates are only one dimension in the overall success of franchising (the other key icon being franchisee survival rates), this dimension is the most transparent and is not vulnerable to the influence of strategic franchisor under-reporting of failure as can be the case with franchisee failure rates (English and Willems, 1994).

2. The Academic vs Franchise Industry Chasm on Franchise System Survivability

Evidence of a chasm between academics and franchise industry spokespeople on the issue of franchise success rates is legion (Price, 1996). To quote Bates:

A recurring theme in government and academic studies is that industry sources (of statistics) have been manipulated in order to enhance public images of franchising's viability.

(Bates, 1998, p. 116)

This situation is not new. A quarter of a century ago, Shelby Hunt, one of the early pioneers of research into franchising, said in an article entitled, 'Franchising: promises, problems, prospects':

Such was the promise of franchising: a boon for everyone. Society would get decreased economic concentration, fewer business failures, and more opportunities for minorities and women. Franchisees would own their own businesses and still compete effectively with the corporate chains. And each new franchise system would follow in the successful footsteps of McDonald's and Kentucky Fried Chicken. What could go wrong? Lots.

(Hunt, 1977, p. 74)

Hunt continued:

Although some franchisors have found the 'promised land' through franchising and grown to giant organizations, the experiences of many franchisors range from substantial problems to outright disasters.

(Hunt, 1977, p. 77)

The conclusion to Hunt's analysis of franchising was that the fundamental problem of franchising lay not in its 'promise' but its 'overpromise'. An inspection of national franchise association web pages in Autumn/Fall of 1999 reveals the following inducements to potential franchisee optimism:

The franchisee gains by a system of commercial management devised by the franchisor in the first place and already tested, so he saves time in using this existing know-how and faces a minor financial risk.

(French Franchise Association, 1999)

Members... (have) a proven product or service... successful over an extended period...

(British Franchise Association, 1999a)

The franchisee will usually need less capital than they would if they were setting up a business independently because the franchisor, through their pilot operations, will have eliminated unnecessary expense.

(Franchise Council of Australia, 1999)

The franchisor provides a method of doing business that has been tested over time in the marketplace.

(International ('American') Franchise Association, 1998)

3. Empirical Evidence on Franchise System Survival Rates

The underlying hypothesis behind the evidence presented below – some of it drawn from earlier literature and some of it previously unpublished – is that franchise system survival patterns largely mirror those of conventional small businesses, with high attrition rates in the formative years, rather than being a sure-fire recipe for success with low system failure rates. After all, the majority of new franchise systems

are in fact themselves small businesses (Stanworth and Purdy, 1994), obliged to construct a front-end infrastructure of managerial support some years ahead of achieving full financial break-even point. In effect, given the demands placed upon an infant franchise system to finance and manage the processes of franchisee recruitment and all that entails, plus induction and field support for franchisees, the new franchise company is, in effect, developing the management and administrative structure normally associated with a medium-sized business, without the income levels normally associated with this scale of business. For a small business intent on developing into a credible franchise operation, the strains normally associated with small business growth are, in fact, likely to be magnified and concentrated, rather than reduced.

Any entrepreneur intending to build up a franchise system needs first to devote at least two years to establishing a basic business idea in terms of testing out sales, marketing, product/service, pricing and staffing strategies. After all, every small business start-up plan inevitably requires considerable modification during the initial months of its implementation. High failure-rate figures, particularly during the first 30 months' operation, verify this claim (Storey, 1994).

Having established a basic business formula, the owner should then, ideally, establish an identical outlet in another location as an initial test of transferability. The process of finding new premises, hiring personnel, organizing a launch and all the other tasks accompanying a new outlet opening, is an essential test of the owners' ability to replicate the success achieved in the founding unit. Again, there will be a steep learning-curve here.

Finally, three key documents need to be drawn up prior to beginning franchising. Firstly, an operating manual, committing to paper detailed instructions for the guidance of franchisees when running an outlet for themselves; secondly, a franchise contract, stipulating the legal obligations of both parties – franchisor and franchisee – and, finally, a franchise prospectus as a marketing tool for use in recruiting franchisees. All three documents require a great deal of time, hard work and, usually, expensive external help from consultants, lawyers and accountants.

Then begins the process of recruiting and training new franchisees and this, again, is liable to prove time-consuming and often very expensive since the business involved has no previous experience or public awareness to draw upon. Stands at franchise recruitment expositions typically cost several thousand dollars and advertisements in trade journals also tend to be expensive. The process of filtering down the 40 or 50 'leads' typically required to yield a single suitable franchisee is also costly, as is the need to establish a central management control system and field support staff able to deliver support to franchisees. In addition, trade marks, trade names and patents may require registration and protection.

Overall, adopting a 'textbook' approach, a business starting up from nothing may well find itself involved in up to five years hard work before it recruits its first franchisee. The founder/s will find that they are not simply involved in testing out one business idea but two – a conventional business configuration plus an allied franchise format. Obviously, the final package has to be one capable of yielding notably better financial returns than the average small business since these must satisfy the franchisee's income needs, service bank loans and pay off loan capital, plus sustaining the franchisor's needs for management services and advertising fees, amounting usually to around 10% on sales turnover.

The above timetable for franchise systems development can be safely reduced in the case of an already well established businesses wishing simply to convert to a

franchise format by cloning their previous success, but the risks may still be high. A report commissioned by the US Small Business Administration estimated that in 1993 initial franchise development costs could easily exceed \$500 000 (Trutko *et al.*, 1993, p. 7-1):

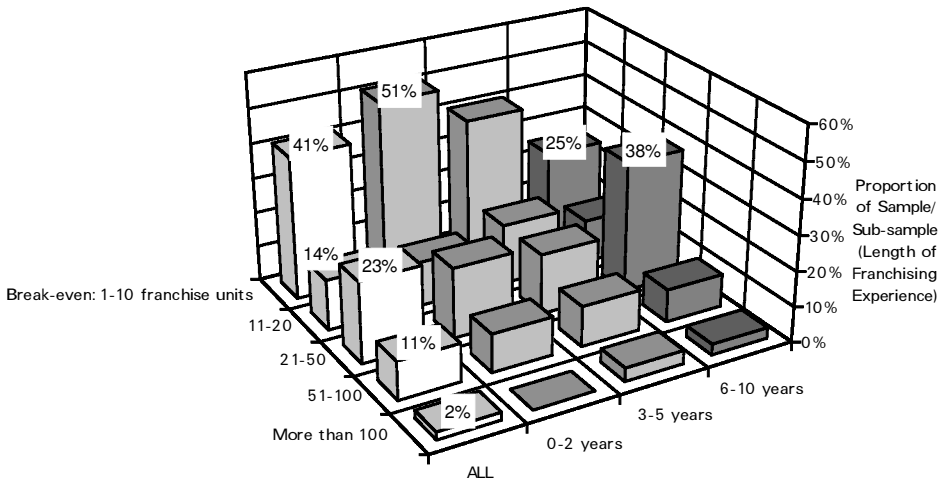
The development of a business from a proven concept through to the sale of its first franchise is typically a long, expensive, and risky process for the franchisor. Even excluding the costs of direct management involvement, the franchisor bears sizeable 'upfront' costs for developing a programme before it can be marketed to franchisees.

Overly optimistic messages from authoritative sources sometimes imply that franchising is a low-cost growth option for would-be franchisors. But insufficient finance poses a greater threat to survival than many younger franchise systems realise (Silvester *et al.*, 1996). Unexpected delays in reaching the break-even size of operation, or later finding it to be further away than first anticipated, may well stretch a system to breaking point if it is under-financed from the outset. The gap between rhetoric and reality in the field of franchising can be very substantial.

A 1996 survey of the 400 indigenous British franchise companies 10 years old or less in order to address the issue of system survival in the first ten years, yielded 145 responses, 139 of them usable (Silvester *et al.*, 1996, 1997). It analysed responses on a range of issues and compared the views and experiences of young and mature systems. Responding firms were grouped into three age bands: 0-2 years (55 firms), 3-5 years (52 firms) and, finally, 6-10 years (32 firms). It is interesting to note that only 32 (23%) of the total of 139 were five years old or more. In an industry which is relatively mature and has remained fairly constant in size (certainly in terms of financial turnover) since the late 1980s, the fact that only one-in-four businesses was older than five years certainly indicates substantial turbulence and system failure.

Using these age groupings, 0-2, 3-5 and 6-10 years, respondents were asked to estimate the number of franchised outlets required to be operational in order for income yielded from them to match the cost of the management support network. The results shown in Figure 1 illustrate changing perceptions with age. For instance, of firms in the 0-2 year stage, 51% were quite optimistic that the break-even point was relatively low in terms of number of outlets (1-10 outlets in fact). By way of contrast, the more experienced firms in the 3-5 year age group were noticeably less likely to suggest that it was as low as 1-10 outlets (only 41% thought so) and were more likely than their less experienced counterparts to suggest 11-20 or 20+ outlets. Finally, however, the most experienced group of all, those in the 6-10 year age group, were very much more likely to opt for the 21-50 outlet range. Only 26% of this group felt that break-even lay in the 1-10 outlet size band. Fifty per cent thought it was 21 outlets or more and 38% thought break-even lay in the 21-50 outlet range. Hence, it appears that optimism becomes tempered by experience over time as earlier estimates become viewed as unrealistic. A process of socialization here, whereby optimism became tempered by experience, may have been reinforced by better survival rates among the more realistic franchisors who had been prepared from the outset for a long haul.

The evidence suggests that the notion of the franchise format, acting as an inoculation against failure is essentially flawed or 'overpromised'. As an antidote to this, it is important to stress the notion of degrees of 'proof' and 'testing', which



Silvester, Stanworth, Purdy & Hatcliff e (1996);

Figure 1. ‘Break-even’ franchise system size: by franchising experience.

come with age, size and experience of system. For, in fact, it could be argued that no franchise system has convincingly cleared the hurdle of proof until it has achieved a break-even number of outlets. Thus, the definition of break-even most firmly grounded in experience appears to be 21–50 outlets. Adopting this definition, the 84 of the 139 respondents (60%) with 20 or fewer outlets might be termed pre-break-even or at the Developmental Stage. The 28 (20%) in the 21–50 outlet range were at the Break-Even Stage and, finally, the remaining 27 systems (nearly 20%) had reached what might be termed the Success Stage. It should be remembered of course that, although only one in five of franchise systems in this survey had passed break-even stage, they may well have accounted for the bulk of outlets and allied financial turnover.

Floyd and Fenwick (1999) have developed an alternative growth stage model defined in terms of stages of organizational sophistication. First, is the Hatching Stage which simply involves the decision to establish a business. The decision to franchise takes the business to the Nestling Stage. Once the business recruits its first franchisee, it has entered the Fledgling Stage where support, infrastructural and management systems are variously developed. Finally, there is the emergence of the Adult Stage once break-even is achieved and the primary focus of franchisors becomes strategic. Of the seven stages of development featured in these two models, only two involve post break-even trading, indicating that much is to be achieved ahead of this. Perhaps only the Success Stage and its equivalent, the Adult Stage should be seen as genuinely ‘proven’ or ‘tried-and-tested’.

4. Conventional Small Business Failure Rates

The answer to the question, ‘how many small firms fail?’ is simply ‘we do not know’ (Daly and McCann, 1992), just as it is not known with total precision how many firms there are in any economy. Nonetheless, official statistics, academic research and practical experience all act to foster fairly high failure rate expectations amongst conventional small firms in their formative years. Though failure rates amongst

young small businesses do appear fairly high, they are probably not as high as is often believed. For instance, in the US, Phillips and Kirchhoff have pointed out that:

Entrepreneurship is clearly an activity involving risk, but the risk of failure is far smaller than popularly believed.

They refer to the popular misconception that:

Four out of five new firms fail within the first five years.
(Phillips and Kirchhoff, 1989, p. 69)

Phillips and Kirchhoff, in their research in small business failures, used the US Small Business Administration's 1976–1986 Establishment Longitudinal Microdata files and revealed survival rates amongst US small business start-ups over a 6-year period averaging 40%, or better than twice the survival rate suggested by the often quoted adage that 'four out of five fail in five years'. Moreover, for firms that grew, survival rates averaged 66%, or two out of three (1989, p. 74). Growth proved a better indicator than sector of failure rate differences. An examination of nine different sector averages showed a sector survival span over six years ranging from a low of 35% in construction to a high of 47% in manufacturing.

Looking at the failure rate levels typical of small businesses generally, Storey, after comparing US and UK data, concluded:

The broad pattern which emerges is that the young are more likely to fail than the old, the very small are more likely to fail than their larger counterparts, and that, for young firms, probably the most powerful influence on their survival is whether or not they grow within a short period after start-up.

(Storey, 1994, p. 109)

There is evidence that this general conclusion extends also to young franchise systems if growth is measured in terms of outlets established (Stanworth *et al.*, 1997, p. 89).

The best statistics available in Britain for practical purposes are those based on VAT (Value Added Tax) registrations and deregistrations and these reveal a somewhat similar picture to the US, albeit with slightly higher survival rates in Britain than in the US (Storey, 1994, p. 96). Approximately one-third of all British small business start-ups fail within three years of formation and about 30% survive through to the end of ten years (Daly, 1987; Storey, 1994, p. 104). Rates of failure appear low in the first 12 months of existence, followed by a rapid rise in years two and three. The annual failure rate then falls away to around 7% amongst businesses 10 years old (Daly, 1987).

5. Franchise Systems Failure Rates

Lafontaine and Shaw conducted a US franchise attrition exercise for successive years beginning in 1980. Looking at their most comprehensive data sets, 28.6% of 1980 starts survived to 1992 (12 years) and 29.2% of 1981 starts survived (11 years) to 1992 (Figure 2). Overall, during the period 1980–1992, they identified 2524 firms entering the franchise industry, of which 1941 exited during the same period. Lafontaine and Shaw claim:

... While many firms keep entering into franchising, giving the impression of tremendous growth, many are also exiting, leading to an overall growth rate at best commensurate with that of the economy. ... From the franchisor's viewpoint, the high rate of exits suggest that many firms fail despite franchising, and many others choose to stop franchising after trying it for a few years. Clearly, these firms have found that franchising is not right for them.

(Lafontaine and Shaw, 1997)

Shane tracked 138 US franchise systems with their franchise origins in 1983 and found that only 24.6% survived 10 years (Figure 3). He concluded that:

... the failure rate of new franchise systems approximates that of new organizations.

(Shane, 1996a, p. 230)

In a follow-up paper, he commented on the implications of young franchise system failure for would-be franchisees:

... a new franchise system brings with it a high probability that the new franchisor will not be around in future years ... Because over half of new franchisors cease to franchise during the first four years, potential franchisees should be very wary of buying into systems that have not yet reached their fourth anniversary.

(Shane, 1996b, p. 1)

6. New British Data

Franchise researchers and other interested parties in the UK had never known with any accuracy how many franchise systems existed within the country at any one time or the degree of turbulence manifest within the sector. There are two principal franchise directories produced in the UK annually – one by Franchise

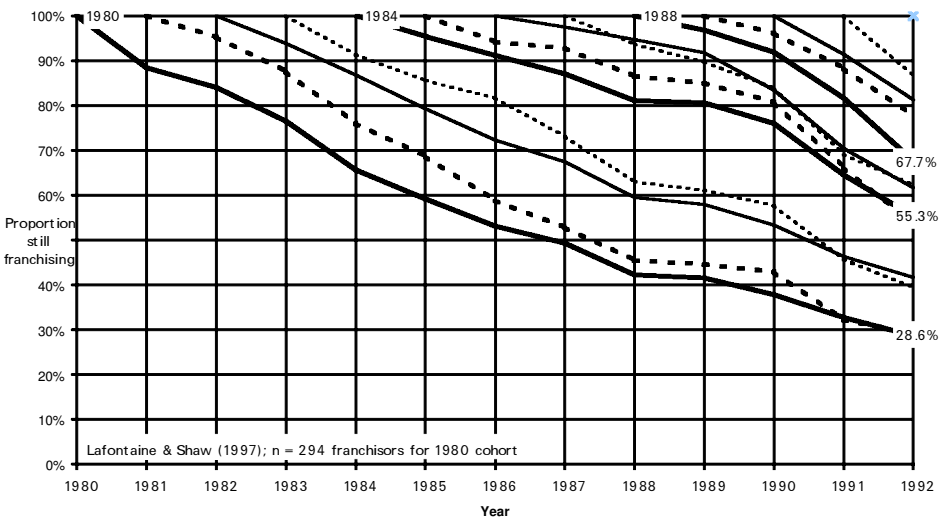


Figure 2. US franchisors starting to franchise in a given year: proportion still franchising in subsequent years.

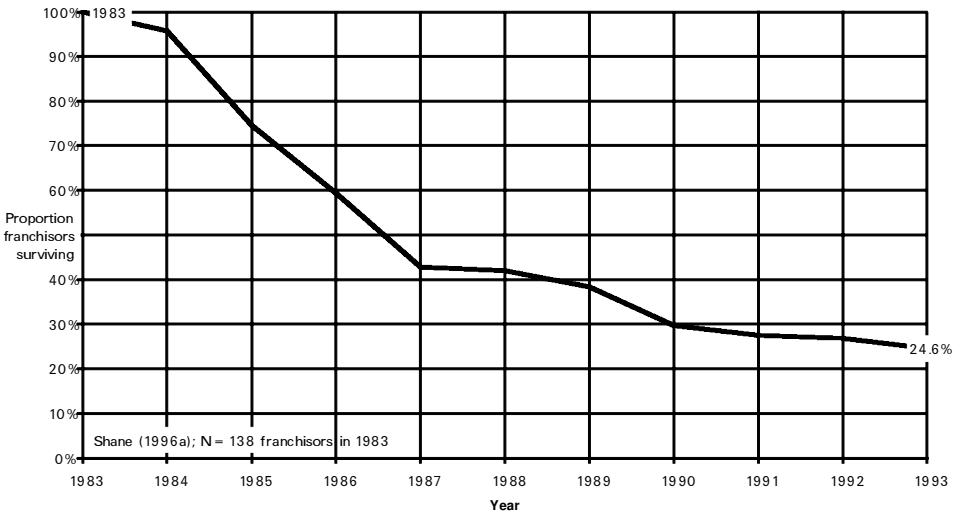


Figure 3. US franchisors starting to franchise in 1983: proportion surviving in subsequent years.

World publications and the other by Franchise Development Services. Researchers at the International Franchise Research Centre, University of Westminster, London, decided in 1996 to combine the two current directories into a single database.

The combined database yielded a total of 732 entries, though less than half (only 324 in fact) appeared in both directories. The Franchise Development Services database contained an additional 305 exclusive entries whilst the Franchise World Directory carried a further 103 exclusive entries (Franchise Development Services, 1995; Franchise World, 1995). Approximately 18–24 months after the directories had been originally compiled, a comprehensive programme of telephone calls was undertaken to all the 732 constituent companies listed in the two directories. All companies were telephoned, many several times, in order to establish whether they were still in existence and still operating a franchise format. Where systems were not still at the addresses given in directories, all reasonable efforts were made to trace them.

The initial database of 732 was first ‘cleaned’ by the exclusion of firms which appeared to be ‘business opportunities’ rather than franchises, duplicates (appearing more than once under different names), or ‘ghosts’ (planted to detect unauthorized use of one of the databases). Exclusion of these entries reduced the franchise system population from 732 to 704. Of these, 467 firms were verified as still operating on the basis of a franchise format, whilst a further 87 had ‘exited’ franchising but were still developing their businesses, albeit now on a non-franchise basis. A further 182 were found to have failed or were untraceable and assumed ‘failed’.

Figure 4 shows the overall sample of 732 entries (subsequently ‘cleaned’ to 704) and points to a number of fairly obvious conclusions. Overall, one-third (33.9%) of these entries had disappeared from the world of franchising. In addition, approximately one-in-eight (12.4%) were deemed ‘exits’ though, typically, franchising had not been an unqualified success for them.

Using dual entry in both directories (as opposed to just a single directory) as a proxy for greater visibility and maturity, it was hypothesized that this would be

	<i>Franchise Systems Appearing in Only One Directory</i>		<i>Franchise Systems Appearing in Both Directories</i>		<i>Combined Directory Totals</i>	
Total Entries.....	408		324		732	
'Cleaned' Total.....	389	100.0%	315	100.0%	704	100.0%
Surviving As						
A Franchise.....	203	52.2%	264	83.8%	467	66.3%
Survived Franchising						
But 'Exited'.....	68	17.5%	19	6.0%	87	12.4%
Failed/Could Not						
Be Traced/Assumed Failed.....	118	30.3%	32	10.2%	150	21.3%

Figure 4. Survival rates of British franchise systems: a combined analysis of all entries from two principal franchise directories.

correlated with reduced failure rates. In the event, the hypothesis was strongly supported when survival rates rose from 52.2% for single entry systems to 83.8% for dual entry systems.

6.1. Britain – Franchises vs Business Opportunities

Franchises in the US are obliged to operate within a government-regulated environment, dictating certain requirements concerning disclosure for those businesses defined as franchises (Federal Trade Commission, 1986). This is in contrast to Britain, where no such regulation exists, and thus the scope for selling undefined 'franchises' is arguably greater.

And in the absence of any penalty or deterrent for doing so, business promoters offering goods or services for sale via distributorships or licenses may wish to publicise their operation as a 'franchise', to take advantage of the implied association between franchising and automatic or guaranteed success that often finds its way into long-standing publications with a wide circulation amongst the public, for instance:

'The system allows the owners (franchisors) to grow their business and the franchisees to cash in on a proven formula', subheading to article, 'Britain is sold on franchising'.

(Oldfield, The Sunday Times, 1999)

A franchise gives you the right to use a well-tried business formula for a start-up fee, which can be as low as a few thousand pounds, and most of which you can borrow. Article 'Could a franchise make your fortune?'

(Woman's Realm, 1999)

It has been suggested to the authors that the publishers of British directories may also include business opportunities to help boost the contents and as a result, increase directory sales to would-be franchisees. As a result, any attrition analysis using such sources may overstate the actual franchise system failure rate because of the inclusion of many so-called 'business opportunities', which many believe are much more prone to failure than franchises.

It could be argued that, ideally, only business format franchises should be included in such studies, perhaps defined as:

Business format franchising is the granting of a license by one person (the franchisor) to another (the franchisee), which entitles the franchisee to trade under the trade mark/trade name of the franchisor and to make use of an entire package, comprising all the elements necessary to establish a previously untrained person in the business and to run it with continual assistance on a predetermined basis.

(British Franchise Association, 1999b)

But such a distinction may have restricted merit as far as prospective franchisees scanning directories for suitable opportunities are concerned and may not fully represent the market under consideration. The understanding of the meaning of 'franchising' in the Britain appears to be limited (Watson and Kirby, 1999). In a recent survey of members of the public, only 10% had a 'clear understanding' (defined as being able to describe more than one element or feature of franchising). Conversely, it is assumed that 90% did not.

Also, another distinction between 'franchises' and 'business opportunities' is said to be the difference in cost, according to Caffey (1999):

Another distinction between franchises and business opportunities is the cost. A retail franchise programme can involve initial fees of \$30 000 or more with a total business investment of \$50 000 and up. In contrast, most business opportunity purchase prices are low enough to be put on a credit card, running from a few hundred to a few thousand dollars.

Using the Franchise Development Services directory (where the cost data was available for 85% of the systems), the proportion of systems with a total franchise cost of less than £10 000 (\$16 000) that either failed or exited amounted to 36% of those within that cost band. For bands within the ranges falling within £10 000 and £99 999 (\$16 000 to \$160 000), the failures/exits accounted for 26% to 33% of the respective cost bands. Thus, the failures/exits did not seem to contain a significant cluster of low-cost business opportunities. Finally, of the (surviving) businesses shown in the directories that were contacted, only 10 businesses thought they were operating a business opportunity rather than a franchise.

The definitional issue, however, does beg a question regarding strict comparisons between data emanating from countries operating tightly-regulated regimes for franchises, as opposed to loosely-regulated countries. Moreover, with speculation that in the US that the definition of 'franchise' is being extended (Ladas and Parry, 1998), then the comparability with earlier franchise data within the same country could be problematical, too.

6.2. British 'Exits'

Occasionally, examples were found of failed franchise systems living on in the form of franchisees sometimes continuing to trade either individually or collectively. Additionally, sizeable numbers of firms withdrawing from franchising were found whilst continuing to seek their business futures along more conventional lines. When contacted, the proprietors of the latter businesses ('exits') explained their withdrawal from franchising usually in terms which indicated their lack of preparedness for the rigors of living with the challenges presented by franchising.

Under-estimating the capital resources required, under-estimating the difficulties involved in franchisee recruitment and the amount of 'handholding' and support required by franchisees, under-estimating the cost of consultants and legal advisors, plus the nervousness of the banks in lending to new franchise systems, featured most frequently. In short, they had often not been fully prepared for the demands and challenges thrown up by franchising which involves a symbiotic inter-dependence between franchisor and franchisee, rather than a once-and-for-all sale of a 'business kit' and set of instructions.

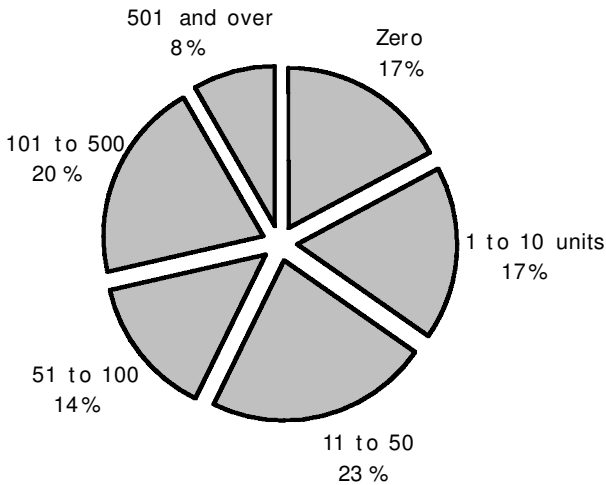
7. New US Data

Recent American research reinforces the general perception of substantially higher rates of churning amongst franchise businesses than the industry had publicly acknowledged previously. In fact, the results of recent IFA (International Franchise Association) sponsored research appear to be tending towards congruence with independent academic research. This study, the Profile of Franchising (IFA Educational Foundation, 1998), is a three-year study of franchise systems registered in the 12 states which oblige franchisors to lodge Uniform Franchise Offering Circulars (UFOCs). Although only a minority of states require such registration, these include such large states as California and are, collectively, acknowledged by the IFA as accounting for approximately half of all franchise systems operating in the entire United States of America.

The research fieldwork and analysis were undertaken by the FRANDATA Corporation, a franchise information company, and the Business and Public Administration Research Centre at the University of Missouri-Columbia. Volume 1, based on the first year of the research project, collected data from Uniform Franchise Offering Circulars filed and registered in the twelve registration states in the calendar year 1996. This led to an overall base for the study of 1156 systems after a modest number of exclusions due to incomplete data, documents failing to arrive before a specified cut-off date (end of December 1996) or duplication in the case of master/subfranchise entries for systems already included.

The process was duplicated in the calendar year 1997 when the comparable total rose modestly to 1178 franchise systems, an increase of 22 (2%) (IFA Educational Foundation, 1999). At first sight, this observation could be taken to indicate a high level of stability in the sector. However, in the 1997 stage of the study, only 834 of the systems identified in 1996 were still in evidence. The remaining 322 (28%) were absent. The most obvious explanatory reasons here would appear to be those of system failure, registration revocation at state level, or a decision not to offer franchises in a registration state.

Figure 5, using data from the first report, where the original 1,156 systems were identified, breaks down the population by numbers of domestic franchised units. Here we see that 17% of systems had no outlets whatsoever, while an identical proportion (17%) had 1–10 outlets and a further 23% had 11–50 outlets. Whilst it is quite possible that the 8% of systems with 500-plus domestic franchised outlets may have accounted for the majority of franchisees overall, the fact remains that over half of all franchise systems had 50 franchisees or less. Given that the 11–50 outlets range appears to be generally the break-even threshold (Silvester *et al.*, 1996, 1997), it could be said that around half of all franchise systems are either pre-break-even or on the verge of break-even at any one time.



IFA Education Foundation (1998); n=1,156

Figure 5. Franchise population by total number of domestic franchised units (UFOC Survey, US).

7.1. Variations in Break-even Size for Different Franchise Systems

It is to be expected that a number of factors will influence the break-even size for a given franchise system, where 'break-even size' is the number of franchise outlets needed for the management services/royalty income to sustain the overhead of an optimum network without the need for further units (survey questionnaire used in Silvester *et al.*, 1996). However, variations in each of these factors may result in different break-even sizes for different types of franchise systems. For instance, the profitability of franchise outlets may be affected by variations in local costs/overheads, such as commercial property rental rates, where British levels in 1998 ranged from \$74 to \$16 per square foot p.a. within London, and elsewhere, where 'prime space' was \$37 in Edinburgh and \$23 in Cardiff (Nelson and Marcheso, 1998). Another factor would be the industry sector, where franchise systems in a given sector may have outlets that are appreciably different in terms of sales turnover range, compared to franchise outlets trading in other sectors. For example, a majority of the outlets of a health and fitness franchise might have a gross sales turnover range falling between £30 000 and £100 000 p.a. (\$48 000 to \$160 000), whereas for a printshop franchise the range might be £100 000 to £0.5m (\$160 000 to \$0.8m) (previously unpublished analysis, derived from data gathered for: Nunn *et al.*, 1998). Also, differences in risks and returns have been observed between real estate and printing franchises (Newby and Smith, 1996, a study of franchise outlets in Australia).

So, whilst the British-derived data has suggested that, as a generalization, the break-even size falls within 21–50 outlets, is it reasonable to assume that the same band can be rigidly applied to franchise systems operating in other countries? In the absence of directly comparable data from franchises operating elsewhere, this is not known with total precision. However, the current analysis is based on an unproven hypothesis that such an assumption could be reasonable.

The fact that some of the year-on-year turbulence amongst the population of franchise systems involves systems with no franchised outlets does not mean that

such firms should be excluded from discussions on franchise system survivability. After all, even if the owners of a prototype pre-franchise business withdraw from franchising after UFOC registration but before selling a single franchise, the implications for franchise system survival rates are still quite important. After all, the process of first deciding to pursue a policy of expansion via franchising and then investing time and money in the process of registration, indicates serious intent. Subsequent failure to sell franchises, the experience of over-riding financial liquidity problems, or any other reason/s for withdrawing from registration, is not inconsequential for franchisors where debates on franchise survivability are concerned. For the purposes of the current IFA study, registered firms without franchise outlets were considered franchises, albeit early stage ones.

Further data from the above report shows that 15% of the population had been franchising for one year or less, but that only 6% had been in business for one year or less. This suggests that those businesses registered but without franchisees did, for the most part, have a business and this, presumably, was the one intended for duplication by means of franchising. Finally, 34% of the 1996 population had ten outlets or less and 29% had 3 years or less franchising experience. Although the data do not allow us to assess the commonality with which the same systems featured in both of these statistics, it would appear the incidence is likely to be high since it is known from other sources that around 50% of new systems fail in the first 4 years and also that systems with 10 outlets or less are typically at a pre-break-even stage of development. Overall, these new IFA data would appear to add considerable weight to the notions of high attrition rates amongst young franchise systems.

8. The Notions of Survivability ‘Proven’ and ‘Tried and Tested’, in Franchising – Some Concluding Remarks

Frequent use of the terms ‘proven’ and ‘tried-and-tested’ in franchise promotional literature could be said to be at the heart of the sector’s tendency for overpromise since research shows quite conclusively that there are more similarities than differences if we compare young franchise systems (less than four years old) with their conventional counterparts. Perhaps this should not be deemed surprising given that many new franchise systems are essentially small business ventures (Silvester *et al.*, 1997) and, while franchising offers a possible route to fast growth, failure rates in the early days will be high. After all, for a small business intent on developing into a credible franchise operation, the strains normally associated with small business growth will be concentrated and magnified rather than reduced.

In essence, the notions of ‘testing’ and ‘proving’ a business formula pervade economic organizations generally. Without these concepts, improvement would be unlikely and failure inevitable. The notion of ‘cloning’ success, so essential to the fundamental concept of franchising, is also generic to conventionally organized businesses and an integral component of internal organic growth, either within a single geographic unit or amongst geographically dispersed units. However, a unique defining aspect of franchising is that of formulaic ‘cloning’ in near identical form to numerous other parties. The separation and crystallization of the boundaries here is the defining characteristic of franchising which separates it out from conventional business activities, even though most of the activities involved in both have much in common.

The evidence of close similarities between franchise business failure rates and those of conventional small businesses is now strong, particularly if all franchise

exits are counted as franchise 'deaths'. However, the evidence points towards franchising being even more risky than conventional small business activity in the first four or five years for both franchisor and franchisee, followed by a period of relatively low failure once break-even has been reached. As Lafontaine points out, franchising does not guarantee success for franchisors or franchisees and, for franchisees investing in less than the very best established franchised businesses, life may well prove even more risky than starting up an independent business. Having said that, a small minority of leading franchisors account for the majority of franchisees and their chances of continued success appear quite high. Thus, to attempt to quote a single statistic to indicate the probability of success of all franchisors or all franchisees is overly simplistic. The conservatism of the banks in funding young franchise systems then appears quite justified and is vindicated by recent research results on franchisor failure rates.

The industry now faces fresh challenges. The target of much of the franchise industry's hype is the potential franchisee. If, as seems the case on the evidence cited here, becoming a franchisee in a young system is far from being the safe investment that the industry has claimed all along, a fresh public stance will be required by the industry. If the industry reacts to this situation by suggesting that young franchise systems openly acknowledge a high risk factor and suggest that new systems charge reduced royalties in the initial stages, this could then simply act to even increase already high failure rates amongst new systems. Perhaps the answer is to encourage more thorough piloting and realistic costing of new systems before offering them for sale. Any failure to act could simply result in heightened pressure for franchise legislation.

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When the Franchisor Fails

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About the author

Jenny Buchan

After nearly 20 years as a commercial lawyer in private practice, Jenny Buchan became an academic at the University of New South Wales. Both as a lawyer and as an academic, her focus has been on franchising. This has led to her ongoing research on the challenges that franchising, as a relatively new business model, poses for insolvency law.

(i) Executive summary

- At least 40 franchisors failed in Australia between 1990 and 2005. (Appendix 1)
- Approximately 1090 franchisees and their families were directly affected. (Appendix 2)
- If each franchisee of a failed franchisor had the industry average number of employees, the 40 failures would have affected more than 11,500 employees.
- These failures have indirectly affected landlords, financiers and other suppliers.
- Failed franchisors have been in business for up to 94 years and they have been in franchising for up to 14 years at the time of failure.
- Failed franchisors, and to a greater extent, their franchisees, were extremely difficult to identify. It is not obvious from the public records whether insolvent companies or bankrupts were franchisors or franchisees.
- Franchisees experienced a range of outcomes including taking the opportunity to go it alone, becoming part of another franchise system, financial loss, unemployment, and the associated consequences such as marriage breakdown and relocation.
- As a result of their franchisors' failure, franchisees also had the following experiences:
 - They experienced difficulty in trading when the media were drawing attention to the franchisor's inability to pay its debts even before it became insolvent. Trading was particularly difficult when the franchisee was selling expensive items such as holidays.
 - Franchisees have no automatic statutory right to a voice at a franchisor's creditor's meeting because often they are not creditors.
 - Liquidators owe a duty to creditors to obtain a fair market price for assets and to limit the ongoing liability of the failed entity. That is, they are not specifically concerned about the outcome for franchisees, so long as terms and prices are acceptable. They are unlikely to be concerned about whether the buyer of the franchisor's business will be able to run the franchise system.
- Fluctuations in the franchisee's income after the failure of the franchisor could trigger a tax audit of the franchisee in the following year.
- Speedy and concerted action by franchisees is essential if the franchisor is failing but often they have difficulty in contacting each other except via the franchisor. Sometimes they don't even know each other's surnames. Employees can turn to their unions for support, but franchisees have no support or advice network.
- Franchisees have no way of knowing in advance that the franchisor is about to fail and therefore they have no opportunity to make contingency plans.
- Franchisees are more like employees who have invested money in the franchisor than independent business operators. Despite the franchise agreement stating very clearly that the franchisee is not an employee of the franchisor, it appears that some franchisees regard themselves as employees.
- Most franchise agreements stipulate that franchisee insolvency is an opportunity for the franchisor to terminate the franchise agreement. However, insolvency is sometimes defined so broadly in the franchise agreement that the law would not regard it as insolvency. In fact, it is rare for franchise agreements to contain clauses that allow a franchisee to terminate it if the franchisor becomes insolvent.
- International master franchise agreements often include contingency planning for Australian national master franchisor failure.
- The research undertaken for this report shows that there is very little centrally-collected data about the legal aspects of this significant part of the Australian economy.



(ii) Introduction

Purpose

The purpose of this report was to determine the effect of franchisor failure on franchisees. The first task was to identify failed systems. The difficulties experienced in identifying failed systems and the franchisees of those systems are covered in the Methodology section of this report.

Australian law leaves franchisees without specific legal redress if the franchisor fails. However, this is not surprising given that the law is not usually pro-active and that, rather, it responds to demonstrated need. Clearly, the case for specific legal recognition of franchisees in a franchisor failure has not yet been demonstrated in Australia. One of the aims of this report is to stimulate debate as to whether franchisees should be afforded some legal protection in the event of franchisor failure and to ask if whether at least there should be some form of mandatory disclosure to provide franchisees with information about their rights and obligations in this event.

Scope

In this report, franchisor failure is said to occur when an administrator or liquidator is appointed to the franchisor. It does not occur when the franchisor fails as a franchisor; it occurs only when the franchisor becomes externally administered. The term 'franchisor' includes the Australian master franchisee of an overseas franchise system but it does not include a state master franchisee of an Australian system.

Franchisees disappear from the public records when the franchisor's business fails. This makes it very difficult to identify these franchisees and the issues which affect them. This report documents the results of the first empirical research that has been conducted of the effect of franchisor failure in Australia on franchisees.

Appendix 1 is a list of franchisors that were known to have failed between 1990 and 2005. The list is incomplete for the following reasons.

- It includes only franchisors that operated through a corporate structure. Not all franchisors are companies. Even if a franchisor is a company, there are no identifiers in the Australian Securities and Investment Commission (ASIC) records that indicate that a company or a trust is a franchisor.
- If a franchisor is not a company, it may not be registered anywhere on the public record that is searchable. Personal bankruptcy records of franchisors that did not operate under a company structure do not contain identifiers that the trust, partnership or individual was a franchisor.
- In some cases it is the Australian master franchisee (AMF) that has failed, not the overseas franchisor. AMFs have been included as failed franchisors here because the future for their franchisees can be as uncertain as that for franchisees with a local, Australian, franchisor.

(iii) Franchising in Australia

There is significant statistical and market related information available about the Australian franchising sector, which has proved invaluable for this report. Frazer and Weaven report the following facts.

- In 2004, there were about 850 franchisors in Australia.
- There were 50,600 business format franchised units operating (about 42,800 franchisees – some have more than one outlet (question D10 in Frazer and Weaven).
- The average age of the franchise systems was 11 years.
- The average total start-up cost of a new franchised unit (excluding GST) was \$120,000 (range \$2,500 to \$870,000).
- The average number of franchised units in a system was 26 (range was 0 to 3,700).
- The average number of employees per franchised unit was 310 (including permanent full-time, permanent part-time and casual).
- Sixty-nine per cent of franchised systems operated from specific premises; and thus often had lease-related obligations.
- Franchising contributed about 10 per cent of Australia's GDP (source: Franchise Council of Australia).

In 1991, the Federal Government commissioned Franchising Task Force Report (Beddall Report) which made the following recommendations.

Recommendation 1.19

The Bureau of Statistics should be required to collect on an annual basis at least the following statistical information in relation to franchising in Australia:

- Number of outlets that have ceased trading (among other things).

The Beddall Report thus acknowledged the dearth of statistical information then available on which to base future policy initiatives. However, even if Recommendation 1.19, with its focus on franchisee failure, had been implemented by the Bureau of Statistics, data about the identity of failed franchisors would not be available in an easily accessible format. The Beddall Report made reference to the then known causes of franchisor and franchisee failure in Chapter 2. In paragraph 2.9 it dismissed the need for attention to be given to franchisor failure by saying:

2.9 Franchisees are clearly vulnerable to the collapse of the franchisor. However even when the franchisor has collapsed, some franchisees are capable of surviving as independently owned and operated outlets, as with a number of the Barbara's House and Garden Franchisees. With appropriate restructuring arrangements, virtually all LJ Hooker Real Estate franchisees survived.

Although the statements in paragraph 2.9 of the Beddall Report are correct, they gloss over situations where franchisees have not fared as well as those identified. Ultimately, the solutions proposed by the Beddall Report were intended to reduce franchisee failure rates.

The need for mandatory pre-franchise disclosure was addressed by the amendment to the Trade Practices Act 1974 (Commonwealth) in 1998 which made a breach of the Franchising Code of Conduct 1998 (FCC) a breach of the Act.. At the same time, the need for legislative recognition of unconscionable conduct in business to business transactions was addressed with the enactment of section 51AC of the Act.

The franchise model is generally proven and successful. However, two widely adopted assumptions about franchising are that:

- the franchise business model is fully evolved, and
- franchisors do not start franchising until they have a proven business.

Franchise accountants, business bankers and insolvency practitioners will be aware that neither assumption is justifiable in all cases.

The increase in the overall number of franchisors from 693 franchise systems in the 1998 Franchising Australia survey to 850 franchise systems in 2004 masks the fact that not all the original number re-appear in 2004. Those that disappear have not necessarily failed as a business. Some franchisors re-purchase franchised outlets from franchisees after deciding to move away from the franchise model. Some simply stop delivering support to the franchisees but do not fail as companies, only as franchisors.

The image of franchising has been scarred by several widely publicised franchisor collapses, particularly those of the Cut Price Deli franchisor in 1995 and Traveland in 2001.

The Cut Price Deli system seemed to drown in a sea of litigation arising from breaches of the consumer protection provisions of the Trade Practices Act. Its collapse was particularly damaging because the system included 150 franchisees occupying prominent retail sites and it had been in franchising for about 11 years.

The experience of Traveland demonstrated that public companies and franchisors can fail. In 2001, the publicly listed Australian company, Ansett Airlines, the official airline to the Sydney 2000 Olympic Games, became insolvent with direct repercussions for its 35 subsidiaries, including the franchisor, Traveland Pty Ltd. At the time of the collapse, Traveland Pty Ltd was operating about 100 company owned travel agencies and employing about 750 staff. In addition, there were about 270 franchisee owned travel agencies trading as 'Traveland.' Administrators were appointed to Traveland Pty Ltd in 2001. The failure was nothing to do with Traveland itself, but was a result of the parent company's insolvency.

Union, public, financier, media, and ultimately government support, was generated for the former employees of Ansett (and, by implication, the employees of its subsidiaries) (see Appendix 3). Consequently the employees of Ansett and Traveland were accorded some dignity and comfort by the clear legal status they enjoyed in insolvency. However, things were different for the franchisees. Insolvency law does not accord any unique status to them.

This research project arose from speculation about the fate of the Traveland franchisees. Despite widespread media coverage of the Traveland collapse, little or no mention was made of the plight of its franchisees, despite the fact that they constituted 73 per cent of its travel agencies.

Without data, the extent of franchisor failure and the effect of franchisor failure on the image of franchising as a trusted business model and on franchisees, banks, landlords and other stakeholders can only be the subject of educated guesswork.

(iv) Theories and models

The lack of information on franchisor failure in the annual survey of franchising and other sources of information available to those who are thinking of buying a franchise does little to encourage lawyers to insert amendments related to the possibility of franchisor insolvency. Even if amendments were sought, franchisees are usually signing a standard contract; therefore amendments that contemplate franchisor failure are unlikely to be acceptable to the franchisor.

The franchisee's situation does not fit comfortably within the insolvency regime. The franchisee has a vital, vested interest in the outcome of the insolvency yet it has no legal right to influence the outcome. In theory, insolvency would give all legitimate stakeholders a right to have their legitimate interests taken into account by the trustee in bankruptcy or the liquidator. When insolvency involves a franchise system the insolvency model locates a key stakeholder, the franchisees, in the wrong place in the insolvency model; the franchisees are an 'asset' or a 'liability' and, as such, have no rights.

Theories

Contract law

The relationships between all players in the franchise system are governed by contracts. These include franchise agreements, leases, licences, supplier agreements, finance agreements, employment contracts and any other documents recording matters between franchisors (and their related entities) and franchisees and, if the franchisee is a company, its directors. In principle, these contracts are made between independent parties and are negotiable.

However, '... franchising is problematic for contract law' (Hadfield p 929). The traditional view of contracts is that the contract records the parties' negotiated agreement. The parties are presumed to have considered all important issues and provided for them. In the absence of bad faith (for which the franchisee may have contractual remedies), unconscionable conduct or misleading or deceptive conduct by the franchisor (for which the franchisee can turn to legislated solutions), the express terms of the contract will govern the relationship between franchisor and franchisee.

Where there is a power imbalance between parties, as with franchisors and prospective franchisees, none of the current common law or legislated legal approaches to redressing the overt power imbalance, "'satisfactorily strikes at the heart of the problem: the incompleteness of the contracts that structure such a complex relationship, one which requires high levels of commitment to protect large sunk investments against opportunism' (Hadfield p 929).

The necessarily incomplete relational contract (franchise agreement) implicitly acknowledges that there will be issues that arise during the course of the franchise relationship that have not been considered. The franchisee believes they will be addressed when they arise and they often are. Some incomplete contracts provide a procedure for resolution of unknowns; others address them as and when they arise. Potential failure of the franchisor is, arguably, not an unknown, and should be provided for by specific provisions or a procedure being included in the contract.

In addition to governing the relationship between franchisor and franchisee, the contract governs the relationship between the administrator or liquidator and the franchisee. Specific statutory provisions override the contract. In the case of the franchise relationship, the Corporations Act and the Bankruptcy Act allow the liquidator to disclaim onerous contracts. This includes franchise agreements, leases, supplier contracts, and other contracts that affect the existence and viability of the franchisees' businesses.

The consumer protection provisions of the Trade Practices Act (Parts IVA, IVB and V), and the requirement for compliance with the Franchising Code of Conduct help to level the playing field in the pre-purchase phase and during the period of the franchise where the franchisor is still solvent. They are no help to the franchisee of a failed franchisor.

Franchising theory

Franchising should only be embarked upon by successful businesses. The myth that franchisors do not fail has been perpetuated in Australian annual surveys of franchising which describe growth in number of franchise systems in successive years without referring to the number of exits. By way of contrast, the NatWest 2004 United Kingdom Franchise Survey provides a more balanced picture of franchising in the UK to the careful reader by observing (p 6):

The net increase in the number of franchise systems (to an estimated 695 in 2004) masks the fact that as always there have been a number of withdrawals as well as additions. During the year, we have identified 63 systems that withdrew from franchising, that is nine per cent of the systems recorded a year earlier. ... Many of the withdrawals and additions are not the result of commercial failure or new business start-ups. Much of the 'churn' seen in the industry is the result of companies deciding to discontinue franchising as a means of expansion, or companies new to franchising conducting trials to test its viability. The criteria we use for inclusion are also extremely strict, so each year some companies are no longer considered appropriate for inclusion. Many brand names may therefore continue to trade successfully (most likely with company-owned outlets), but are no longer judged to be actively involved in franchising.

This notion of a proven, and by implication infallible, business model, is perpetuated by the Franchise Council of Australia. In his message introducing the July/August 2005 edition of *Franchising Magazine* the chairman of the Franchise Council of Australia (Stephen Giles) cites as a reason for the current high level of credibility of the franchising model of business development in Australia (p 12):

3. Australia has a regulatory framework that provides strong protection to franchisees.

Giles's comments would be accurate if he had said that Australia has a regulatory framework that aims to provide strong protection to franchisees. The statement in its current form arguably gives intending franchisees the impression that the law has addressed all gaps in the model. When it comes to the issue of franchisor insolvency, this is not the case.

Insolvency law

Creditors are paid out in insolvency according to priorities. Some have security for the money owed them and are entitled to sell the security to recover the debt. Entitlements due to employees are given special treatment in insolvency legislation. The reason generally put forward for prioritising debts due to employees is that employees are particularly vulnerable if their employer becomes bankrupt or is wound up. The priority was introduced into insolvency legislation for social welfare reasons 'to ease the financial hardship caused to a relatively poor and defenceless section of the community by the insolvency of their employer'. (Law Reform Commission General Insolvency Inquiry, 1988, para 722, quoting the Cork report, para 1428)

However, 'the principal rationale for the employee priority has been significantly diminished by the development of a sophisticated social welfare system. Further, the effect of the priority is to deprive other unsecured creditors of their claim to a share of the available assets. Included in that class of unsecured creditors may be small traders who were substantially dependent upon the insolvent for their business and persons who were in an employee-like relationship with the insolvent but who are classified (in a strict legal sense) as independent contractors. There, creditors may be as vulnerable as employees in the event of bankruptcy or liquidation but enjoy no protection' (Law Reform Commission General Insolvency Inquiry, 1988; Para 723).

Franchisees are included in this class of unsecured creditors, having, as they do, an employee-like relationship with the insolvent franchisor. Under the current law, they typically have no specific legal rights that a liquidator would be required to recognise. They must rely on contractual rights.

Models

The three relevant models for this report are the relational contract (including the notion of privity of contract), the franchise model and the insolvency model.

The relational contract model

The relational contract model is arguably the contract model that best explains the legal basis of the franchise relationship. A relational contract attempts to document and provide for a 'continuing process between people whose interests include maintaining business relations' (Williamson, quoted by Seddon and Ellinghaus, p 1124). 'Two firms that are intimately bound up with each other because of the nature of their business will tend to behave in a less strictly contractual way' than they would do if they had a choice of firms to contract with' (Seddon and Ellinghaus p 1126). This is true of franchising where the franchisor and the franchisee are bound together by the franchise. The franchisor must, however, retain flexibility to experiment and develop the business.

The weakness in franchise agreements (contracts) is that they contemplate and provide for the failure of the franchisee but, almost without exception, are silent about the possible failure of the franchisor. Franchise agreements between a franchisor and an Australian national master franchisor (AMF) often do contemplate the failure of the AMF. As is appropriate in a well drafted relational contract, a mechanism is provided for the franchisor to require franchisees to sign up with a newly appointed AMF.

A further challenge for contract law is the doctrine of privity of contract. As a general rule, only the parties to a contract can sue for breach of a contract. Some franchisors operate through several legal entities, each having a different role. As soon as the franchisor conducts the franchise system through more than one entity, the franchisee is disadvantaged because the doctrine of privity of contract only gives the franchisee the power to sue the entity with which it has a contractual relationship.

The franchise model

In its simplest form, a franchise relationship is between a franchisor and a franchisee. It is governed by a franchise agreement. Both franchisor and franchisee have numerous other contract-based commitments such as leases, finance arrangements, stock supply contracts, computer software licenses, the franchise operating manuals and employment contracts with their respective employees.

With very few exceptions, franchisors in Australia have to comply with the Franchising Code of Conduct (FCC). The FCC (the Schedule to the Trade Practices (Industry Codes – Franchising) Regulations 1998) is federal legislation. A franchisor is defined as follows in section 4:

‘franchisor includes the following:

- (a) a person who grants a franchise;
- (b) a person who otherwise participates in a franchise as a franchisor;
- (c) a sub franchisor in its relationship with a sub franchisee;
- (d) a master franchisee in a master franchise system;
- (e) a master franchisee in its relationship with a franchisee’.

‘Although the franchise relationship may appear unremarkable on the surface, it has in fact a highly distinctive structure. Unlike either an employment relation or an ordinary independent contractual relation, the franchise relationship is characterised by the fact that franchisees own the bulk of the capital assets of the franchise and franchisors retain the right to determine how franchisees will use those assets’ (Hadfield, p 991). This situation poses challenges for several areas of the law including insolvency. The significance is that the franchisor has used its superior negotiating power to place the franchisee in a position where, through no fault of the franchisee, the franchisee’s capital assets are vulnerable.

The franchise model can be extended by the inclusion of the following:

- national franchisees where a franchise system operates in more than one country,
- master franchisees, and
- area developers.

The franchisor must make a disclosure to the franchisees. However, the franchisor is often merely one of an interconnected web of legal entities. The franchise system often comprises several discrete, but related businesses. The other related entities may have an effect on the solvency of the franchisor. They could be, for instance:

- a parent company of a wholly owned franchisor;
- Franchisor Franchising Pty Ltd (a private, limited liability company) that will be the franchisor’ on the franchise agreements;
- the shares in Franchisor Franchising Pty Ltd may be owned by companies, individuals or trusts;
- Franchisor IP Pty Ltd may own the intellectual property, and will grant licenses to the franchisor, giving it the right to grant licences to franchisees;
- Franchisor Properties (NSW/SA/ WA etc) Pty Ltd may hold the head lease on the franchisees’ premises;
- Franchisor Construction Pty Ltd may be the supplier of shop designs and fit-outs;
- Franchisor Supplies Pty Ltd supplies stock to the franchisees; and
- Franchisor Finance Pty Ltd may supply finance to franchisees.

All companies may be owned by the same individuals. Where the franchise business is owned by a public company (9% of franchisors in Australia are public companies, Frazer and Weaven) it is likely that there will be a public limited company, of which Franchisor Franchising Pty Ltd and all of the other businesses mentioned above will be wholly owned subsidiaries. The situation is complex and it changes from system to system and across industry sectors. While a franchisor may think of all the interconnected entities as “‘the franchise’, the law interprets the franchise as a number of discrete legal entities, each with its own creditors, debtors, assets and liabilities.

Only the franchisor and a related party that owns intellectual property rights relevant to the franchise have to make disclosure of current solvency to intending franchisees in order to comply with the Franchising Code of Conduct. Any review of the law would need to consider whether it would be desirable for franchisees to receive disclosure of the names and function of all players in the franchisor’s related entities.

The insolvency model

Corporate and personal insolvency are both regulated at federal level. The basic model for each regime is the same although each has different policy objectives. Personal insolvency is regulated by the Bankruptcy Act 1966 (Cth), corporate insolvency by the Corporations Act 2001 (Cth).

The general purpose of bankruptcy law is to provide a protective and ordered process in the event of financial distress; to facilitate the equal access by creditors to a debtor's property in order to compensate them for their loss; and to allow individuals who find themselves in financial difficulties to be given a fresh start, freed from the financial obligations that were the subject of the bankruptcy (Keay and Murray):

The general policy objective of the insolvency provisions in the Corporations Act is to allow for the orderly winding up and ultimate deregistration of insolvent companies. The basic components of the legislative corporate insolvency scheme are:

- If a corporation cannot pay its debts as and when they fall due (that is, the corporation is insolvent), (Corporations Act 2001 (Cth), s 95A) an application may be made to the court to appoint a liquidator. The application may be made by a creditor, the corporation, a director or member of the corporation, ASIC or a liquidator (Corporations Act 2001 (Cth), s 459P).
- Once the liquidation has commenced, the directors no longer manage the affairs of the corporation: the liquidator manages them. The liquidator is the only person empowered to dispose of company property. A corporation in liquidation is given some protection - creditors cannot enforce any judgements or orders they may have obtained (Corporations Act 2001 (Cth), s 468(4) and 500(1)); and other legal proceedings may not be brought or pursued against the corporation without the leave of the court (Corporations Act 2001 (Cth), s 471B and 500(2)). This includes franchisees who have obtained judgements in their favour.
- The assets of the corporation are realised and the proceeds distributed by the liquidator proportionately to those creditors who are able to prove debts in the corporate insolvency.
- Once the creditors have been paid, the surplus assets of the corporation (if any) are distributed to its members, also on a proportional basis (Keay and Murray).

Unless a franchisee is a creditor, there is no room in the insolvency regime for it to have a voice in the franchisor's insolvency, far less a share of the insolvent's estate.

(v) Methodology

In order to identify franchisees, the following public records and databases were searched electronically.

- media reports, using the Factiva database;
- Australian Securities and Investments Commission (ASIC) – administrators and liquidators file documents surrounding corporate insolvency at ASIC. www.asic.gov.au;
- insolvency and Trustee Society of Australia (ISTA) – trustees in bankruptcy file documents surrounding personal insolvency at ITSA;
- Australian Competition and Consumer Commission (ACCC) – initiates investigations and prosecutions for breaches of the Code. www.accc.gov.au;
- state and territory business name records; and
- federal, state and territory court records using the www.austlii.edu.au and Casebase databases.

Media reports were a valuable starting point. In most cases a failed franchisor was identified in a media report by its trading name. Where the trading name and the legal identity of the franchisor were similar, it was possible to find the legal identity of the franchisor (eg The Furniture Wizard Pty Ltd traded as Furniture Wizard). However, in cases there was no relationship between the identity and the trading name (eg Chaste Corporation Pty Ltd traded as TRIMit), it was very difficult to find the identity of the franchisor. After creating an initial database of possibly insolvent franchise systems, ASIC records were then checked to verify the actual status of each corporate franchisor and copies of insolvency related records were purchased to determine whether franchisees could be identified from the records filed with ASIC and, if so, how they were categorised.

Identifying former franchisees of failed systems

The most difficult challenge in the project was identifying and finding current contact details for individual former franchisees. Only franchisor records contain complete records of franchisees. Following a system failure, the administrator or liquidator would have compiled a list of franchisees but there is no requirement to file the list with ASIC or ITSA. Without access to these records, it was impossible to ascertain if all of the franchisees had been identified.

There are few court cases involving franchise failures, thus searches of court records yielded little information. The exception was the Synergy in Business system which was prosecuted successfully by the ACCC. The reported case *ACCC v Ewing* [2004] FCA 5, lists the names of 31 franchisees.

Where business names had been registered to satisfy state and territory business names requirements, extracts of the relevant registration were purchased. Although the registration had generally lapsed, the contact details of the former franchisee were still on the records. However, they are often not current.

As one of the failed systems was a travel agency (Traveland), an advertisement was run on the daily electronic newsletter that circulates to the travel industry. This elicited three responses from former Traveland franchisees.

Advertisements specifically aimed at former franchisees of failed franchisors were placed in a number of national and state daily newspapers including *The Australian* and the *Daily Telegraph*. It was an expensive exercise and the response rate was very low (see Appendix 4). Specific advertisements were not placed in Tasmania, the Northern Territory or Western Australia because of the relatively low number of franchisees in those states. A press release sent to one daily newspaper was picked up and used.

Qualifying franchisees

Searching state and territory business names registers proved to be the best way of identifying former franchisees. Only 87 franchisees from 14 failed systems were ultimately identified by name through the public records and it was not possible to locate many of these.

Surveys were sent to former franchisees who agreed to participate. Two survey instruments were used. The first was tailored for Traveland (46 questions) due to the high proportion of Traveland respondents whose identity was known and the second (45 questions) was generic. Completed surveys were returned by 14 former franchisees. This low response rate means that the survey responses are not statistically valid, therefore this research is of limited significance.

Because franchisees were difficult to track down, letters were also sent to administrators and liquidators of specific systems where their identity was known. In all cases, these professionals provided valuable information.

(vi) Research challenges

The main challenge here was the range and complexity of the legal ownership structure of the franchises and those of the relevant public records.

Franchisees are often private companies, with contractual obligations supported by the personal guarantees of the directors. The franchisors, as is seen below, are also primarily companies (Frazer and Weaven 2004 Question D18).

AUSTRALIAN FRANCHISORS USING ENTITY %	LEGAL ENTITY	REGISTER ENTITY	FILE INSOLVENCY RECORDS
64.6	private company	ASIC	ASIC
9	public company	ASIC	ASIC
9	trust	ATO/ASIC if corporate trustee/ ?	depends on ID of trustees
6.9	sole ownership	ATO	ITSA
6.9	partnership	ATO/ ?	ITSA as individuals
3.5	other	?	?

Distinguishing franchised businesses from non-franchised businesses

Some businesses do not knowingly establish themselves as a franchise and only realise that they are operating as a franchise after court action. For instance, Synergy in Business became insolvent on 6 June 2002. Proceedings were commenced by the ACCC on 22 July 2002. In *Australian Competition and Consumer Commission v Ewing* [2004] FCA 5 (28 January 2004), the ACCC successfully alleged that the licensor was in fact franchising and had breached the FCC. These breaches gave the franchisees rights under the Trade Practices Act. The 31 franchisees had signed licence agreements and had not known they were franchisees until 18 months after the franchisor failed.

Finding former franchisees

As indicated, finding former franchisees was a major challenge. The Synergy in Business case, *Australian Competition and Consumer Commission v Ewing* [2004] FCA 5 named the 31 licence holders but did not state their addresses or even the states where the franchisees operated.

ASIC records

Where the franchisor is a public company, (for example the failed Ansett and Carlovers) there is no requirement to report the identity of the franchisees in the company's annual return. While franchisees are treated as an asset or a liability by a liquidator, they have no identity as individuals.

Liquidators lodge the prescribed paperwork with ASIC or ITSA. The lists of sundry debtors and unsecured creditors contain names and addresses of people and companies that owe and are owed money by the failing company, but give no indication of the nature of the debt or the claim. Therefore it is difficult to distinguish which debtors and creditors (if any) are franchisees.

A franchisee may be characterised as a sundry debtor or a creditor, depending on the structure of the franchise. In many cases franchisees are not mentioned in the material filed by the liquidator.

Details must be cross referenced to court reports, media releases or a business name extract to determine their status. Employees' claims, by contrast, are identified in a separate schedule – schedule E to the report of affairs filed by the liquidator.

Business names register

Businesses that do not trade under their company name or their personal name are required by state or territory law to register their business name in the state or territory in which they operate. However many businesses ignore this legal requirement. For example, in the failed system No Regrets (with 600 franchisees) which became insolvent in 2002, there are only two registered business names – one in New South Wales and one in Western Australia. Therefore there are 598 former franchisees that cannot be identified through the public records. In The Furniture Wizard (with 35 franchisees) only 21 have registered business names.

Once a business name has been registered in compliance with state legislation, it is added to the centralised, federal, ASIC website (<http://www.asic.gov.au/asic/asic.nsf>) The site typically provides information such as the following that was extracted from ASIC's database at 11:07:32 on 16/03/2005. The Furniture Wizard Pty Ltd is an insolvent company that was deregistered in 1999.

The information generated by the search (below), states that there is 'no document list available for this organisation type'. This implies that there is no further information available about the business.

Name	Furniture Wizard – Wangara
Registered state/no	WA 0217638D
Type	Business names
Registration date	Unknown
NextReview date	Unknown
Status	Deregistered
Principal place of business	Not available
Jurisdiction	Department of Consumer & Employment Protection, Western Australia
No document list available for this organisation type	

In fact, an inquiry at the Western Australian Fair Trading Office reveals that historical information about the business named Furniture Wizard – Wangara is available. Sometimes this historical information contains the name and residential address details of the former franchisee.

The human dimension

A further challenge to research on franchisees of failed franchisors is that many former franchisees' lives have been disrupted by the loss of their business. Former franchisees were not always willing to participate in a survey.

Litigation records

The lack of reported court cases about franchising also limited attempts to discover information about the inner workings of franchise systems from court records. The Franchising Code of Conduct mandates mediation as the compulsory method of attempting to resolve franchise disputes before proceeding to litigation. As mediation is a process of confidential dispute resolution, no system specific details are published.

In addition, anecdotal evidence from the Franchisees Association of Australia indicates that many franchisees choose not to become involved in litigation against their franchisor, even when they feel they have a strong case, because they fear that if the franchisor's business is negatively affected their own business will be similarly affected.

Interpreting information on franchisors' websites

After hearing that the Australian master franchisor for Kernel's Amazing Popcorn was insolvent, the system website was checked. The website indicates a franchise system that is in good health, one that a prospective franchisee may be attracted to. It does not identify the franchisor. The only legal entity named is Jatora Pty Ltd which has the role of 'negotiating and holding the head lease on all its locations'.

A search of the ASIC company and business name records name had a different outcome with 17 business names registered incorporating 'Kernel's Popcorn' but no company names. The Australian master franchisor is not called Kernels. The ASIC search reveals that Jatora Pty Ltd is 'under external administration and/or controller appointed'. The administrator was appointed on 18 March 2005. A resolution that the company be wound up was recorded by ASIC on 21 April 2005. It is unclear from publicly available information prior to the company's failure, whether Jatora plays any other role other than head tenant in the leases. However, the liquidators' report to creditors filed with ASIC compliant with s 239A of the Corporations Act shows that Jatora was the Australian master franchisor.

The Kernel's situation highlights three very real challenges for franchisors, potential and existing franchisees and administrators and liquidators.

- Ideally, both the franchisor's and the franchisee's businesses can trade on until a buyer for the franchisor is found. However, both franchisor and franchisee can be affected by the insolvency, particularly where customers are required to pre-pay significant sums of money for services or goods such as for travel or furniture. It is easy to see that the franchisee's business may suffer a downturn if customers become aware of the franchisor's insolvency.
- In Kernel's case, the website discloses that the franchisor 'holds the head lease on all its locations'. It has about 20 sites, mainly in shopping centres. Usually a lease will declare that the tenant has committed a breach of its lease if an administrator is appointed. This could give a landlord an opportunity to terminate the lease, leaving the franchisee without premises unless they renegotiated directly with the landlord. Former Kernel's Popcorn franchisee, James Rixon is reported as saying that 'when Kernel's failed he started a new company with other franchisees and they will trade under a new franchise brand. Rixon says it was fortunate that he had a good relationship with his landlord and he was able to negotiate a new deal' (*Business Review Weekly*).
- A further complication in this case is that the franchisor is actually an Australian master franchisee of a Canadian franchise system. It is common for such agreements to list the appointment of an administrator as an event that would give the international franchisor the right to terminate the agreement with the local master, and to 'cherry pick' amongst the franchisees, with no obligation to take over all franchise agreements.

Challenges for franchisees when the franchisor fails

Often, franchisees' only point of connection with each other is via the franchisor. They may not know each other's names or addresses. If the franchisor collapses, franchisees can lose their only means of getting in touch with each other. This problem is not overcome by the current wording of the disclosure the franchisor makes to comply with the Franchising Code of Conduct (see clause 6.2 and 6.3 FCC below). The franchisor is required to supply business contact details (but not the name of the franchisee) for some or all franchisees in the system at the time the franchisee obtains the disclosure. If the result of the failure is that the franchisee loses its business address and phone number, the link is severed.

6. Existing franchisees
- 6.2 For each existing franchisee:
 - (a) business address, if this is not the franchisee's residential address; and
 - (b) business phone number; and
 - (c) year when the franchisee started operating the franchised business.
- 6.3 However, if there are more than 50 franchises, the franchisor may instead give details under item 6.2 for all franchisees in the state, region or metropolitan area in which the franchise is to be operated.

Individual franchisees cannot see signs of failure because they see only one part of the picture. An employee, however, may have received their pay late or received other signs of the impending failure of their employer such as rumours from within the business or from suppliers.

Nor would lenders to individual franchisees be able to see any signs of failure, even if the franchisor and the franchisee were both customers of the same bank.

- They would operate different sized accounts and be dealt with by different sections of the bank.
- They would most likely be in different geographic locations.
- The business names of the franchisee and the franchisor would be different so there may be no trigger that connects them. This is unlike identifying employees of a failing company (for instance former Ansett or Traveland employees) who will often be receiving regular deposits of pay from their employer by direct credit and can be identified fairly easily by checking common information.

The creditors who may be in the best position to distinguish franchise system failure from individual franchisee failure may be the managers and owners of large city and suburban shopping centres where the franchisees are tenants. However, they are unlikely to compare information frequently with other shopping centre owners.

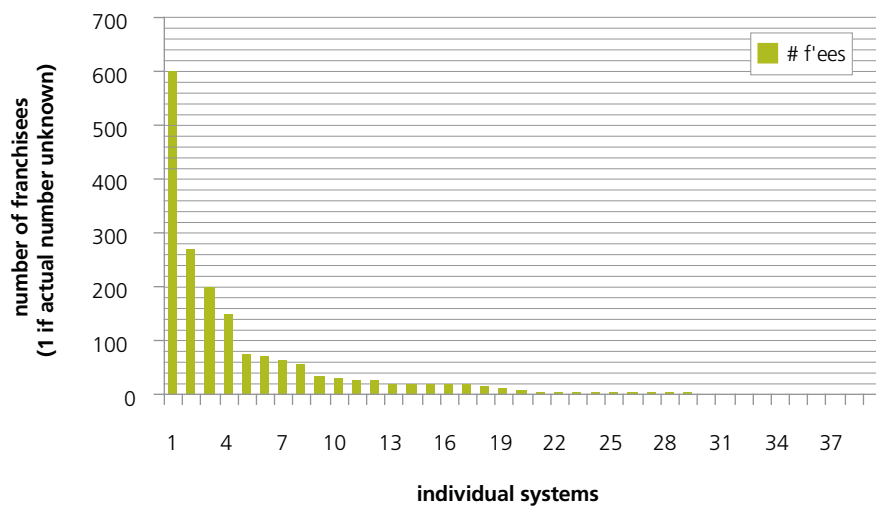
Australian franchise agreements do not generally provide rights to franchisees in the event of the franchisor's failure. Of 36 franchise and state master franchise agreements, only one New South Wales master franchise agreement makes any provision for franchisor insolvency. In this environment, it may be unreasonable to expect liquidators to think of franchisees other than as assets for sale, contractual liabilities to be disclaimed, or as debtors or creditors.

Franchisees use a wide range of local advisers, not necessarily big accounting or legal firms. The big firms, traditionally acting for franchisors, may have dealt with franchisor failure, but local advisers may never have dealt with individual franchisees affected by a franchisor's failure. While the franchisor's accounting and legal advisers have access to the complete picture, an individual franchisee of a failing franchisor may only have access to information supplied by the media, other franchisees or the liquidator. This information is unlikely to assist them to make a fully informed decision about the future of their business.

In many large and well established franchises, franchisees are represented by the system's franchise advisory councils while the franchise is trading but once the franchisor gets into financial difficulty many franchisees become fully focused on the plight of their own businesses. A small or new system is less likely to have a franchise advisory council. The franchisees in any system are likely to be scattered over a wide geographical area.

While it is only possible to estimate the number of franchisees affected by franchisor insolvency, a review of the data sources suggest that more than 1090 franchisees have experienced their franchisor's business failing (Appendix 2).¹

Number of franchisees in systems when franchisor failed



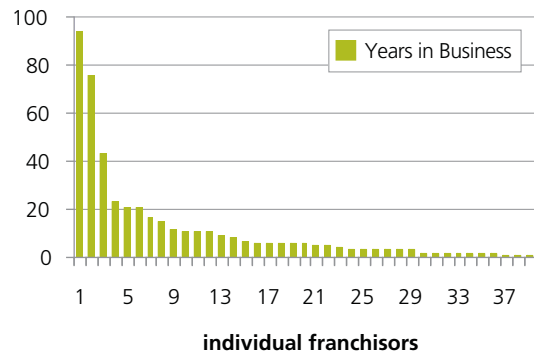
The media reports of the widely publicised Traveland failure variously reported the system as having between 265 and 285 franchisees at the time the franchisor failed. The lack of reliable data stems from:

- the fact of the uniform appearance of franchisor owned and franchisee owned outlets, whether it be the physical outlet or the entry in a white pages or other directory;
- the inconsistent status of franchisees in the administration or liquidation (all are notionally assets but some are actually liabilities; a few are creditors and many are likely to be debtors);
- the fact that franchisees are not required to be listed in the documents that must be filed to comply with the Corporations Act or the Bankruptcy Act when a franchisor's business fails;
- the fact that the only accurate information is in the franchisor's records, and this information is confidential;
- the fact that some franchisees have more than one franchised outlet. In the Traveland situation, some franchisees had three or four travel agencies, each trading under a separate franchise agreement.

¹ NOTE: where the minimum number of franchisees is not known, 'one (1)' has been entered for the purposes of creating the chart below. A '?' has been entered instead of one (1) in Appendix 2.

Failed franchisors do not fall into specific industry categories, nor does the age of the system or the number of years the franchisor has been trading or franchising seem to be a defining factor in future success. The table in Appendix 2 and the graph below illustrate this.

Years in business



Of the 15 industry categories used by Frazer and Weaven, the identified failed franchisors fell into seven. They were spread across personal services, business services, retail food, retail non-food, wholesaling, transport and 'other'. The retail food and retail non-food based businesses require retail premises and varying amounts of fit out; the personal services and business services franchises required relatively little capital investment. The respondents to the survey conducted to support this report, however, mainly purchased low entry cost franchises which did not require expensive fitouts

If the franchisor's business is in a pre-liquidation stage and is being run by an administrator, the administrator will consider all options. If there is a chance of the franchisor trading out of the financial trouble or a buyer being found for the franchisor's business, the administrator and the franchisor's creditors may let the franchisor continue trading, and thus retain its market share, while a buyer is sought. This is what happened with Ansett and Traveland. While it is a desirable strategy for the creditors, it does make for uncertain times for franchisees. The challenge this strategy can impose on franchisees is shown by Traveland's post insolvency story.

Case study: Traveland

The insolvency of the Traveland franchisor is described as a tragedy in four acts by Trevor Sykes (Sykes). He recounts;

Act I. 24 September 2001 '... saw the parent company, Ansett's administrators sell Traveland to a dot.com company that had not previously been involved in the travel industry, Internova Travel for \$500,000. At this stage Traveland had 104 branches and 750 staff. Internova Travel (incorporated specifically for the Traveland purchase) bought the money-losing business with borrowed money, without tying down its potential partners and financiers.'

Act II. 28 September 2001 saw the Australian Investment Corporation of Western Samoa (AIC) buy half of Internova Travel for \$500,000. In this Act,

'the half a million AIC put up seems to have disappeared straight down the insatiable maw of Traveland in wages and other costs.'

Act III. 8 October 2001, Financial Options Group Inc (FOGI), a company owned by the two Sydney entrepreneurs who controlled AIC, paid \$2million for the balance of Traveland. Possession of the business passed on 8 October but settlement was not required until 24 October. The money was not paid and on 26 November 2001 Internova Travel's directors put it into administration, which quickly turned into liquidation. The Australian Securities and Investment Commission put FOGI into liquidation on 18 February 2002.

Act, IV. was performed on 23 December 2001. FOGI's liquidator sold Traveland to Travelworld for \$250,000. Travelworld now has all Traveland's staff and licenses. Sykes concludes: 'Finally, Traveland was vanishing like the Cheshire cat.'

Throughout the drama recounted by Sykes, there is little mention of the estimated 270 to 285 Traveland franchisees. There is no mention of the franchisees in the Ansett court cases relating to the insolvency (Ansett cases). The Traveland business, including the logo, was an asset in the Ansett insolvency. The Traveland Franchise Council was of the view that franchisees did not have grounds for terminating franchise agreements. This was a view shared by a Melbourne QC who was consulted by one of the franchisees:

'We'd just renewed the franchise agreements on our 4 outlets for 5 years when the franchisor's administrator was appointed. We went to see a QC to see if we could get out of the agreements and there was no way.'

According to a former franchisee, the purchasers of Traveland knew nothing about travel or franchising, and eventually they failed as franchisors. Once it became obvious to the franchisees that the new owners of the Traveland brand did not have the expertise to run a franchised chain of travel agents, the franchisees moved in several directions:

- Twenty franchisees switched to UTAG travel.
- Several franchisees switched to Harvey World Travel.
- One hundred and fifty Traveland franchisees joined Travelworld (International Franchise Association News 01/02/02).
- One franchisee surveyed for this report became an employee of another agency, having lost so much that he could not continue as a franchisee.
- At least three franchisees re-branded as independent travel agents.
- The fate of the approximately 100 other former Traveland franchisees is unknown.

It should be noted that a liquidator does not appear to have an obligation to sell assets of the failed franchisor to the purchaser who would be the most suitable from the franchisees' perspective, nor even to a purchaser who is well motivated towards the franchisees. Theoretically, there is nothing to stop a liquidator selling the franchisor's business to a direct competitor of the franchisor. That direct competitor may elect not to buy the franchise agreements but, instead, to simply buy the brand and shelve it.

What happens to franchisees' assets and liabilities when the franchisor fails?

When the franchisor fails, the franchisee encounters a situation not provided for in the franchise agreement which is likely to take them by surprise. Franchisees of failing franchisors sought assistance from a range of advisers when their franchisor failed. The 14 former franchisees who responded, claimed to have sought advice from multiple sources, including:

- accountant (7)
- administrator (3)
- liquidator or Provisional Liquidator(10)
- tax agent (1)
- banker (1)
- local solicitor (4)
- liquidation lawyer (1)
- franchise lawyer (5)
- franchisor (3)
- franchisor's employees (not franchisee) (3)
- other franchisees (10)
- purchaser of franchisor's business (1)

The accounting profession (accountants, administrators and liquidators or provisional liquidators) has the greatest opportunity to help franchisees of failed franchisors because many businesses have an ongoing discourse with their accountant, and the accounting profession takes the lead role in administration and insolvency in Australia. In some countries, the lead role in insolvency is taken by lawyers.

This also suggests that some of the sampled franchisees initially consulted fellow franchisees. This was an opportunity for them to work together to have a say in the liquidation.

It was surprising that so few franchisees in the sample consulted their banker. Perhaps this was because the survey sample consisted mainly of franchisees that had funded their entry into the business without borrowing. However, in situations where a large capital investment was funded by debt, you would expect that more franchisees would consult their banker.

Franchisees experienced the following business consequences as a result of the franchisor's failure. None of the sample became bankrupt or insolvent themselves.

- I re-branded as a franchisee of another system and kept trading (5)
- I became an independent business person in the same business and premises (2)
- I had to close my business (5)
- I lost money (13)
- I did not continue to trade when my franchisor became insolvent – I became an employee of another travel agency (1)
- I did not continue to trade when my franchisor became insolvent – I left the area of business my franchise was in (5)
- I did not continue to trade when my franchisor became insolvent – I became unemployed (3)

The FCC does not contemplate franchisors' insolvency, and only provides for the right for the franchisor to terminate the franchisee's agreement in the circumstances described in clause 23 below:

23 Termination – special circumstances

A franchisor does not have to comply with clause 21 or 22 (ie give franchisee a proscribed amount of notice) if the franchisee:

- (a) no longer holds a licence that the franchisee must hold to carry on the franchised business; or
- (b) becomes bankrupt, insolvent under administration or an externally-administered body corporate; or, etc

Gillian Hadfield noted, in her 1990 analysis that 100 per cent of US franchise agreements contain clauses which give the franchisor the right to terminate for specified grounds, including bankruptcy in 79 per cent of cases. In her very detailed analysis of franchise rights and obligations, she made no mention of clauses that gave comparable rights to franchisees. Given that a franchisee seldom has the right to terminate the agreement if the franchisor fails, it is relevant to ask what effect the franchisor's failure has on the franchisee.

Franchisees' comments on the effect of franchisor failure

Some comments made by survey participants about the effect of the insolvency on their franchise business or other aspects of franchising include:

'I lost a lot of money, reputation and health.'

'I think that the emotional turmoil and lack of assistance from government, associations and lawyers (due to fear of repercussion) left us weaker and more vulnerable, which has resulted in many owners selling up or becoming ill from exhaustion – trying to rescue their business. This event had major impact on staff sick days too.'

'Very unhappy with how the whole issue was handled by Traveland, their lawyers and buyers.'

'The former Traveland franchisees who were still running travel agencies had to collect the travel tax levy that the government imposed on all travellers to help fund claims by Ansett employees. This rubbed salt in the wound.'

'"Because of the great discrepancy in income from the years of being a franchisee to the year following the insolvency, the Australian Taxation Office had audited our (the former franchisee's) tax.'

'Most business clients did not use me once the franchisor went into administration.' (Restoration and repair service)

'I believe my story is a fairly common one. Had my franchisor put the time, money, resources into developing our franchise, as promised, and as we franchisees certainly all were, our businesses were going to be very profitable indeed. Instead (possibly due to greed and haste) the franchisor attempted to take all our intellectual property, research and development, systems and techniques, contact details, client details, etc to establish a new franchise to operate in direct competition to ours. This resulted in much conflict and friction between franchisees and franchisor, threats of legal action, etc. A number of franchisees bonded together to seek legal advice... to protect ourselves, our businesses and our futures. Through a very messy string of events the franchisor went into liquidation. A number of ex-franchisees continued business under a co-op or collaborative agreement. Unfortunately I did not have the funds (this franchisee lost more than \$75,000 because of the franchisor insolvency) nor the strength or heart to be part of this. Those that continued in business (in the same sector) are still operating today! '

'People would walk into the shopping centre and see my Traveland sign. I would then hear them say, "That's the one that failed isn't it.'

Franchising is often likened to a marriage. As with matrimonial property, a franchisee's assets originate from two sources – those owned prior to franchising and franchise related assets. Before buying the franchise business, a franchisee often owns assets as an individual. On buying into a franchise system, they acquire assets in the business. The franchisee may use secure the purchase of the franchise business with personal assets such as real estate, thus putting those assets at risk. While the need to use real estate as security for debt is a commercial reality, there seems to be some imbalance if the franchisee loses assets due to the franchisor's failure.

Franchisee's personal assets

The franchisee's assets usually consist of real property, personal property such as vehicles, cash in the bank or shares in public companies. If the franchisee is a husband and wife team, or siblings, the assets may be owned by more than one individual. Where a franchisee uses personal loans or guarantees from family members, these can be at risk. The franchisees in the survey used their assets as security to fund the purchase of the franchise. Five respondents had secured their borrowings with mortgages over their homes.

In the 2004 Franchising Australia Survey, 29 per cent of the franchisor respondents reported that they provided finance to franchisees. The most popular methods were direct finance supplied by the franchisor (59%) and finance from third parties – usually companies related to the franchisor (39%). Sixty-four per cent of franchisors offering financing required a personal guarantee from the franchisees' directors, a charge over the item's finances (48%), or security in the form of a mortgage over the franchisee's real estate (29%) (Frazer and Weaven B2, B3, B4).

In the United Kingdom, three in five franchisees borrow money when starting up their business, the need for specific business premises being a significant driver of borrowing. Those who required specific premises for their operation needed an average of £54,500, compared to the £14,000 among those not needing specific premises. Retail banks provide finance to 85 per cent of borrowers. Other providers include relatives and friends (11%) and the franchisor (1%) (United Kingdom Franchise Survey p 37).

Assets acquired on becoming a franchisee

The major asset of the franchisee is the right to operate the franchise business. This contractual right is granted by the franchisor. In addition there is usually stock and plant (including vehicles for mobile franchises and for car rental franchises), employees and goodwill. The specific assets in the business obviously vary with the type of franchise. Specific contractual rights and liabilities will determine the fate of each asset if the franchisor fails. Whereas a lender cross-collateralises loans, it is not commercially realistic to make each of the franchisees' contracts with its many suppliers and employees contingent on the franchisor's solvency. The franchisor is assumed to be the solid base on which the franchisees build their businesses. Some assets continue to have value even if the right to trade as a franchisee is no longer available. Others quickly become a liability. For many, the outcome cannot be predicted.

(viii) Goodwill

In legal terms there are three types of goodwill: business goodwill, site goodwill and personal goodwill. The franchisee pays for business goodwill and possibly site goodwill when buying into a franchise system. Personal goodwill is added by the franchisee. A component of goodwill is usually taken into account when the franchise fee is calculated. In 2004, the average franchise fee in Australian franchises was \$35,000 (\$40,000 for retail franchises) (Frazer and Weaven, A6). Former franchisees who responded to this survey paid franchise fees of up to \$60,000, but on average less than \$35,000 was goodwill (denoted as a franchise fee in the franchise agreement).

In exchange for the franchise fee (business goodwill), the franchisee has the right to trade using the franchisor's intellectual property and system for the duration of the franchise term. This money is a sunk cost that is paid before the franchisee starts trading and is recouped over time as the franchisee derives value from the franchisor's brand. Two franchisees in the sample paid \$10,000 or less in fees, and two paid more than \$40,000, with the rest in between.

Liquidators are frustrated when franchisors quickly disburse money out of the franchisor entity to franchisor related companies. These funds may be paid to the franchisor's leasing company for leasing services, to the supplier company for negotiating supply contracts, and so on. This makes it difficult for the liquidators to access the money to satisfy a franchisor's creditors. The net effect of this practice is that even if the franchisor becomes insolvent soon after the franchisee has joined the system, there may not be much of the franchise fee in the franchisor's control after the franchisee has started trading. The potential for rapid dispersal of funds out of the franchisor entity should be taken into account in any solution for franchisees.

Most franchise systems offer a five-year initial term with the option of a renewal. This means that franchisees expect that the system will exist for the duration of the term and any renewal. The franchisees surveyed fitted this pattern, with more than half having an initial five-year term and most having the right to renew their franchise. They were embarking on a long-term relationship with their franchisor and made commitments on that basis.

In theory, in this relational contract the parties have considered all likely eventualities or, as a default position, they put mechanisms in place to deal with unexpected occurrences when they were negotiating the contracts.

How the purchase of the franchise is funded will depend on the amount of money needed, the amount of equity available and the available security. The survey respondents mainly purchased low entry cost franchises. Thus their borrowings were low and the risk of losing personal assets (other than savings) was correspondingly low. Only three had a total investment of more than \$50,000.

Ten of the former franchisees surveyed did not borrow to buy the franchise. Three borrowed 80 to 100 per cent of the purchase costs. If the franchisor's failure meant they were no longer able to conduct the business, then they would have difficulty in servicing the debt.

Given the cost of entry into some systems, it is important that financiers be aware of the additional liabilities a franchisee will be exposed to if the franchisor fails. The viability of the franchisee's business following the franchisor's failure depends on factors such as the number of employees, the ability of the franchisee to re-brand or trade independently of the franchisee and the right of the franchisee to stay in or divest itself of premises. The surveyed franchisees did not obtain any concessions from their financier due to the franchisor's insolvency.

Once a liquidator is appointed, franchisee agreements can be regarded as an asset which the liquidator may sell. Agreements with underperforming franchisees or where the franchisor is primarily liable for cost of leasing the premises are a liability which the liquidator may choose to disclaim. The franchisee is dependent on the franchisor for support, as well as for the ongoing maintenance of the intellectual property (the brand). Franchisees have no legal right to participate in the sale of themselves as an asset, (a situation analogous to employees in the sale of a business) and insolvency is not necessarily a sufficient reason for the franchisee to terminate the agreement.

Almost without exception, franchisees lose money when their franchisor fails. Of the franchisees surveyed, eight lost between \$30,000 and more than \$75,000.

Causes of financial loss included legal fees, lost investment, liabilities to employees and written off fees.

The insolvency did not mean that the franchisee was unable pay business related debts. Their ability to pay these debts depended on what options were available to them to trade while the franchisor's insolvency was administered and the nature of their business.

Although almost half of the franchisees could pay some of their business related liabilities, eight could not continue trading once the franchisor became insolvent. A more detailed study would reveal where the effect of franchisor failure was felt the most keenly. It is likely that franchisees hardest hit would be those that:

- were new to the system;
- did not have specific qualifications but were attracted to the franchise, believing that they would learn from the franchisor;
- had high sunk costs (debt-servicing needs) from paying a high franchisee fee and had paid for an expensive fit-out in a major shopping centre;
- had many employees;
- did not have the lease in their own name and lost the right to the site when the franchisor's failure constituted a breach of lease;
- did have the lease in their own name and were not able to trade profitably once the franchisor failed.

In many cases, the franchisor's failure meant that the franchisee had no equity left to start a new business.

(ix) Premises

In Australia, 69 per cent of franchise systems offer franchise businesses that operate from specific commercial sites (eg, outlets in retail shopping centres, restaurants, petrol stations, hotels, vehicle rentals); 25 per cent of franchises have mobile operations available (eg, dog washes, home services, courier services) and in 24 per cent the franchisee has the option of being home-based (eg, dog minding, book-keeping services) (Frazer and Weaven; Question D13). The right to occupy premises generally stems from one of the following sets of arrangements:

- premises owned by franchisor, leased to franchisee;
- premises owned by franchisee, used for business. For example, home-based operations, or where the franchisee already owns a suitable retail or industrial site. Some franchise agreements specifically forbid a franchisee from owning the site;
- premises leased by the franchisee direct from the landlord. This often occurs where the business does not depend on a particular site. The franchisee has primary responsibility for the costs of the premises and the failure of the franchisor will not directly affect this relationship;
- premises leased to the franchisor by the landlord, then sub-leased or licensed by the franchisor to the franchisee. This arrangement is common when a particular type of site is desirable for the business. The franchisor aims to ensure that even if the franchisee sells or fails, the site remains within the system. In some situations (for example, *Neldue Pty Ltd v Moran & Ors* [2004] WASC 100; *Loyal No 46 v Miller* [2001] FMCA 30), the franchisee guarantees the performance of the franchisor under the head lease. This may cause problems for the franchisee if the franchisor fails. As guarantor, the franchisee may be liable for moneys owed to the landlord, but the franchisee is not guaranteed the right to lease the site if the head lease is disclaimed.

The franchisees surveyed reported a variety of relationships with landlords, with four in major shopping centres and four in stand-alone premises. Others did not rent property. Of these, only one had the lease in the franchisor's name, three held the head lease themselves and the other three had other arrangements.

The six franchisees who reported that they incurred no real estate related costs up until the time of trading were likely to have worked from home or from premises that they already had the use of, or from a vehicle.

Ongoing commitments in relation to premises are as great a concern as having the premises lease disclaimed. If the franchisee has the ongoing responsibility for the lease, but no longer has the support of the franchisor, it can be very expensive for him. However, the continuation of the lease is not normally contingent on the ongoing solvency of the franchisor. In some situations it is desirable to have the lease and the franchise agreement linked. In others it is not desirable for either franchisor or franchisee.

The leasing scenario in the franchise system conducted by Brian's Systems Australia Pty Limited (Administrator Appointed), the franchisor of Charlie's Coffee & Donuts, typifies the franchisee's predicament. There, the franchisor seems to have become insolvent because it was simply not able to deliver on promises made in the disclosure document. The administrator was appointed in February 1995. The franchisor's failure ...

'... first impacted on the lease of the (franchisee's) premises at Bankstown Square which was in the name of that company. Eventually the lease was terminated and the applicants (franchisee) accepted an offer of a monthly tenancy over the kiosk in August 1995. ...'. (*Smith & Ors v DCM Coffee & Donuts Limited, Charles Lee, Wayne Douglas Plant, Brian's Systems Australia Pty Limited (Administrator Appointed)* Industrial Relations Commission of New South Wales 5 November 1997, Marks J, p13).

The survey revealed that one franchisee had one year remaining on the lease, four had two to three years and one had four to five years..

Where a lease has four to five years remaining it has probably only been operating for one or two years and the franchisee would be very vulnerable. In a shopping centre, a franchisee may have invested in the shop fit-out but would not have traded long enough to recoup the cost before the franchisor became insolvent. The franchisee's right to re-brand and remain in the rental premises could be at the discretion of the shopping centre manager.

(x) Stock and Plant – vehicles

For car rental franchises, when cars are leased to the franchisee, the franchisee has the right to use the franchisor's brand and to be a part of its network, but the leasing costs are simply a cost of doing business. Car rental franchisees usually lease vehicles from companies that are not related to the franchisor. The problems that may arise for these franchisees if the franchisor fails are similar to the problems that arise where the franchisee has the right to the lease of the premises but no right to the brand: the franchisee is left with a fixed-term lease but has no obvious way of making the vehicles pay for themselves.

Vehicles from which the franchisee runs the business are an asset of the franchisee. In these cases, the vehicle is an asset that is owned or leased by the franchisee. As long as the vehicle has not been modified to look like a lawn mower or a hamburger to comply with the franchisor's brand requirements, its value need not be altered by the franchisor's insolvency. At worst, the franchisee can remove the signage and continue to use the vehicle.

Nine franchisees obtained less than 25 per cent of products from the franchisor, three obtained between 25 and 50 per cent and one obtained most of its products from the franchisor.

Interestingly, the Traveland franchisees typically had their own suppliers of travel products, independent of Ansett or the franchisor which may explain why most of them survived the franchisor's insolvency. The response pattern to this question emphasises that there is no single solution to the franchisor insolvency issue.

(xi) Employees

In 2004, franchisees employed 18,777 full-time permanent employees and provided 13,038 permanent part-time jobs and 10,684 casual jobs. There has been a trend towards a higher number of permanent jobs in the franchising sector (Frazer and Weaven, Question D17). Survey participants were asked how many employees they had. Nine had one to five employees, four had six to ten and one had eleven to fifteen.

Employees are a business asset until there is no income to pay them, then they become a liability. While employees have rights to notice and payments when they are laid off, the franchisee has no corresponding rights to pass on the cost of the retrenchment to the franchisor.

Employees in a travel agency business will often be qualified travel agents. A franchisee will be reluctant to lay them off as the agency will lose the expertise and the goodwill they have built up with the agency's clients. The Traveland survey showed that some franchisees had to lay off staff when the administrator was appointed to the franchisor's parent company. It should be noted that 2001 was a challenging time to be selling airline travel. As well as the 9/11 attacks, other factors such as the increasing popularity of internet ticket purchasing were challenging the profitability of travel agents at this time. The uncertainty that followed the Ansett and Traveland failure would have unsettled some franchisees. Those who responded 'not applicable' may not have had any staff; or, they may have waited out the administration to see whether a suitable buyer would be found before they took staffing decisions.

The franchisees of other franchises who responded to the survey did not sell products that required specialist industry training, such as travel agents require.

Shareholders of franchisees

Shareholders of franchisee entities are also affected by franchisor insolvency as they often guarantee the franchisee's debts. Single person companies are permitted in Australia so the third of the sample reporting one shareholder may have used a corporate entity to limit personal liability. Eight of the franchisee companies had two shareholders. These were most likely to be family members.

Franchisees' status as creditors or debtors

In 1995, 'the effect of the Cut Price Deli collapse was that its unsecured creditors would become entitled only to a small distribution in respect of their outstanding debts. That category included those franchisees who had obtained prior judgements against the franchisor while those with proceedings still outstanding received nothing' (Giugni and Terry). Franchisees that had no concluded litigation with Cut Price Deli were not eligible to participate in the franchisor's liquidation.

For a franchisee to be a creditor, the franchisor must owe it money. It is unusual for a franchisor to routinely pay franchisees unless the franchise is structured under the terms of a commission agency agreement. In this case, the franchisor would collect payment for goods or services from a customer and pay the 'commission' for the sales, to the franchisee. It is more common for funds to be owed by the franchisor to the franchisee on an ad hoc basis. It is feasible for a franchisee to require the franchisor's directors to provide the franchisee with personal guarantees that commissions will be paid. If the franchisee is in a weak bargaining position, the franchisor may not agree to this. Outcomes for individual franchisees will depend on their negotiating skill.

Franchisees were asked about the payments the franchisor made to them. Half the franchisees did not receive recurring payments from their franchisors and are therefore unlikely to be classified as a creditor of the franchisor.

There was one unexpected response to the question, 'What rights did you have in the franchisor's liquidation?' because one franchisee was a secured creditor. The remaining franchisees were unsecured creditors or had no status at all in the insolvency. The unsecured creditor comes after the franchisor's employees and other creditors in terms of priority.

Recurring payments that a franchisee owes its franchisor may make it a debtor to the insolvent franchisor. Franchisees reported some form of ongoing payment to their franchisor in most cases.

If the franchisees are creditors, they are entitled to attend the franchisor's creditors' meetings. This allows them to see the magnitude of the problem and to be in direct communication with the liquidator. Liquidators say that they do include franchisees in early creditors' meetings. Therefore, it was interesting to note that only one of the responding franchisees was invited to a creditors' meeting even though it was not a creditor.

The anecdotal report of the Danoz Direct franchisor insolvency shows an effect of the franchisees being involved in the negotiations to wind up a company.

Angry creditors of failed TV shopping network TVSN believe they have the numbers to scuttle a vote tomorrow on an agreement that would return them no more than 6.5c in the dollar.

Franchisees of TVSN subsidiary Danoz Direct, who are owed more than \$5 million, believe they have the numbers to vote down the deed of company arrangement (DOCA) proposed by the group's directors and administrators.

Under the rules of the pooled DOCA, the agreement must be approved by a majority of each group of creditors.

Sydney accountant Michael Morris, who went guarantor for his franchisee son and daughter-in-law, said the DOCA was a disgrace and a 'slap in the face' to the unsecured creditors. He said they would vote against the DOCA and take their chances in the courts, unless the administrators came up with a better offer. "They would prefer to lose their measly maximum 6.5c in the dollar and sue the directors for their role in the failure of the business," Mr Morris said" (*Sydney Morning Herald*, July 2005).

Liquidators' rights

Liquidators have the statutory right to disclaim any onerous contracts to which the failed franchisor is a party. These could include franchise agreements and leases of premises from which the franchisee operates. This right enables a liquidator to disclaim unsuccessful franchisees, leases for sites a purchaser did not want, or onerous leases, while retaining contractual relationships with others. The law does not require a liquidator to treat all franchisees equally.

An example of the liquidator disclaiming onerous contracts is the Kernels Extraordinary Popcorn leases (owned by Jatora Pty Ltd (Administrators appointed) ACN 075 509 590. Although the Kernel's website stated there were 25 stores (and still stated that in July 2005, four months after the liquidator disclaimed all the leases), in fact the administrator reported there were 24 Kernels stores (20 franchised, two operating with management agreements and two franchisor owned). These stores were located in shopping centres in NSW, Queensland and Victoria. The head leases were in the franchisor's name. Plant and stock in the stores belonged to individual franchisees. The administrator, in his report, says (in the Report to Creditors):

'I was without funds to allow the continued trading for the four corporate stores, and it was necessary for me to disclaim all of the company's leases on 24 March 2005.'

The implications for the franchisees are that if they decide to continue operating their stores they will each have to negotiate with their landlord for a new lease. Unless the franchisees band together they will each be negotiating as an independent retailer, without the expertise and group negotiating power for which they had paid the franchisor. Their weak negotiating position is exacerbated by the fact that they have already fitted out one shop and they will be aware of the cost of replacement premises if they are not able to re-secure their existing lease. Further, they had lost the \$45,000 that they initially paid to the franchisor as their franchise fee.

(xii) Options for franchisees

Neither statute law or the FCC provides guidance to franchisees of a failed franchisor. It appears that a franchisee whose franchisor becomes insolvent in Australia has no right to influence the outcome of the liquidation unless it is a creditor.

Only one franchisee surveyed was buffered to some degree because of a clause inserted into the franchise agreement to protect its business in the event that the franchisor went into receivership. In this case the franchisor's insolvency gave the franchisee the right to walk away from the franchise agreement.

If the franchise system no longer exists, the franchisee usually has no specific rights in the franchisor's insolvency, and possibly no right to use the franchisor's brand, assuming it still has value. The franchisee is still contractually bound to the franchisor or whoever purchases the franchise from the liquidator.

The franchisee has to meet other contractual obligations entered into as a consequence of becoming a franchisee, such as those to landlords, financiers, suppliers and employees. None of these will be contingent on the solvency of the franchisor. One Canadian liquidator suggests that 'renegotiating the franchise agreements in order to support the franchise and preserve goodwill may be a possibility. Financing the franchisor could be considered if the franchisor's primary lenders were willing to engage in reorganisations outside formal proceedings' (Coltraine).

There are two contract claims that a franchisee of an insolvent franchisor may be able to bring: either a claim against the liquidator for unjust enrichment or a claim of fundamental breach of the franchise agreement. Both actions may have the best chance of success where the franchise term has only just begun. This would mean the franchisee has paid all up-front costs but has derived minimal benefit from the investment. It would severely tax an individual franchisee's resources to mount this action alone. Therefore, it would be best undertaken with all the other disenfranchised franchisees.

Frustration or fundamental breach of the franchise agreement

'Events may occur after a contract has been made which makes its performance pointless, more difficult or more costly, or even impossible. Such events may result in the termination of the contract by operation of law, on the basis that it has been frustrated' (Seddon and Ellinghaus p 881). The common law action for frustration or fundamental breach is basically the same in Australia as in Canada. In Canada, in *Magnetic Marketing Ltd v Print Three Franchising Corp. et al* (1991), 38 CPR (3d) 540, the plaintiff franchisee sought rescission of its franchise agreement based upon fundamental breach. It also sought the return of the franchise fee, royalty fees and advertising fees paid to the franchisor. In considering the issue of fundamental breach and the numerous alleged breaches of the franchise agreement by the franchisor, the court found that the franchisee had obtained substantially what it had bargained for under the franchise agreement, and accordingly it found that there was no fundamental breach of the agreement' (Goldman, 11).

Goldman explains this particular decision stating: 'Whether a fundamental breach argument has any chance of success is fact dependent. The greater the benefit that the franchisee has already received from being part of the franchised system, the less likely that the franchisor's bankruptcy will be found to have fundamentally breached the franchise agreement' (Goldman, 12).

Unjust enrichment

Also available to franchisees in Australia, though not tested in Australian courts, is the right to embark on litigation against the liquidator (because it is not possible to commence litigation against the insolvent franchisor without the court's consent), or against the directors of the failed franchisor. This action could take the form of an equitable action claiming unjust enrichment. To succeed in an unjust enrichment plea 'a restitutionary claim based on unjust enrichment depends upon the plaintiff establishing the following elements:

- 1) the defendant has been enriched by the receipt of a benefit. In the case of the franchisor, an up-front fee may have been charged for the right to conduct a franchise for, say, five years, but the franchisor became insolvent after two years. Therefore, three-fifths of the initial franchise fee could be the starting point;
- 2) the enrichment was at the plaintiff's expense;
- 3) it would be unjust to allow the defendant to retain the benefit; and
- 4) there are no bars to the restitutionary claim (no other consideration barring the claim, such as a subsisting valid and enforceable contract between the parties).

To succeed in a restitutionary claim all these elements must be satisfied. In the first instance, the plaintiff must prove elements 1-3 on the balance of probabilities. In many cases this would be sufficient. Generally speaking it is up to the defendant (liquidator) to raise the issue of a bar to restitution. Then the plaintiff must prove element 4. "If, on the balance of probabilities, the court is not satisfied that there is no bar to a restitutionary claim, then the plaintiff fails" (Davenport and Harris).

The use of an unjust enrichment action could be considered by franchisees that recently paid a franchise fee but derived very little benefit prior to the franchisor's failure. The pool of money available to the liquidator to pay creditors is artificially expanded by the franchise fee; thus the liquidator is 'unjustly enriched'. This was pleaded by a group of franchisees in Ontario, Canada in one of the Country Style Food Services cases. There, the franchisees did not act quickly or cohesively enough to succeed; the comments about unjust enrichment did not form part of the decision, but the court did not rule out unjust enrichment as a possible cause of action by the court for future franchisor insolvency cases.

Franchisee self-help

In practical terms, some franchisees find a way of making the most of the opportunities that their franchisor's failure opens to them by forming a buyers' group and continuing trading. This action was taken by former Great Australian Ice Creamery franchisees and some franchisees of one of the failed juice shop franchisors. Others re-brand and continue trading under a former competitor's banner. However this may be difficult if the area is already well serviced by another franchise system. Joining another system worked for many of the former Traveland franchisees. Yet others continue trading as an independent business, unaligned to any particular group.

(xiii) Conclusions

The conclusions in this report are based on survey responses from 14 former franchisees of franchise systems where the franchisor became insolvent. Generally, when a franchisor fails, a franchisee's assets are affected significantly and the liabilities remain unchanged. The franchisor's liquidator and the franchisee have to look to contractual rights in the franchise agreements, but most franchise agreements are silent on the rights of franchisees in a franchisor's insolvency.

The available remedies currently involve litigation based on failure of contract. They have not been tested in Australia, but have been tested unsuccessfully in Ontario, Canada. The outcome of any court action will depend on the facts of the case. The lack of success in Ontario is not an indication of what the outcome would be if similar cases were tried in Australia. Lessons to be learned from those court cases, however, are that speedy and cohesive action by franchisees will have the best chance of success, and that franchisees who are new to the system or who have recently paid to renew their franchises will be better placed to conduct successful contract-based cases than those who have already derived a significant benefit from being part of the system.

The franchising and insolvency models do not fit comfortably together. Insolvency categorises franchise agreements as 'assets' or 'liabilities' that the liquidator has the right to disclaim. This does not acknowledge the distinctive structure of the franchisor-franchisee relationship. Nor does it acknowledge the complex web of entities that makes up the modern Australian franchise system.

Further, it fails to take account of the fact that 'unlike either an employment relation or an ordinary independent contractual relation, the franchise relationship is characterised by the fact that franchisees own the bulk of the capital assets of the franchise and franchisors retain the right to determine how franchisees will use those assets' (Hadfield). This makes the franchisees a little like the franchisor's secured creditors, but gives them no comparable rights.

Hypothetically, contracts can be negotiated to at least provide a mechanism for addressing franchisor failure. However, it is highly unlikely that the sector would universally embrace contractual changes. In any case, this would be an economically inefficient solution to a complex problem.

The features that make the franchise model so adaptable to a wide range of business activities are also responsible for it being unlikely that a 'one size fits all' approach is the best way to address the problems the franchisees face when their franchisor fails. The size of the investment, the prior skill that a franchisee must have before purchasing the particular franchise, the secondary commitments that a franchisee has entered into as a direct consequence of becoming a franchisee, the length of time the franchisee has been in the system, the availability of competent buyers of the franchisor's intellectual property, and a multitude of other factors mean that providing appropriate solutions for franchisor failure is a unique challenge for the legal system.

There were specific difficulties encountered with this report which made it difficult to identify the potential subjects, that is, the former franchisees of failed franchisors.

- There is very little empirical legal research on franchising in Australia.
- The data that ASIC collects and records does not permit identification of a company as being involved in franchising.
- Franchisees often fail to register their business names in compliance with their state or territory laws.
- Franchisees seldom contemplate the possibility of the franchisor failing when they are negotiating the franchise agreement.

Relatively few of us have been saved from serious injury by our seat belt, but for those few, life would have been very different without it. For those of us who have not had to rely on a seatbelt, we have felt a lot more relaxed knowing it was there. Any solution to franchisor insolvency must recognise that the vehicle is well designed and it works well, but there may be room for a little more consumer protection to be factored into it.

(xiv) Recommendations

The recommendations relate firstly to the negotiation of the initial franchise agreement, and secondly, to what can be done if the franchisor fails.

Negotiating the franchise agreement

Because the franchisee is still outside the system when negotiating their initial purchase, they will not know what changes other franchisees have been able to negotiate as they have gone in. Most likely, each franchisee will have a different accountant and lawyer. The greater the number of individual lawyers representing individual ingoing franchisees, the less likely it is that any of them will be able to secure any contractual rights for the franchisees if the franchisor fails.

Franchisor failure poses real challenges to the law. Currently, a franchisee's best protection lies in prevention. When the franchisor and the franchisee are having their initial discussions, the franchisee should think about how the franchisor's failure would affect him and take it into account in the negotiations.

It should be remembered, however, that the franchisee is signing a fairly standard contract. Theoretically, both parties can include any terms they agree to in the contract, but in fact, the franchisor is unlikely to change it at the request of an individual franchisee.

Going into a franchised business, the franchisee must remember that one of the worst case scenarios would be if the franchisor were to fail.

The franchisee should try to include some basic clauses in its franchise agreement to mitigate its worst potential exposures, although this would still not prevent liquidators from disclaiming all contracts, including leases and franchise agreements. The effect of franchisor failure will be different for every franchisee depending on:

- the amount of money the franchisee borrowed;
- the time the franchisee has been in the business;
- the franchisee's age;
- the franchisee's prior work experience and his education;
- the commitments he will undertake on becoming a franchisee (leases, supplier contracts, etc) and the time those commitments still have to run;
- the direction in which the money flows within the system (franchisee to franchisor (usual) or franchisor to franchisee (unusual but it does happen)).

Having identified his vulnerable areas, the franchisee might wish include clauses relating to the following items in the franchise agreement.

- **Contract:** The franchisee would like to be able to walk away from the franchise agreement and all contractual obligations with the franchisor and its related entities if the franchisor goes into administration or becomes insolvent. Whether the franchisee would exercise this right would depend on whether a suitable buyer was found for the franchisor's business. Franchisees with these contractual rights, acting together, would be much stronger than they currently are.
- **Rights in the franchisor's insolvency:** The franchisee could seek the right to vote on the suitability of any proposed purchaser of the franchisor.
- **Property:** Some consideration should be given to whether the franchisee would need or want ongoing access to the franchisor's intellectual property. In relation to real property, a franchisee might seek an option (negotiated with the owner of the premises) to take over the lease if the franchisor breaches the head lease.
- **Suppliers:** The failed franchisor will provide the franchisee with their suppliers' names, contact details and price lists for major items.
- **Debts:** If the franchisor is going to routinely owe the franchisee money, the franchisee could ask for security or for personal guarantees given by the directors of the franchise (or the relevant franchisor related entity). Then if the franchisor defaults on any payments that have an adverse effect on the franchisee, the franchisee can call in the guarantee in a specified (short) time.
- **Default rights:** If events gave the franchisor the right to terminate the franchise agreement, the franchisee would like these events to give him reciprocal rights.

Negotiating with the administrator or liquidator

Contract law and business failure law (insolvency and bankruptcy) in Australia simply do not provide viable solutions for franchisees of failed franchisors. Contract law credits franchisees with more power and negotiation skill than many, if not most, actually have. The law relating to business failure does not acknowledge the franchisee as a legitimate stakeholder.

Any proposals must be flexible enough to permit the value of the brand to be retained. However, solutions should aim to allow the franchisee to continue in business with or without the brand. Franchisees should negotiate with the liquidator as a cohesive group. The administrator or liquidator will not be able to register them as priority creditors, but he or she will recognise their value. The franchisees as a group may even be able to buy the brand. In the end though, every concession secured by franchisees in relation to every contractual commitment will be as a result of their ability as negotiators.

(xv) References

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(xvi) Appendices

Appendix 1

TRADING NAME	ENTITY NAME	FRANCHISOR (F) OR AUSTRALIAN MASTER(AMF)	ASIC STATUS 0605	PROBLEM
A1 Mobile Radiator Repairs	A1 Mobile Radiator Repairs Pty Ltd ACN 069 828 619	F	DRGD	1999
Century 21 Pty Ltd	Century 21(South Pacific) Pty Ltd	AMF	DRGD	1998
Collins Booksellers	Collins Booksellers Pty Ltd	F	EXAD	2005
Cut Price Deli	Cut Price Deli Pty Ltd ACN 000 917 475	F	DRGD	1995
Danoz Direct	Danoze Direct Retail Pty Ltd	F	EXAD	2005
Data Vault	Data Vault Services Pty Ltd	F	EXAD	2005
Delifrance (Australian arm)	Delifrance Australia	AMF	EXAD	2003
Furniture Wizard	The Furniture Wizard Pty Ltd	F	DRGD	1999
Great Australian Ice Creamery	Icecreameries of Australia Pty Ltd	F	DRGD	1998
ie Networks	IE Networks Pty Ltd	F	EXAD	2005
Juice Station	The Juice Station Pty Ltd	F	EXAD	2005
Kernels Popcorn	Jatora Pty Ltd ACN 075 509 590	AMF	EXAD	2005
King of Croissant	King of Croissant Pty Ltd	F	EXAD	2002
Lloyd Scott Enterprises	Lloyd Scott Enterprises Pty Ltd ACN002739773	F	EXAD	2001
Mini Tankers International	Mini-Tankers International Pty Ltd	F	EXAD	2003
Mobile Computer Cleaning	Mobile Computer Cleaning Pty Ltd	F	EXAD	2003
Modern Garages	Arbin (no 1) Pty Limited (formerly Abrogram Pty Limited, Modern Garages Pty Limited)		DRGD	1999
Mystic Crystals	Mystic Crystals Franchises (Australia) Pty Ltd	F	EXAD	1999
NoRegrets	NoRegretsAustralia	F	EXAD	2002
Nrgize	Nrgize Australia Pty Ltd	F	EXAD	2005
Office Support Services	Office Support Services International Pty Ltd	F	SOFF	2004
Old Papa's Café	Old Papa's Franchise Systems Pty Ltd	F	EXAD	2002
On Time Copy Centre	On Time Business Solutions	F	EXAD	2000
Only \$2	Only \$2 P/L 47 088 133 279	F	EXAD	2005
Party Land	Partyland Australia P/L	F	EXAD	2005
Personal Actions	Personal Action Pty Limited	F	DRGD	2003
Photo Safe	Photo Safe Australia Pty Ltd	F	EXAD	2004
Rugs Galore	Rugs Galore P/L 12 007 343 204	F	EXAD	2002?
Sam's Seafood	Sam's Seafood Holdings	F	EXAD	2005
Simply No-Knead	Simply No Knead Franchising Pty Ltd	F	DRGD	2000
Snow Deli	Snowdeli Pty Limited	F	DRGD	1990
Soils Ain't Soils	Soils Ain't Soils Pty Ltd	F	EXAD	2003
Speeds Shoes	Speeds Shoes Pty Ltd/ 326SSP Ltd; Speeds Shoes Group Pty Ltd	F	EXAD	2004
Synergy in Business	Synergey In Business Pty Ltd	F	DRGD	2002
Tokyo Joe's	The Australian Sushi Company Pty Ltd	F	DRGD	2003/4
Top Snack Foods	Top Snack Foods Pty Ltd ACN 064 180 801; Nick Kritharas Holdings Pty Ltd (ACN 054 663 464); Adway Holdings Pty Ltd (ACN 054 201 857)	F	DRGD	2000
Traveland	Traveland Pty Ltd	F	EXAD	2001
TRIMit	Chaste Corporation Pty Ltd	F	EXAD	2001
Wonderland of Pets	Wonderland of Pets P/L and Kiltaro P/L	F	DRGD	1996

Appendix 2

CATEGORY OF FRANCHISE ACTIVITY*	TRADING NAME	STARTED	STARTED FRANCHISING	PROBLEM	KNOWN MINIMUM NUMBER OF FRANCHISEES	YEARS IN BUSINESS
12	A1 Mobile Radiator Repairs	?	1997	1999	4	?
12	Century 21 Pty Ltd	?	?	1998	?	?
12	Collins Booksellers	1929	?	2005	20	76
11	Cut Price Deli	1974	1984	1995	150	21
10	Danoz Direct	1998	?	2005	?	?
10	Data Vault		?	2005	?	?
11	Delifrance (Australian arm)	1995	?	2003	19	8
15	Furniture Wizard	1996	maybe 1998	1999	35	3
11	Great Australian Ice Creamery	1977	1982	1998	62	21
10	ie Networks	2004	?	2005	?	1
11	Juice Station	1996	?	2005	17	9
11	Kernels Popcorn	1996	2002?	2005	25	6
11	King of Croissant	1997	?	2002	1	?
10	Lloyd Scott Enterprises	1984	?	2001	?	17
10	Mini Tankers International	1991	?	2003	200	12
10	Mobile Computer Cleaning	1997	?	2003	56	?
12	Modern Garages	1988	1994	1999	?	11
12	Mystic Crystals	1993	?	1999	2	6
12	NoRegrets	1998	?	2002	600	4
15	Nrgize	2004	?	2005	8	?
10	Office Support Services	2001	?	2004	?	3
11	Old Papa's Café	2000	?	2002	3	2
10	On Time Copy Centre	1997	1998	2000	17	3
12	Only \$2	1999	?	2005	25	6
12	Party Land	2000	?	2005	3	5
9	Personal Actions	1992	?	2003	?	?
10	Photo Safe	2002		2004	?	?
12	Rugs Galore	1991	?	2002?	4	11
14	Sam's Seafood	?	2004	2005	16	?
11	Simply No-Knead	1985	1989	2000	5	15
11	Snow Deli	1987	?	1990	10	3
15	Soils Ain't Soils	1980	?	2003	4	23
12	Speeds Shoes	1910	1989	2004	75	94
10	Synergy in Business	?	1999	2002	31	?
14	Tokyo Joe's	?	?	2003/4	6	?
11	Top Snack Foods	1994	?	2000	5	6
13	Traveland	1958	1990?	2001	270	43
9	TRIMit	1999	?	2001	70	2
12	Wonderland of Pets	1994	?	1996	3	2

NOTES to Appendix 2

* see next page for industry classifications

"?" in Appendix 2 indicates information could not be discovered from public recordsKey to column 1 of Appendix 2

INDUSTRY CLASSIFICATIONS IN AUSTRALIA

Accommodation	1
Telecommunications	2
Construction	3
Recreation	4
Education	5
Finance	6
Health	7
Manufacturing	8
Personal Services	9
Business services	10
Retail food	11
Retail non-food	12
Transport	13
Wholesaling	14
Other	15

Appendix 3

	OUTCOMES FOR 14,000 EMPLOYEES OF ANSETT	OUTCOMES FOR FRANCHISEES OF TRAVELAND
Australian Federal Government's response	Air Passenger Ticket Collection Levy Act 2001 (Cth) (that established Special Employee Entitlement Scheme for Ansett Group employees) Appropriation (Budget Variations) Act 2003	Fluctuation in income triggered Australian Taxation Office tax audit following year. Those still in travel businesses acted as collection agents for Air passenger Ticket Collection levy. (this 'rubbed salt into the wound' for franchisees)
Union's response	Set up designated website, posted news about progress of insolvency; kept pressure on government not to let the employees be forgotten.	Franchisees not eligible to be in the union, not employees; and not represented as a group of claimants.
Financier's response	Funds set up by banks to help their customers who were Ansett employees	Business as usual, no recognition of problems consequent on failure of franchisor. Troubled franchisees did not consult their banks systematically.
Recognised priority in legislation	Re: wages, superannuation, leave entitlements	On ad hoc basis as: <ul style="list-style-type: none"> • unsecured creditors eg ticket refund owing • Debtor – owe franchise related sums.
Lost	Job Some entitlements Some of superannuation	Business while the liquidators searched for buyers. Value of trading as Traveland Cost of rebranding Some closed and lost business.

Appendix 4

AdVERT. Location	Date Ran	Cost	Response
Daily Telegraph; Business Owner Section – NATIONAL	Tuesday, 30 November 2004	\$740.00	1 insolvency practitioner
The Age; Early General News section – MELBOURNE	Wednesday, 17 November 2004	\$645.15	1 franchisor (solvent)
Adelaide Advertiser; Business Owner section – ADELAIDE	Tuesday, 12 October 2004	\$393.36	2 former franchisees 1 insolvency practitioner
Australian; Business section – NATIONAL	Wednesday, 8 September 2004	\$561.00	Australian Taxation Office in Canberra
Courier Mail; – QUEENSLAND	Saturday, 17 July 2004	\$321.20	2 non franchisees including Bailiff's Office in Brisbane
Bailiff-Sheriff's Website www.bailiff-sheriffaustralia.com.au Public Notices section	Posted 19 September 2004	No charge	None
E-Travel Blackboard website www.etravelblackboard.com	Posted 9 July 2004	\$50.00	3 former Traveland franchisees
Franchise Chat website http://www.franchise-chat.com	Posted a discussion topic	No charge	None



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Ph: +61 (0)7 3716 0400 Fx: +61 (0)7 3716 0300
Email: admin@franchiseadvice.com.au

Program	VIC	NSW	QLD	WA	SA	FOR FRANCHISORS			FOR FRANCHISEES
						MANAGEMENT	ADMIN	FIELD SUPPORT	
Franchise Field Support (2-day core program. From \$600) A comprehensive field support workshop that provides essential skills for franchisee field teams to help build their franchisees' businesses, enhance performance and improve compliance. (FCA CPD points avail)	28-29 February	20-21 February	18-19 February	25-26 February				✓	
	1-2 September	11-12 August	4-5 August	25-26 August	18-19 August				
Field Support - Optional Program (1-day program. From \$330) Techniques for managing call cycles and site visits. Strategies for supporting multiple-unit franchisees. (FCA CPD points avail)	3 September	13 August	6 August	27 August	20 August			✓	
Franchise Field Support Master Class (1-day program. From \$330) The next level in franchisee support. Available only to those who have completed the 2-day core program of the Franchise Field Support workshop.	4 September	14 August	7 August	28 August	21 August			✓	
Franchise Recruitment Essentials (1-day program. From \$330) A framework for franchisee selection from advertising to agreement and an essential workshop for anyone with recruitment responsibilities.	17 April	9 April	7 April	14 April		✓			
Financial Benchmarking & KPI's (1-day program. From \$330) Lift performance at head office and franchisee level by implementing better monitoring and measuring procedures. Understand and improve the profit drivers of the business.	4 June	3 June	2 May	6 June		✓	✓	✓	✓
			12 November						
Introduction to Franchising (1-day program. From \$330) For new franchisor staff, potential franchisees and intending franchisors who need a fundamental knowledge of franchising to accelerate job effectiveness, or to assess business opportunities.	18 June	19 June	18 March				✓	✓	✓
			11 June						
Introduction to Mediation & Negotiation Skills (1-day program. From \$450) Understand the basics of mediation and negotiation in resolving disputes. Learn to identify and manage conflict. Ideal for front line personnel.	13 October	1 May	21 July			✓	✓	✓	
Managing Multiple Outlets (1-day program. From \$330) An insight into the management, planning and other skills required by franchisees to successfully become multiple unit operators.	18 April	10 April	8 April	15 April					✓
Mediation Course (5-day program. From \$1,995) A comprehensive course covering both the theory and practice of mediation that enables successful participants to mediate franchise disputes and apply for accreditation to the Office of the Mediation Advisor.	13-17 October	1-2 & 7-9 May	21-25 July			✓			
Property Lease - Negotiation & Administration (1-day program. From \$360) Learn how to negotiate the best leasing deal on commercial or retail properties, and how to develop systems and procedures for managing leases for individual outlets or entire chains. An essential seminar for any franchise property or site selection specialist.	20 May	19 May	29 February			✓	✓	✓	✓
Site & Territory Selection (1-day program. From \$360) Learn how to develop and refine your site & territory selection processes to maximize outlet & marketing performance. Ideal for both service & retail franchisees.	9 May	8 May	17 April			✓			✓
Training & Induction for Franchisees (2-day program. From \$600) New approaches to franchisee training and induction that accelerates learning and system compliance., including approaches on how to deal with franchisees and staff across generations. A must-attend for franchise training managers.	13-14 March	5-6 March	3-4 March	10-11 March		✓	✓		
	25-26 September	17-18 September	15-16 September	22-23 September					
Writing & Implementing Operations Manuals (1-day program. From \$330) Make your system know-how accessible and effective, regardless of whether you are writing a new ops manual, updating, or introducing new policies or procedures.	28 May	27 May	26 May	23 May		✓	✓		

→ All event dates are correct as at the time of printing, but may change due to circumstances beyond the Franchise Advisory Centre's control. This calendar dated January 9, 2008.

→ Registration numbers for some events may be limited. Minimum numbers may also apply for an event to proceed. FCA CPD points may apply for some events.

→ Specific information about each event is available on the Franchise Advisory Centre website, separate brochure, or both. Information may be changed and updated during the year.

Visit www.franchiseadvice.com.au for more details of these and other programs to be released during 2008.

MEDIA RELEASE
Thursday 21 June 2007



NEW RESEARCH TELLS WHAT MAKES FRANCHISE BUYERS TICK

New Australian research looking into the reasons why someone would leave their job and buy a franchise shows financial factors and field support are key drivers in the decision-making process.

The study uncovered the key drivers critical to purchasing a franchise were local area marketing budgets and mentoring from support staff. Franchisors looking to sell franchises in an environment of low unemployment and rising employee salaries need to take these factors into account when selling to potential franchisees who are currently salaried employees.

Encouragingly, 71 percent of people looking into Franchising want to be a franchisee rather than a salaried employee but 78 percent need three to 12 months to research their decision.

Market intelligence firm and survey author 10 THOUSAND FEET surveyed over 570 prospective franchisees for the *2007 Franchisee Recruitment Report* in March 2007 during the Sydney Franchising Exhibition.

Franchise Council of Australia (FCA) has thrown its support behind the Report believing it contains information every franchisor should have at their fingertips to extend their business network and target potential franchisees well.

According to FCA CEO Richard Evans there is no doubt the franchising sector is creating wealth for the Australian economy. Already there are over 960 franchise systems with franchisees employing some 700,000 Australians in over 72,000 workplaces. Generating the equivalent of 14% of GDP – it's an important sector.

"The intelligence uncovered in the 2007 Franchisee Recruitment Report is vital for every franchisor looking for the most effective and targeted way to communicate to potential franchisees. In the current economy, recruiting quality franchisees is very competitive and franchisors need to have messages that cut through the clutter. This Report arms them with the latest facts and provide insights into key motivating factors," Evans said.

According to 10 THOUSAND FEET's Managing Director Ian Krawitz, the Report looks at a wide range of issues related to franchisee recruitment in the current Australian marketplace, uncovering vital nuances that every franchisor needs to understand to make the most of their marketing push in a highly competitive marketplace.

"Selling franchises is an important part of the ongoing development of any franchise business. What the *2007 Franchisee Recruitment Report* has uncovered is there are different motivating factors for people looking to buy a franchise," he said

The Report also has data on the demographics of prospective franchisees, how many hours per week they are willing to work, how much they are willing to spend on a franchise business and what type of franchise they are most interested in (21% want a food franchise).

"What franchisors need to appreciate is the market is not homogenous. Different messages are required for different audiences and the marketing needs to have a long term focus."

Endorsed by the Franchise Council of Australia, the 2007 Franchisee Recruitment Report is in its second year and has already pre-sold 65 percent of the total sales compared to 2006. For more information or to purchase a copy for \$660 (ex GST) please call 10 THOUSAND FEET on 02 8080 7544 or visit www.10THOUSANDFEET.com.

<ends>

For media interviews with 10 THOUSAND FEET's Ian Krawitz please contact:
Kath Christie br&new pr: T: 03 9292 8922 M: 0422 293 544 E: kath@brandnew.net.au



Queensland Government
State Development

Franchise Seminar Series

Final Report as at August 30, 2001

Overview:

The seminar series was an outstanding success, and surprised even the Franchise Council as to the level of interest in franchising in Queensland. Attendance at almost all seminars was very strong by both potential franchisees and franchisors alike. It is important that the momentum created by these seminars is not lost, and that this regional seminar series becomes an annual event.

Attendances & Venues:

The # *Bkd* field shows the total number of people who pre-booked and/or attended the seminar. The # *Att* field shows only the number of people who attended. For reasons best known to themselves, some people would book and then not attend. Others would just appear on the night without a prior booking (although these have also been counted in the # *Bkd* field below).

Location	Date	Venue	# Bkd	# Att
Gold Coast	Tuesday, June 19	Gold Coast International Hotel	71	58
Ipswich	Wednesday, June 20	Ipswich Civic Centre	25	22
Brisbane South	Tuesday, June 26	Fitzy's Hotel & Convention Centre	123	97
Brisbane North	Wednesday, June 27	Kedron-Wavell Services Club	120	81
Toowoomba	Tuesday, July 10	Rumours International	80	75
Caloundra	Wednesday, July 11	Caloundra Cultural Centre	75	56
Wide Bay	Tuesday, July 24	Hervey Bay Resort & Hotel	23	18
Bundaberg	Wednesday, July 25	Brothers Sports Club	52	33
Gladstone	Monday, July 30	Country Plaza International	23	17
Rockhampton	Tuesday July 31	Rockhampton Leagues Club	34	25
Mackay	Wednesday August 1	Windmill Motel & Reception Centre.	30	23
Townsville	Monday, August 6	Townsville Plaza Hotel	89	64
Cairns	Tuesday, August 7	Mercure Harbourside Hotel	93	58
Mt Isa	Tuesday, August 14	Mercure Mt Isa Hoteal	8	7
Total:	14 Seminars		846	634

The result of 846 people who booked to attend the seminar is 26% higher than anticipated in the original proposal, showing a much higher level of interest in franchising than either the Department of State Development or the Franchise Council expected. Of these, 634 actually attended the seminar, although contact details for nearly all 846 have been captured for follow-up by local DSD offices. (This list previously provided to DSD).

Seminar Evaluations:

The evaluation forms were distributed at each seminar and the responses summarised in the table below. This shows an overwhelming approval of the content, length, relevance and presenter of the seminar series.

Location	Presenter Rating	Content Rating	Length Rating	Usefulness Rating	Expectation Rating
Gold Coast 32 Responses	Excellent: 12.5% Very Good: 37.5% Good: 46.9% Fair: 3.1% Poor: 0%	Excellent: 18.7% Very Good: 28.1% Good: 40.6% Fair: 12.5% Poor: 0%	Too Short: 3.1% Too Long: 46.9% Just Right: 50%	Not: 0% Very: 68.9% Extrem: 31.1%	Yes: 87.1% No: 12.9%
Ipswich 11 Responses	Excellent: 40% Very Good: 50% Good: 10% Fair: 0% Poor: 0%	Excellent 20% Very Good: 60% Good: 20% Fair: 0% Poor: 0%	Too Short: 0% Too Long: 10% Too Right: 90%	Not: 0% Very: 40% Extrem: 60%	Yes: 100% No: 0%
Brisbane South 48 Responses	Excellent: 29.1% Very Good: 56.3% Good: 12.5% Fair: 2.1% Poor: 0%	Excellent: 25% Very Good: 60.4% Good: 12.5% Fair: 2.1% Poor: 0%	Too Short: 4.4% Too Long: 13% Just Right: 82.6%	Not: 0% Very: 60.4% Extrem: 39.6%	Yes: 95.8% No: 4.2%
Brisbane North 31 Responses	Excellent: 48.4% Very Good: 32.2% Good: 19.4% Fair: 0% Poor: 0%	Excellent: 32.3% Very Good: 41.9% Good: 22.6% Fair: 3.2% Poor: 0%	Too Short: 12.9% Too Long: 22.6% Just Right: 64.5%	Not: 0% Very: 60.4% Extrem: 39.6%	Yes: 87.1% No: 12.9%
Gold Coast 32 Responses	Excellent: 12.5% Very Good: 37.5% Good: 46.9% Fair: 3.1% Poor: 0%	Excellent: 18.7% Very Good: 28.1% Good: 40.6% Fair: 12.5% Poor: 0%	Too Short: 3.1% Too Long: 46.9% Just Right: 50%	Not: 0% Very: 68.9% Extrem: 31.1%	Yes: 87.1% No: 12.9%
Ipswich 11 Responses	Excellent: 40% Very Good: 50% Good: 10% Fair: 0% Poor: 0%	Excellent 20% Very Good: 60% Good: 20% Fair: 0% Poor: 0%	Too Short: 0% Too Long: 10% Too Right: 90%	Not: 0% Very: 40% Extrem: 60%	Yes: 100% No: 0%
Brisbane South 48 Responses	Excellent: 29.1% Very Good: 56.3% Good: 12.5% Fair: 2.1% Poor: 0%	Excellent: 25% Very Good: 60.4% Good: 12.5% Fair: 2.1% Poor: 0%	Too Short: 4.4% Too Long: 13% Just Right: 82.6%	Not: 0% Very: 60.4% Extrem: 39.6%	Yes: 95.8% No: 4.2%
Brisbane North 31 Responses	Excellent: 48.4% Very Good: 32.2% Good: 19.4% Fair: 0% Poor: 0%	Excellent: 32.3% Very Good: 41.9% Good: 22.6% Fair: 3.2% Poor: 0%	Too Short: 12.9% Too Long: 22.6% Just Right: 64.5%	Not: 0% Very: 60.4% Extrem: 39.6%	Yes: 87.1% No: 12.9%
Toowoomba 41 Responses	Excellent: 32% Very Good: 61% Good: 7% Fair: 0% Poor: 0%	Excellent: 34% Very Good: 49% Good: 17% Fair: 0% Poor: 0%	Too Short: 0% Too Long: 7% Just Right: 93%	Not: 0% Very: 63% Extrem: 37%	Yes: 100% No: 0%
Caloundra 42 Responses	Excellent: 31% Very Good: 48% Good: 19% Fair: 2% Poor: 0%	Excellent: 19% Very Good: 69% Good: 12% Fair: 0% Poor: 0%	Too Short: 5% Too Long: 33% Too Right: 62%	Not: 0% Very: 71% Extrem: 29%	Yes: 100% No: 0%
Wide Bay 10 Responses	Excellent: 20% Very Good: 70% Good: 10% Fair: 0% Poor: 0%	Excellent: 20% Very Good: 70% Good: 10% Fair: 0% Poor: 0%	Too Short: 0% Too Long: 20% Just Right: 80%	Not: 0% Very: 50% Extrem: 50%	Yes: 100% No: 0%
Bundaberg 16	Excellent: 56% Very Good: 44% Good: 0%	Excellent: 13% Very Good: 69% Good: 18%	Too Short: % Too Long: 19% Just Right: 81%	Not: % Very: 62% Extrem: 38%	Yes: 100% No: 0%

Responses	Fair: 0% Poor: 0%	Fair: 0% Poor: 0%			
Gladstone 16 Responses	Excellent: 19% Very Good: 50% Good: 31% Fair: 0% Poor: 0%	Excellent: 19% Very Good: 56% Good: 25% Fair: 0% Poor: 0%	Too Short: 00% Too Long: 6% Just Right: 94%	Not: 6% Very: 63% Extrem: 31%	Yes: 94% No: 6%
Rockhampton 21 Responses	Excellent: 33% Very Good: 57% Good: 5% Fair: 5% Poor: 0%	Excellent: 33% Very Good: 43% Good: 24% Fair: 0% Poor: 0%	Too Short: 0% Too Long: 14% Just Right: 86%	Not: 0% Very: 62% Extrem: 38%	Yes: 100% No: 0%
Mackay 22 Responses	Excellent: 28% Very Good: 36% Good: 36% Fair: 0% Poor: 0%	Excellent: 36% Very Good: 32% Good: 23% Fair: 9% Poor: 0%	Too Short: 9% Too Long: 36% Just Right: 55%	Not: 0% Very: 59% Extrem: 41%	Yes: 91% No: 9%
Townsville 41 Responses	Excellent: 51% Very Good: 44% Good: 5% Fair: 0% Poor: 0%	Excellent: 37% Very Good: 51% Good: 10% Fair: 2% Poor: 0%	Too Short: 0% Too Long: 32% Just Right: 68%	Not: 0% Very: 54% Extrem: 46%	Yes: 100% No: 0%
Cairns 47 Responses	Excellent: 49% Very Good: 40% Good: 11% Fair: 0% Poor: 0%	Excellent: 36% Very Good: 47% Good: 17% Fair: 0% Poor: 0%	Too Short: 4% Too Long: 21% Too Right: 75%	Not: 0% Very: 53% Extrem: 47%	Yes: 100% No: 0%
Mt Isa 7 Responses	Excellent: 14% Very Good: 86% Good: 0% Fair: 0% Poor: 0%	Excellent: 14% Very Good: 43% Good: 43% Fair: 0% Poor: 0%	Too Short: 0% Too Long: 29% Just Right: 71%	Not: 0% Very: 57% Extrem: 43%	Yes: 100% No: 0%

Both the presenter and the seminar content was rated as good or better by more than 85% of the attendees in the first four seminars, rising to more than 90% for the last 10 seminars.

All seminars met the expectations of 85% or more of the attendees. All seminars were delivered by Jason Gehrke, Queensland Chapter secretary of the Franchise Council of Australia (and principal, WordWerx Public Relations).

Lessons & Improvements:

Following the Gold Coast seminar, the presentation was reduced from 104 to 94 slides, then reduced again after the Ipswich seminar from 94 to 32 slides. Most of this reduction was made possible by deleting unnecessary historical information, and verbalising points that previously were written on slides. This was further reduced to 29 slides after the two Brisbane seminars.

The delivery was also improved through a more dynamic and interactive approach taken with the audience to elicit questions throughout the seminar, rather than just at the end. This helped to increase the perceived value of the seminar and maintain the audience's interest.

Taking questions on the fly however requires the presenter to draw more heavily on their own knowledge and to rely less on the powerpoint slides to deliver the presentation. The use of many varied anecdotes helped answer the questions asked from the floor, and illustrate important parts of the seminar content.

A 15-minute franchisee interview segment was introduced for the two Brisbane seminars after the half-time break. In this segment, the seminar presenter interviews a real live franchisee about why they became a franchisee, how this has affected them personally, their plans for growth, etc. (The interview has a list of 15 questions in all which may be asked). The franchisee interview segment was maintained for Toowoomba, Sunshine Coast, Bundaberg and Mackay, but dropped for the other locations.

Challenges / Observations / Other:

Video – The Department of State Development organised the videotaping of the Hervey Bay seminar for internal training purposes.

Advertising – Promoting the seminars as cost-effectively as possible was a challenge in itself. Advertising for each seminar included radio, newspaper, and some television coverage. All advertising was negotiated at the most favourable rates possible – at least at Government rates, and often lower.

All advertising and other outlays were paid up-front by the Franchise Council of Australia's chapter secretariat.

Intending Franchisors: Approximately one-third of seminar attendees indicate an interest in franchising a business or concept. This is a greater level of interest than first anticipated, and suggests further consideration of programs for these intending franchisors be considered.

Recommendations

The success of the seminars to date shows that there is a lot of interest in franchising. The primary interest group is potential franchisees, followed by potential franchisors, and then existing franchisees and advisors.

The seminar has provided each of these groups with an essential first step toward making informed decisions about their involvement in franchising. If people decide to buy a franchise or to franchise their business as a result of attending these seminars, this is good. An equally valid outcome is if someone decides NOT to buy a franchise or franchise their business as a result of attending these seminars. This outcome is equally good because it has averted a potential disaster, and therefore avoid the personal, social and community problems caused by business failures of any kind.

Given the large numbers of people who booked or attended the seminars, combined with the average decision-making timeframe of three months to three years for a potential franchisee, it is strongly recommend the series should be held in the regions outside South East Queensland at least once a year. These non South East Queensland seminars should also be grouped into larger blocks of four seminar clusters, rather than one, two and three. This would maximise economies of scale in travel, and maintain momentum for the presenter. It may also improve promotional efficiencies by more heavily concentrating on certain regional media

In Brisbane, the franchise information seminar should be held on a monthly basis, with quarterly seminars held to service the Toowoomba, Gold Coast and Sunshine Coast areas.

As the Franchise Council of Australia is wholly funded by membership subscriptions, it would need further funding from the State Government to promote and stage these public information seminars. The seminars would need to be free for the public to attend in order to maximise the seminar's reach to potential franchisees. (Previous attempts by the FCA to run information seminars on a cost-recovery basis attracted so few potential franchisees as to be a fruitless exercise).

It is strongly hoped that the Department of State Development will continue to back its Franchising Strategy in future budget allocations.

Jason Gehrke
Secretary
Franchise Council of Australia
Queensland Chapter

August 30, 2001



Queensland Government
State Development

2002 Franchise Seminar Series

Final Report, 17 September 2002

Overview:

The Franchise Council of Australia (QLD Chapter) has received an overwhelming response from potential franchisees to the **2002 Franchise Information Seminars**. The 10 seminars conducted around Queensland were made possible by funding from State Development as part of the implementation of its Franchising Strategy.

Attendances & Venues:

The *# Bkd* field shows the total number of people who pre-booked and/or attended the seminar. The *#Att* field shows only the number of people who actually attended the workshop. For reasons best known to themselves, some people have booked and then not attended. Others would just appear on the day without a prior booking (although these have also been counted in the *#Bkd* field below).

Brisbane Bookings

Location	Date	Venue	# Bkd	# Att
Brisbane South	23 July 2002	Fitzy's Hotel	107	86
Brisbane North	24 July 2002	Kedron-Wavell Services Club	158	120
Mackay	30 July 2002	Reef Resort Motel	15	5
Rockhampton	31 July 2002	Rockampton Leagues Club	34	27
Gladstone	1 August 2002	Country Plaza International	15	10
Cairns	6 August 2002	Holiday Inn Cairns	67	49
Townsville	7 August 2002	Holiday Inn Cairns	71	48
Toowoomba	13 August 2002	City Golf Club	52	42
Sunshine Coast	20 August 2002	The Outlook Mooloolaba	67	43
Gold Coast	21 August 2002	Surfers Paradise Marriott Resort	155	106
Total:			741	536

The result of 741 people who booked to attend the seminar is 206 (38%) greater than the target of 535 set in the original proposal. The number of people who physically attended a seminar (536) also exceeded the stated target.

Names and full contact details (where available) for all 741 people who booked to attend the seminar have been provided to State Development for distribution to its State Development Centres for local follow-up.

Seminar Evaluation:

An evaluation form was distributed at the seminars, and the responses from each seminar are summarised in the following table.

	Presenter			Cont.	Length			Usefulness			Expectations	
	Cont.	Del.	Rel.		Short	Long	Right	Not	Very	Extrem	No	Yes
Brisbane Sth	4.15	4.28	4.16	4.14	0.0%	15.4%	84.6%	0.0%	65.4%	34.6%	0.0%	100.0%
Brisbane Nth	4.30	4.27	4.28	4.20	0.0%	16.4%	83.6%	0.0%	60.7%	38.3%	0.0%	100.0%
Mackay	4.40	4.60	4.60	4.60	0.0%	25.0%	75.0%	0.0%	75.0%	25.0%	0.0%	100.0%
Rockhampton	4.22	4.39	4.28	4.11	0.0%	5.6%	94.4%	0.0%	55.6%	44.4%	0.0%	100.0%
Gladstone	4.20	4.30	4.20	3.90	10.0%	10.0%	80.0%	0.0%	30.0%	70.0%	10.0%	90.0%
Cairns	4.42	4.63	4.50	4.37	5.9%	5.9%	88.2%	0.0%	63.6%	36.4%	0.0%	100.0%
Townsville	4.54	4.66	4.41	4.33	2.6%	0.0%	97.4%	0.0%	62.5%	37.5%	2.6%	97.4%
Toowoomba	4.29	4.30	4.17	4.28	4.3%	4.3%	91.4%	0.0%	40.0%	60.0%	0.0%	100.0%
Sun. Coast	4.32	4.48	4.48	4.24	4.2%	8.3%	87.5%	0.0%	44.0%	56.0%	0.0%	100.0%
Gold Coast	4.38	4.66	4.50	4.37	1.9%	9.6%	88.5%	0.0%	58.5%	41.5%	3.8%	96.2%
Av. Totals	4.32	4.46	4.36	4.25	2.9%	10.1%	87.1%	0.0%	55.5%	44.4%	1.6%	98.4%
Av. Total %	86.4%	89.1%	87.2%	85.1%								

Seminar presenter Jason Gehrke received average approval ratings in excess of 85% for content, delivery and relevance. The seminar itself had an approval rating of 85.1%.

The seminar length was reduced to 2.5 hours (down from three hours last year), and this received an approval rating of 87%.

The seminar received an overwhelming usefulness rating of 100% (ie. Everyone who attended found the seminar useful). The seminar also met the expectations of 98.4% of the surveyed audience.

These results meet or exceed responses to the same criteria for the 2001 Franchise Information Seminar series.

Other comparisons between the 2001 and 2002 Seminar series are shown in the table below:

	2001	2002
Total number of people registered	846	741
Total number of people attended	634	536
Total number of seminars	14	10
Average attendance per seminar	45.3	53.6
Total series funding	\$ 43,999.20	\$ 35,992.10
Average cost per seminar	\$ 3,142.80	\$ 3,599.21
Timeframe	June 19 – August 14	July 23 - August 21
Seminar duration	3 hours	2.5 hours

Other differences:

While seminars for both this year and last year were highly interactive, with the presenter taking questions “on the fly”, the seminars this year were even more interactive by encouraging the audience to raise benefits and disadvantages of franchising to start the evening. This was facilitated by “rewarding” audience involvement with chocolates which helped keep them alert as well as ensured their attention.

The number of slides in the powerpoint presentation was further reduced from last year, and several short videos were added to vary the presentation. No franchisee interviews were conducted this year.

A key difference this year is that fewer seminars were held, and although the average funding per seminar increased by 14.5%, this resulted in an 18.3% increase in registrations.

Lessons & Improvements:

The new format for the seminar this year was extremely popular and improved audience engagement in the topic. The larger the audience, the better the result.

The Mackay seminar drew a disappointing number of attendees, particularly by comparison to a similar size location such as Rockhampton. The Mackay venue was also less than suitable and it is not recommended that this venue is used again.

Audience feedback at each seminar indicates that newspaper advertising is by far the most effective advertising medium to promote the seminars, followed by radio, with television a distant last. It is recommended that future seminar series do not include a television advertising schedule, and that newspaper advertising is increased accordingly.

Recommendations:

Both the 2001 and 2002 seminar series shows there is strong (and growing) interest in franchising from potential franchisees.

The seminars have provided essential information to many prospective franchisees, and given them the right information about entering a franchise business before committing themselves. This serves to both increase their chances of success should they proceed, or reduce their chances of failure if they decide not to enter franchising as a result of attending the seminar.

It is recommended that the seminar series be conducted on an annual basis in central and north Queensland, with quarterly seminars held at Toowoomba and the Gold & Sunshine Coasts, and monthly or bi-monthly seminars in Brisbane.

The Franchise Council is strongly appreciative of State Development's support for franchising in Queensland, which, according to the 2002 Franchising Australia Survey, leads all other Australian states in numbers of franchise system head offices and franchise outlets per head of population.

It is sincerely hoped that State Development will continue to support this initiative of its Franchising Strategy in future budget allocations.

Jason Gehrke
Secretary
Franchise Council of Australia
Queensland Chapter

17 September 2002



FRANCHISING Australia

2006

Franchising Australia 2006 Survey

Sponsored by



Prepared by

**Lorelle Frazer
Scott Weaven
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**Service Industry Research Centre
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Foreword

Griffith University is proud to endorse the *Franchising Australia 2006* survey sponsored by the Franchise Council of Australia. *Franchising Australia 2006* provides a comprehensive report on the status of the Australian franchising sector from the franchisor perspective. It provides evidence of the continuing growth and maturity of franchising in this country. For example, the report indicates:

- There are approximately 960 business format franchise systems in Australia in 2006, compared with 850 in 2004 and 700 in 2002.
- One quarter of Australian franchise systems have entered international markets.
- There are an estimated 62 000 units operating in business format franchises.
- The growth rate in franchised units from 2004 to 2006 was 14.6 percent.
- Some 426 500 persons are employed in business format franchise organisations.
- Sales turnover of the entire franchising sector was estimated at \$128 billion in 2005.
- Franchising contributed 14 percent to Australia's Gross Domestic Product (GDP) in 2005.

In addition to the above impressive growth of franchising, there are signs of increasing maturity and solidarity in the sector. Two thirds of franchise systems now offer multiple unit opportunities to franchisees, allowing individual investors to expand their operations. Franchisees remain involved in franchising for an average of seven years, indicating their level of commitment to the franchising model. Indeed, in the 2005 financial year the vast majority of franchisees (91 percent of franchised units) experienced no change of ownership.

The data collected in this survey have provided much needed up-to-date information about franchising in Australia. It will aid franchisors in benchmarking their systems against others in Australia, and will assist current and prospective franchisees in making informed investment decisions.

I highly recommend this report to anyone with an interest in the Australian franchising sector. The authors are experienced franchising researchers who have produced a rigorous and detailed profile of franchising activities in this country. Griffith University is pleased to once again collaborate with the survey sponsor, the Franchise Council of Australia, in this important contribution to our knowledge of franchising in Australia.



Professor Michael Powell
Pro-Vice Chancellor (Business)
Griffith Business School

Author profiles

Professor Lorelle Frazer



Professor Lorelle Frazer is the Dean, Learning and Teaching, of the Griffith Business School and a member of the University's Service Industry Research Centre.

Professor Frazer was the first person in Australia to complete a PhD in franchising and she has been an active franchising researcher for more than a decade. Her research has been published in international academic refereed journals, including the *Journal of Business Research*, *European Journal of Marketing*, *Journal of Marketing Channels* and the *Australasian Marketing Journal*. She is a member of the International Society of Franchising, which meets annually to debate worldwide franchising issues.

Professor Frazer teaches franchising in the Griffith Business School at both undergraduate and postgraduate programs. Her postgraduate Franchise Structure and Management course has been commended by the University for its innovative teaching approach and strong support from industry.

The series of *Franchising Australia* surveys, which have been published in 1998, 1999, 2002, 2004 and 2006, have all been co-authored by Professor Frazer.



Dr Scott Weaven is a Lecturer in the Department of Marketing and is a member of the Service Industry Research Centre at Griffith University's Gold Coast campus. He completed a PhD in franchising in 2004 and has co-authored the *Franchising Australia* surveys in 2002, 2004 and 2006.

Dr Weaven is a member of the International Society of Franchising and has published his research in international academic refereed journals and conferences, including the *Academy of Marketing Science Review*, *International Small Business Journal*, *Asia Pacific Journal of Marketing and Logistics* and the *Journal of Marketing Channels*.

Dr Weaven teaches marketing and entrepreneurship in the Griffith Business School.



Owen Wright is a sessional Lecturer in the Department of Marketing and a PhD candidate in the Service Industry Research Centre at Griffith University. His extensive industry experience includes management roles within the franchising sector and as a consultant to franchisors. He is a member of the Australian Marketing Institute and the European Marketing Academy.

Mr Wright has published his franchising research in international academic refereed journals including the *Journal of Marketing Management* and the *Journal of Brand Management*. He teaches franchising and retailing in the Griffith Business School at both undergraduate and postgraduate levels.

Sponsor profile

Franchise Council of Australia

The Franchise Council of Australia (FCA) is the premier body representing the dynamic franchising sector in Australia and is a representative voice to government. With a vision to developing excellence at every level of the sector, the Franchise Council of Australia is committed to ensuring professional development, business growth and strong networking opportunities for all franchisors, franchisees and suppliers.

Since 1983, the Franchise Council of Australia has offered advice on best practice franchising, education, training and development and access to the latest news and information. Members also have the opportunity to network with peers in prominent organisations, attend professional development activities to keep abreast of current trends in franchising and participate in highly specialised training seminars.



Richard Evans
CEO Franchise Council of Australia

The FCA is a nationally incorporated, not-for-profit association with its national head office in Melbourne, Victoria. It provides localised member services through five state chapters – one in each mainland state of Australia. The FCA is closely associated with franchising associations around the world, and is a founding member of the Asia Pacific Franchise Conference (APFC). It is also a member of the World Franchise Council (WFC) and, in 1999 and 2000, was the Secretariat for the World Franchise Council.

Membership

Membership of the Franchise Council of Australia is voluntary, and is open to any organisation or individual involved in the franchising sector, including franchisees, franchisors, lawyers, accountants, banks, consultants, academics and publishers.

Phone: 1300 669 030
Web: www.franchise.org.au
Email: info@franchise.org.au



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Executive summary

The results of the *Franchising Australia 2006* survey reveal that the Australian franchising sector continues to expand and experience impressive growth. Franchising now occurs in a range of industry sectors and there is evidence of franchisors adopting innovative approaches to stimulate system growth.

The key findings of the survey are highlighted in this Executive Summary. Where possible, estimates have been included for the entire population of Australian business format franchises. Franchising activities in motor vehicle and fuel retailing were not captured in the survey due to the unique characteristics of these industries. However, relevant data on motor vehicle and fuel retail franchises have been generated from publicly available sources, including the Australian Bureau of Statistics, Australian Institute of Petroleum and the Federal Chamber of Automotive Industries, and this information has been incorporated into the Executive Summary only.¹

Below are the highlights of the *Franchising Australia 2006* survey.

Total number of franchisors in Australia

Some 910 business format franchisors have been identified following an extensive search. However, this figure includes several systems that offer multiple concepts under a single brand name and these organisations have been counted only once. Hence, it can be estimated that there are *960 business format franchise systems* operating in Australia in 2006. Of these, 93 percent are Australian-based franchise systems.

Following the introduction of the Franchising Code of Conduct (the Code) in 1998, growth in total systems initially slowed, but has again flourished as the comparison below reveals:

1998	693 franchisors
1999	708 franchisors
2002	700 franchisors
2004	850 franchisors
2006	960 franchisors

¹ Figures have been based on an average unit price of petroleum and motor vehicle retail sales. The modelling process, while constantly being improved, remains based on the retail pricing in both sectors. This pricing is subject to market fluctuations and is therefore susceptible to different interpretations.

The growth rate of franchise systems from 2004 to 2006 is 12.9 percent, resulting in a slight slow down since 2002. This is a positive sign as the number of franchise systems per capita in Australia is often regarded as too high. The growth in franchising experienced since 2002 reflects a confident regulated franchising sector in a strong local economy. In particular, the increase in franchise systems over the past two years indicates that entrepreneurs continue to use franchising as a means of market penetration. It should be noted that 24 franchisor organisations appear in the BRW List of Top 500 Private Companies in Australia, demonstrating that franchising has a significant impact on Australian business.

Total number of units in franchise systems in Australia

It is estimated that there are 56 200 business format franchised units operating together with some 5 660 company-owned units, producing a total of 61 860 units in business format franchise systems. In addition, there are approximately 5 700 fuel retail outlets and 2 690 motor vehicle retail outlets. It is important to note that business format franchise units account for slightly less than 5 percent of all small businesses in Australia², indicating that there are further opportunities for growth at the unit level.

Growth of franchise units in Australia

By comparing the estimated total of 61 860 franchise units in 2006 with 54 000 units estimated in 2004, the growth rate at unit level is 14.6 percent. It should be noted that the growth rate in franchised units (that is, excluding company owned units) from 2002 to 2004 of 14 percent has decreased to 11 percent in the period 2004 to 2006. However, the total growth rate of 14.6 percent reported above has occurred because of an increase in company ownership of units over this latter period. The increase of company held units is typical of a mature franchising sector.

Hence, overall growth in the sector is strong, represented by significant increases in both the number of franchise systems and franchise units held.

Turnover of the Australian franchising sector

The total sales turnover of business format franchise units was estimated at \$67 billion in 2005. In addition, motor vehicle sales were estimated at \$30 billion and fuel retail at \$31 billion, resulting in a total sales turnover of approximately \$128 billion for the sector. This represents an impressive contribution of 14 percent to Australia's gross domestic product (GDP).

² Australian Bureau of Statistics 8127.0 Characteristics of Small Business, Australia (Reissue) 2004.

Employment in the Australian franchising sector

The total number of persons employed in business format franchise systems is estimated to be 426 500, made up as follows.

Employment status	Number of Employees	Percent
Permanent full time	208 100	48.8%
Permanent part time	72 800	17.1%
Casual	145 600	34.1%
Total	426 500	100.0%

The above proportions are dissimilar to the population of employed persons in Australia, indicating either errors in reporting by franchisors or inherently different employment patterns in franchising. Because franchising is characterised by some large retail chains, particularly in fast food, there may be greater opportunities for casual employment in the franchising sector. A large proportion of franchise units, particularly in property and business service and personal service industries, is owner/managed by sole operators, thereby employing no staff.

Profile of franchise systems in Australia

Industries. The majority of franchising takes place in the retail non-food industry (29 percent of franchisors and 36 percent of franchise units). Next, the property and business services sector accounts for 21 percent of franchisors and some 7 percent of franchise units.

Age of systems. Franchisors have been operating their businesses for an average of 16 years and franchising for 10 years, demonstrating the level of maturity in the sector. On average, franchisors operated their businesses for four years before adopting a franchising strategy. However, many franchisors still enter franchising at a very early stage of their business development, with close to 20 percent of businesses franchising immediately and a further 13 percent doing so within the first 12 months of operation.

Size of systems. Although the sector is showing signs of maturity in terms of franchising experience, the size of systems remains relatively low in terms of sustainability. The average number of franchised units per system was 22, together with an average of 1 company unit. Nearly half the franchisor respondents (48 percent) held fewer than 20 franchised units. Hence, system growth remains a challenge for the majority of franchisors, with many deciding to expand internationally in order to stimulate further growth.

Geographical distribution. The majority of franchising activity occurs in New South Wales (34 percent of total units). Victoria represents 24 percent and Queensland 20 percent of franchising. These proportions reflect the relative populations in each state. This pattern of franchising activity has remained constant over the past decade.

System structure. Two thirds of franchisors have now adopted master franchising arrangements in their domestic operations. Franchisees operate from a mixture of locations, including mobile or home-based arrangements. Slightly more than one quarter (28 percent) of franchise systems have franchisees operating from home and 22 percent of systems have mobile franchisee operators, compared with 45 percent operating from a retail site.

Franchising disputes and unit closures

The level of reported disputes in the franchising sector remains low. Substantial disputes (those referred to an external advisor for action) were experienced by 35 percent of franchisors in the previous 12-month period, but most were with only 2 franchisees. Mediation is being used more than twice as often as litigation as a means of resolving disputes. The proportion of franchisees in disputes equates to less than 4 percent. The most common causes of disputes were related to system compliance, communication problems and misrepresentation claims.

Patterns in changes in franchise unit ownership continue to provide evidence of stability in the sector. During 2005, the majority of franchised units (91 percent) did not change ownership. Of the remainder, most changes occurred when franchisees sold their businesses to new franchisees or the franchisor. Fewer than 2 percent of franchised units ceased to operate, supporting the notion that franchising failure rates are low. In addition, franchisees remain in the system for an average of 7 years, indicating that their businesses are operating profitably.

International expansion by Australian franchise systems

Slightly more than one quarter of Australian based systems are currently franchising internationally. Franchisors continue to target New Zealand, Singapore, Malaysia, China/Hong Kong, United Kingdom and the United States of America. International expansion is relatively new for the majority of franchisors with most venturing overseas within the last five years.

Franchisors held an average of only 29 franchised units prior to operating overseas, indicating that firms are proactively entering international markets prior to reaching domestic saturation. These firms may be indicative of the 'born global' phenomenon whereby franchisors attempt to capture market share rapidly. Master franchising and 100 percent ownership are used by the majority of franchisors to structure their overseas operations.

Conclusion

The *Franchising Australia 2006* results provide evidence of a mature franchising sector operating within a regulated framework and strong economy. The major challenge for franchisors is finding enough suitable franchisees to enable system expansion. This has prompted a move towards greater use of multiple unit franchising and international expansion. The low levels of disputation that continue to be reported by franchisors indicate that problems in franchising tend to be isolated rather than systemic. In summary, the Australian franchising sector continues its trajectory of expansion and represents a professional and successful business distribution model for entrepreneurial activity.

Background

Franchising Australia 2006 provides a detailed and comprehensive report on the status of the franchising sector in Australia. It continues the series of *Franchising Australia* surveys that have been produced since 1998. The 2006 report reveals a maturing franchising sector that has adapted to a strong and growing national economy.

Following the introduction of the Franchising Code of Conduct (the Code) in 1998 and the close scrutiny of the franchising sector by the Australian Competition and Consumer Commission (ACCC), it has been useful to trace the effects of regulation on franchising practices and performance over time. The current survey demonstrates that the Code has had an enduring positive effect on franchising activity in this country.

The growth of Australian franchising continues to impress. The sector experienced a period of rapid growth in the 1980s and 1990s, reflecting its level of early maturity and the lack of specific franchising legislation at that time. In 1998 a total of 693 business format franchisors was identified, expanding to 708 in 1999 and remaining at approximately 700 in 2002. This steadying of growth was predictable following the introduction of franchising legislation and a number of franchising system mergers. Some 850 franchise systems were identified in 2004, following a renewed confidence by investors and consumers.

In 2006, a total of 910 franchisors has been identified. However, this figure includes several systems that offer multiple concepts under a single brand name and these organisations have been counted only once. Hence, it can be estimated that there are *960 business format franchise systems* operating in Australia in 2006. This represents significant growth over the past eight years and indicates that the sector continues to strengthen and mature.

The data collected in the survey provides much needed current information about the Australian franchising sector, which often suffers from inaccurate reporting, speculation and generalisations. The results of the survey provide empirical support and evidence of continued positive franchising practices and performance in the sector.

Introduction

The *Franchising Australia 2006* survey was conducted from May to August 2006. The known population of business format franchisors was included in the survey.

The main purpose of the survey was to learn more about current practices and performance of the franchising sector and to enable meaningful comparisons to be made with data collected in previous years. The data collected in 2006 related to:

- A profile of the franchising sector in terms of age, size, growth, composition and international expansion;
- Operational practices employed by franchisors, including growth strategies, franchise fee arrangements, communication strategies and dispute resolution procedures;
- A profile of franchisees, including issues related to franchisee recruitment and selection.

Conduct of the survey

The Franchisors

The 2006 survey included the known population of Australian business format franchisors. A comprehensive database of franchisors was compiled by Griffith University researchers from a number of sources. Several existing databases on the internet, including that of the Franchise Council of Australia, were scrutinised, as well as published franchising directories. In addition, trade journals such as Franchising Magazine and capital city newspapers were scanned for information relating to franchise organisations. This resulted in the compilation of a database of 1125 organisations assumed to be involved in franchising.

Following administration of the survey the Griffith University database was modified to reflect information provided regarding active franchising arrangements. Organisations were removed from the database if they appeared to be no longer operating or if they indicated they were either no longer franchising, not yet franchising, or were not involved in franchising arrangements. Several organisations indicated that they were licensing arrangements, but were encouraged to participate in the survey.

The lack of any official registration requirements on franchisors makes it impossible to state accurately the population. However, the search conducted by the researchers was extensive and we are confident that most franchisors were included in the survey. Thus, sampling error is not a concern in this survey. We estimate that the number of business format franchisors in Australia in 2006 is around 910. When multiple systems operating under a single brand name are considered, the number of franchise systems approximates to 960.

The Questionnaire

The survey was conducted electronically via the internet. Because the franchising sector is heavily surveyed for various purposes, it was decided to make the task as easy as possible for participants to complete and so an online survey was once again administered.

It was necessary to employ an extensive series of follow-ups and reminders to encourage people to respond. The FCA promoted the survey to its members in a number of ways, including direct emails and press releases. The research team contacted potential respondents by telephone and email to encourage participation. The questionnaire was pilot tested in two stages. In stage one, a sample of 10 consultants and 10 academics pilot tested a hard copy of the survey instrument. Based on this feedback, several changes were made to the questionnaire and a revised version was pilot tested electronically to a new sample of 10 franchisors, 5 consultants and 10 academics. Only minor changes were needed for the final questionnaire. The 10 franchisors involved in the second pilot test were excluded from the main survey.

An email notification was sent by the chief researcher to the remaining franchisors, asking for their cooperation and providing a hypertext link to the survey website placed on a secure server at Griffith University. Only the three researchers had access to the submitted surveys. Participants were asked to name their systems in the survey responses, enabling identification of respondents. Several follow-up emails and telephone calls were made to nonrespondents over a period of three months. Respondents were invited to complete and submit the survey electronically or request a hard copy of the questionnaire in the mail. Several respondents were contacted to obtain missing data from their submissions or to correct inconsistent responses. At no stage did the survey sponsor, the Franchise Council of Australia, observe the questionnaires or raw data collected.

Survey responses

Surveys were sent to the known population of franchisors as indicated below.

Organisations listed on database		1125
Less exclusions:		
Mergers and multiple listings under different names	29	
Organisations assumed no longer operating	25	
Organisations not yet franchising	18	
Organisations no longer franchising	90	
Organisations identifying as not involved in franchising	50	
Organisations in receivership or under administration	<u>3</u>	<u>215</u>
Confirmed population of franchisors		910
Less pilot study participants	10	
Less organisations which would not provide an email address	19	
Less returned emails (generally returned due to mailbox being full)	<u>21</u>	<u>50</u>
Total number of organisations included in sample		860

Of the 860 franchisors included in the sample, some 220 participated in the survey. Of these, 209 responses were received electronically and 11 by mail. Two responses were incomplete and unable to be used and one response arrived after the closing date. Thus, 217 useable responses were included, resulting in a *response rate of 25.2 percent*. This is higher than the 21.1 percent response rate (148 responses) recorded in 2004, and was obtained through a rigorous survey administration procedure.

Estimations for the whole franchising sector

As not all franchisors responded to the survey, the problem exists of estimating results for the entire franchising sector. Non-sampling errors may occur when estimates are derived from a sample. These include errors that occur because not all franchises are included in the sample of respondents. In particular, there may be a difference between those who

responded and those who chose not to participate. Two tests were performed to determine whether such nonresponse bias was evident.

Firstly, the common statistical test of comparing early with late respondents was conducted on all variables. Late respondents are assumed to be similar to nonrespondents because they respond less readily and only after prompting. The results of this test indicated that there were no significant differences between the two groups.

Secondly, a sample of 50 nonrespondents was compared with the 217 respondents on several key variables. Information for nonrespondents was obtained from the *Franchising 2006 Yearbook and Directory*. The variables examined were head office location, industry category, number of years operating, number of years franchising, number of franchised units, total number of units, and total start-up investment for a new franchise unit. This test indicated that nonresponse bias did not exist. Hence, it can be concluded that nonresponse bias was not a problem in this survey and that there are no significant differences between franchisors who responded and those who did not.

Another form of non-sampling error may occur due to incorrect responses being provided by respondents. To minimise this possibility, the data were checked carefully for out-of-range values, and where possible, respondents were contacted to verify irregular responses.

Since no franchisors in the fuel and automotive manufacturing industries were included in the survey, and these are known to be extremely large and not comparable with franchisors in other industries, this has been taken into account by excluding them from the estimations and listing them separately, where possible, in the Executive Summary.

The estimated results for the whole franchising sector are included only in the Executive Summary. However, the actual results for each individual question, together with comments, are included in the main report.

Survey results

Franchising Australia 2006

The survey results in this report are presented in the order of appearance in the questionnaire. Responses have not been manipulated in any way, apart from the correction of obvious errors made by participants. For example, if a range of values was provided as a response, an average value was calculated. To assist comprehension, additional tables have been included summarising common responses.

Hence, the data presented have not been estimated to infer results for the population of franchisors. In this section, the data relate only to respondents of the survey. Due to the non-normal distribution of the data, which has occurred because of the large variation in responses, the median figure (that is, the middle figure in a graded list of responses to a question) has been reported as the 'average' unless otherwise stated.

To aid in the interpretation of results, some comparisons are made between sub classifications of data where appropriate. This analysis has been included in the report. Due to the rounding of figures in the tables, discrepancies may occur between the sum of component items and the total (that is, not all percentages will add to exactly 100%).

A. Franchise Profile

Industry

For the purposes of conducting the survey, a database of the population of business format franchises in Australia was compiled. This population of 910 franchise systems has been classified by industry, below, for comparison with the 217 survey respondents. The respondent sample differs from the population slightly but with a noticeable difference in the property and business services industry segment, with a smaller proportion being represented in the sample of respondents.

The largest industry segment is retail (non food) which accounts for 29 percent of franchisors. Some 21 percent of franchisors are involved in property and business services and a further 15 percent in retail food. These segments dominate franchising activity, although examples of franchising can now be found in almost every industry.

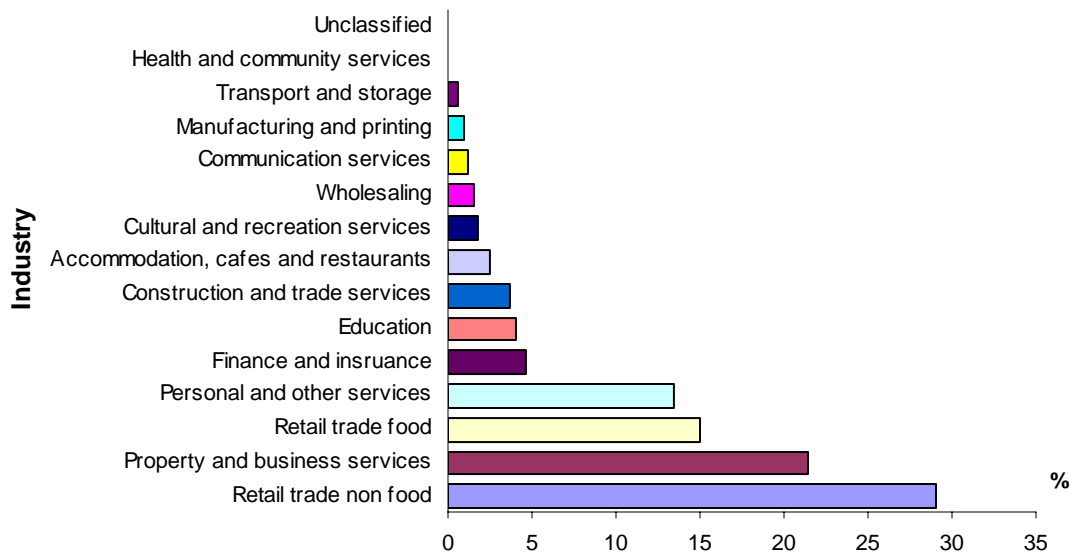
A1 *In which industry is your franchise system involved?*

Response (Industry)	Population of franchisors		Respondent franchisors		Total number of respondents' units per industry	
	Number	Percent	Number of responses	Percent	Number of units	Percent
Retail trade non-food (includes automotive services)	264	29.0	55	25.3	5182	35.5
Property and business services	195	21.4	21	9.7	1066	7.3
Retail trade food (includes fast food)	136	15.0	30	13.8	2400	16.5
Personal and other services (includes video hire and gardening services)	123	13.5	27	12.4	1779	12.2
Finance and insurance	43	4.7	20	9.2	1322	9.1
Education	37	4.1	13	6.0	345	2.4
Construction and trade services	34	3.7	16	7.4	469	3.2
Accommodation, cafes and restaurants	23	2.5	7	3.2	187	1.3
Cultural and recreation services	16	1.8	4	1.8	129	0.9
Wholesaling	14	1.5	2	0.9	58	0.4
Communications services (includes postal, courier & telecommunications)	11	1.2	8	3.7	455	3.1
Manufacturing and printing	8	0.9	3	1.4	151	1.0
Transport and storage	5	0.6	4	1.8	881	6.0
Health and community services	1	0.1	1	0.5	67	0.5
Unclassified	0	0.0	6	2.8	103	0.7
Total	910	100.0	217	100.0	14594	100.0

Notes: 1) Some 211 out of 217 respondents were able to be classified.

2) Franchisors were coded according to industry type using the major categories provided under the Australian and New Zealand Standard Industrial Classification (ANZSIC) coding system.

Industry categories



Age of franchise systems

There is evidence that the franchising sector is approaching maturity. Franchisors have been operating their business for an average of 16 years and franchising for 10 years. On average, franchisors operated their businesses for four years before adopting a franchising strategy. However, many franchisors still enter franchising at a very early stage of their business development, with just under 20 percent of businesses franchising immediately and a further 13 percent doing so within the first 12 months of operation.

The greatest uptake in franchising has been from the 1990s onwards. Fully 41 percent of businesses have begun franchising since 2000.

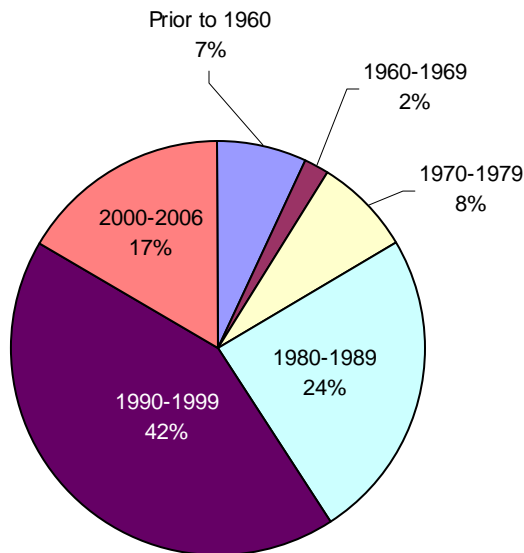
A2 *In which year did this business commence operations?*

A3 *In which year did this business commence franchising?*

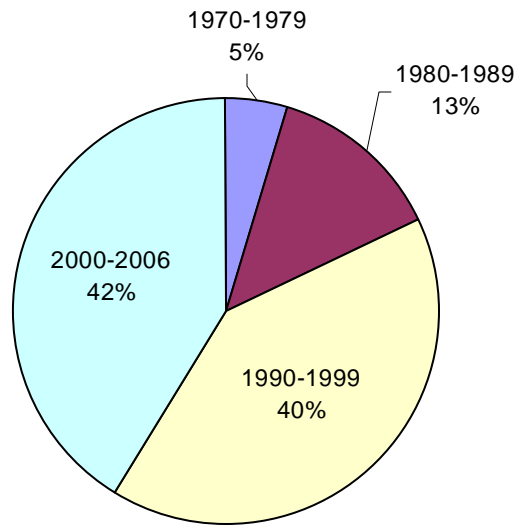
Response (Year)	Year commenced operations		Year commenced franchising	
	Number of responses	Percent	Number of responses	Percent
Prior to 1960	15	6.9	0	0.0
1960-1969	4	1.9	0	0.0
1970-1979	17	7.9	10	4.7
1980-1989	52	24.1	29	13.5
1990-1999	92	42.6	87	40.5
2000-2006	36	16.7	89	41.4
Total	216	100.0	215	100.0

- Notes: 1) A total of 215 franchisors provided a response from an expected 217.
 2) The average number of years was: operating 16 years and franchising 10 years.
 3) Businesses had been operating for a range of 1 to 174 years and franchising for a range of 1 to 37 years.

Year commenced operations



Year commenced franchising



Size of franchise systems

Although the sector is showing signs of maturity in terms of franchising experience, the size of systems remains relatively low. The average number of franchised units per system was 22, together with an average of 1 company unit. Slightly more than one third (36 percent) of organisations are fully franchised, holding no company units.

Nearly half the franchisor respondents (48 percent) held fewer than 20 franchised units. Many experts believe that more than 20 units are needed for a system to be viable, indicating that these organisations will need to expand rapidly. There was no significant correlation between the size of franchise systems and their age, as would be expected if the small systems were younger or large systems were older. Hence, system growth remains a challenge for the majority of franchisors.

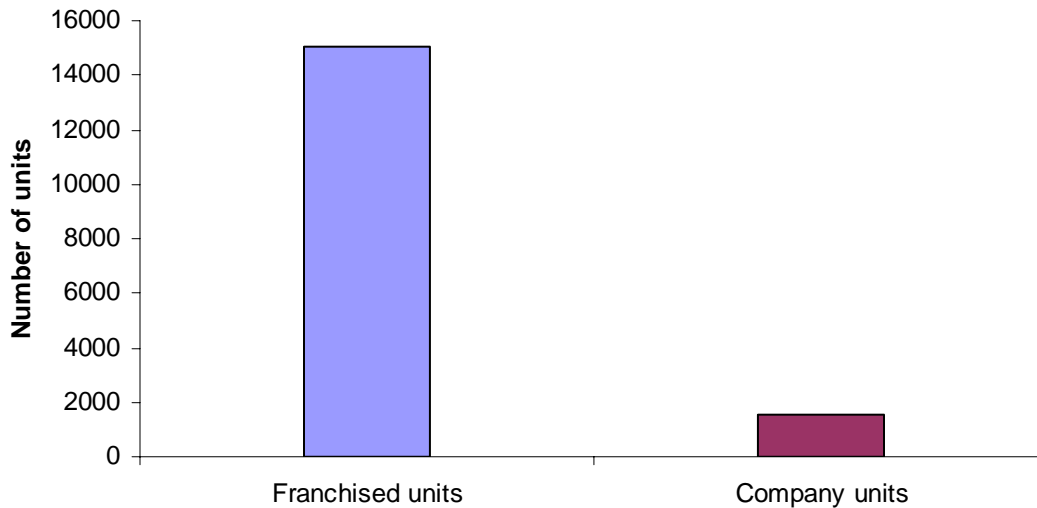
A4 *How many franchised units were operating within your franchise system in Australia as at 31 December 2005?*

A5 *How many company-owned units were operating within your franchise system in Australia as at 31 December 2005?*

Response (Number of units at 31 December 2005)	Number of responses	Total number of units	Average number of units	Range	
				Minimum	Maximum
Franchised units	217	15032	22	0	1425
Company units	216	1506	1	0	265

Notes: 1) A total of 216 franchisors provided a response from an expected 217.

Total number of units



Turnover of franchise systems

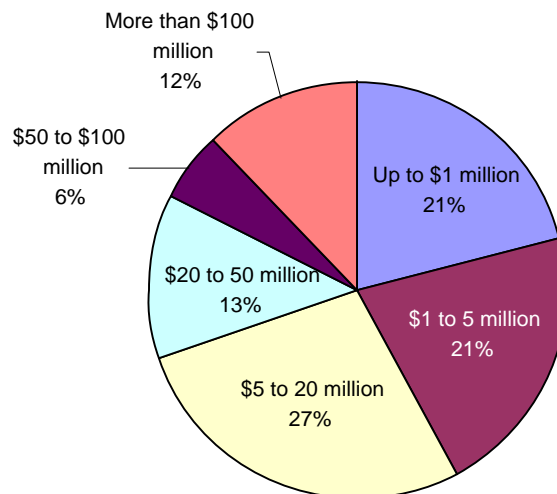
The average total system turnover (that is, total sales for both company and franchised units) was \$9 million. However, there is a large industry variation due to differences in business activity and system size. Retail systems reported an average annual turnover of \$20 million, compared with \$3.25 million for non-retail franchises. Within retailing, food retailers reported system turnover of \$10 million, compared with \$3 million for non-food retailers. These variations reflect the relative size of systems.

A6 What was your system turnover (total sales for all company and franchised units) in Australia as at 31 December 2005?

Response (Total system turnover)	Number of responses	Percent
Up to \$1 million	38	21.0
\$1 to 5 million	38	21.0
\$5 to 20 million	50	27.6
\$20 to 50 million	23	12.7
\$50 to 100 million	10	5.5
\$100 to 500 million	14	7.7
\$500 million to \$1 billion	4	2.2
More than \$1 billion	4	2.2
Total	181	100.0

- Notes: 1) A total of 181 franchisors provided a response from an expected 217.
 2) The average system turnover was \$9 million.
 3) Total system turnover ranged from \$5000 to \$2 billion.

Total system turnover



Geographical distribution

The majority of franchising activity occurs in New South Wales (34 percent of total units). Victoria represents 24 percent and Queensland 21 percent of franchising. These proportions reflect the relative populations in each state. This pattern of franchising activity has remained constant over the past decade, since data have been collected on the franchising sector.

A7 *How many franchised units do you currently operate in each state/territory?*

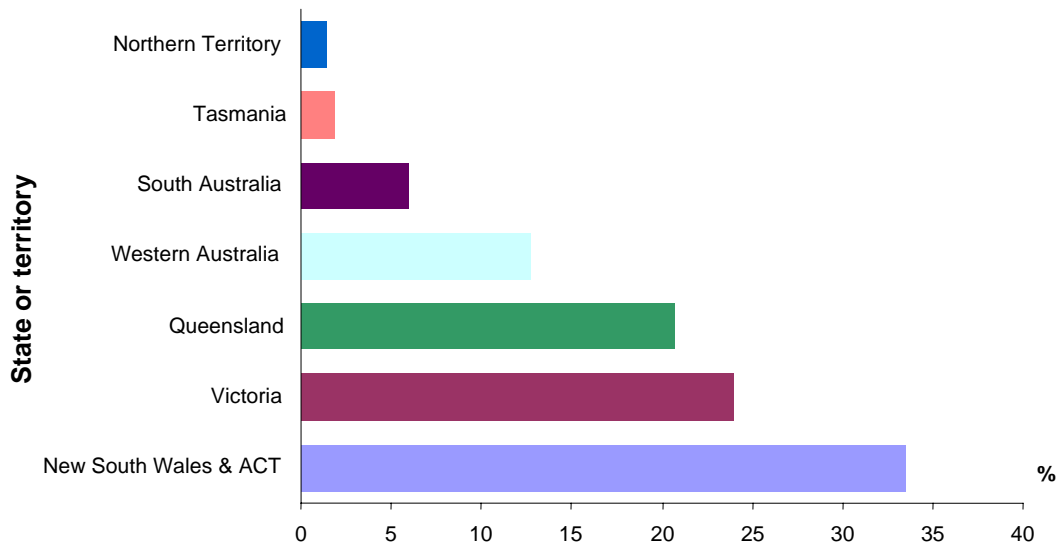
A10 *How many company-owned units do you currently operate in each state/territory?*

Response (State)	Franchised units		Company-owned units		Total units	
	Total number	Percent	Total number	Percent	Total number	Percent
New South Wales & ACT	4511	34.0	383	28.9	4894	33.5
Victoria	3150	23.7	333	25.0	3483	23.9
Queensland	2715	20.5	303	22.8	3018	20.7
Western Australia	1702	12.8	152	11.4	1854	12.7
South Australia	756	5.7	119	8.9	875	6.0
Tasmania	251	1.9	20	1.5	271	1.9
Northern Territory	181	1.4	20	1.5	201	1.4
Total	13266	100.0	1330	100.0	14596	100.0

Notes: 1) A total of 216 franchisors provided a response to the number of franchised units held from an expected 217.

2) A total of 215 franchisors provided a response to the number of company-owned units held from an expected 217.

Geographical distribution of total units



- A8** *Of the total number of franchised units listed above, how many operate within capital cities?*
- A9** *Of the total number of franchised units listed above (in each state and territory), how many franchisees hold those units?*
- A11** *Of the total number of company-owned units listed above, how many operate within capital cities?*

Slightly more than half of all franchised units (7174 units = 54 percent) are located in capital cities. This proportion is slightly lower than the proportion of the population located in capital cities (64 percent)³, indicating opportunity for further growth in urban locations. Individual franchise systems reported having no franchised units (in 17 systems) through to 650 units held by franchisees located in capital cities. However, a greater proportion of company-owned units is held in capital cities (917 units = 69 percent). Company units are typically used for franchisee/staff training and for market research purposes, so will logically be located close to the franchisor's head office.

Multiple unit ownership is quite widespread with some 8325 franchisees holding the 13 266 units reported by respondents. At the individual system level, one third of franchise systems (33 percent) involved no multiple unit ownership and two thirds (67 percent) had some level of multiple unit ownership by franchisees. Hence, the so-called "mum and pop" type operation where the franchisee devotes his/her time entirely to a single franchise unit is much less common than the "franchisee-as-manager" operation, indicating that franchising provides an opportunity for investors to expand their holdings.

Growth projections

- A12** *How many additional franchise and company owned units (in total) do you expect to open in Australia over the next two years?*

Growth projections offered by franchisors are modest. Respondents indicated that they would add an average of 4 additional units (franchised and company owned) to their systems by the end of the current year (2006) and a further 6 units in 2007.

- Notes:* 1) A total of 212 franchisors provided a response from an expected 217.
2) Growth projections in 2006 ranged from zero to 220 units. Some 15.6 percent of respondents expected no growth.
3) Growth projections in 2007 ranged from zero to 230 units. Some 10.8 percent of respondents expected no growth.

³ ABS catalogue 3218.0 Regional Population Growth Australia & New Zealand, 2002-2003

Location of operations

Head office location

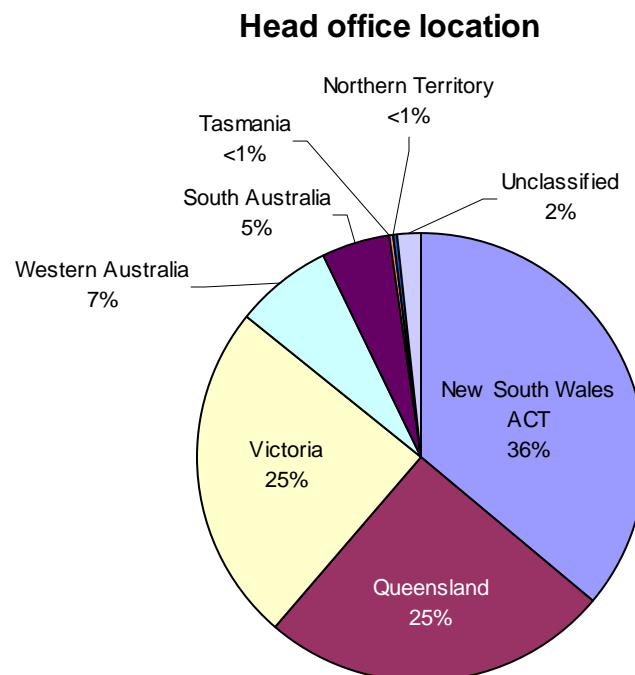
Slightly more than one third (36 percent) of franchisors have located their head offices in New South Wales. Around one quarter of head offices are located in Queensland (25 percent) and Victoria (25 percent). The domination of franchising activity in these three states is similar to other commercial activity in the country.

A13 *In which state/territory is your franchise head office located?*

Response (Head office location)	Number of responses	Percent
New South Wales / ACT	329	36.2
Queensland	229	25.2
Victoria	224	24.6
Western Australia	62	6.8
South Australia	46	5.1
Tasmania	3	0.3
Northern Territory	1	0.1
Unclassified	16	1.8
Total	910	100.0

Notes: 1) Source: Griffith University database of population of franchisors.

2) Responses from 216 franchisors were compared with above population data and were found to be consistent.



Franchise unit location

Whilst a fixed site such as a retail or commercial site is the most common location from which franchisees operate, some 20 percent of franchisor respondents indicated that their franchisees operate from a mixture of locations, including mobile or home-based arrangements. Slightly more than one quarter (28 percent) of franchise systems have franchisees operating from home and 22 percent of systems have mobile franchisee operators, compared with 45 percent operating from a retail site.

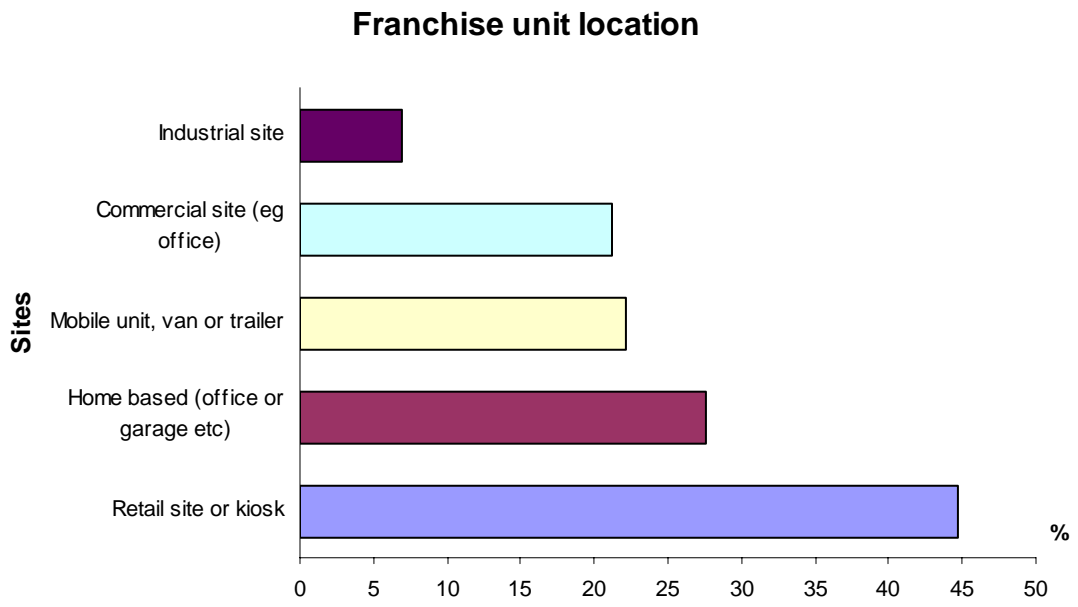
The choice of location or style of operation is linked to industry segments, with the largest industry for each type of operation quoted here. Approximately one third of mobile franchisees operate in the personal services industry, one quarter of home-based franchisees operate in finance and insurance, three quarters of franchisees based in retail sites operate food or non-food retail stores, and half the franchisees located in commercial sites work in either finance and insurance, education services or property and business services.

The start-up capital requirements (excluding GST) for mobile and home-based operations were an average of \$49 000 (consistent with the under \$50 000 threshold in the Franchising Code of Conduct), whereas franchises operating from retail sites averaged \$234 000. Whilst the cost of a mobile or home-based unit has not increased since the 2004 survey, the cost of a retail site franchise has increased by an average of \$18 750, reflected in an increase in fit-out costs rather than in the franchise fee.

A14 Where do your franchisees locate their businesses?

Response (Sites)	Number of responses	Percent
Retail site or kiosk	97	44.7
Home based (office or garage etc)	60	27.6
Mobile unit, van or trailer	48	22.1
Commercial site (eg office)	46	21.2
Industrial site	15	6.9

- Notes: 1) All 217 franchisors answered the question.
 2) Multiple responses were recorded for some respondents.
 3) A total of 44 franchisors (20 percent) responded that a mixture of locations was used within their systems.



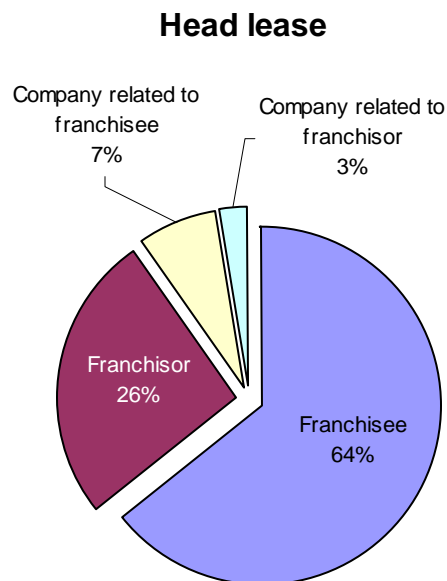
Head lease

Where the franchise units operate from a specific site, the head lease is held by the franchisee in almost two thirds (64 percent) of cases. Approximately one quarter (26 percent) of franchisors hold the head lease. At the industry level however, franchisors are more likely to hold the head lease in retail (food and non food systems).

A15 If franchisees operate from specific commercial sites, who holds the head lease?

Response (Head lease)	Number of responses	Percent
Franchisee	100	64.1
Franchisor	41	26.3
Company related to franchisee	11	7.1
Company related to franchisor	4	2.6
Total	156	100.0

Notes: 1) A total of 156 franchisors provided a response from an expected 157.



Employment

In franchised and company-owned units fully 41 percent of staff are employed on a permanent full-time basis. With a high proportion of franchising occurring in retailing, particularly in fast food, some 40 percent of staff are employed as casuals, many of whom would be students gaining experience in the work force. Permanent part-time staff account for the remaining 19 percent of people employed in franchise units.

This pattern changes at the franchisor head office level where the majority (90 percent) of staff are employed on a full time basis and where part time (8 percent) and casual (2 percent) staff are used less frequently. In summary, the franchising sector provides secure employment for large numbers of people as well as opportunities for casual work in relevant industries.

A16 *How many staff are employed at head office in total?*

A17 *How many staff are employed in your franchised units in total?*

A18 *How many staff are employed in your company-owned units in total?*

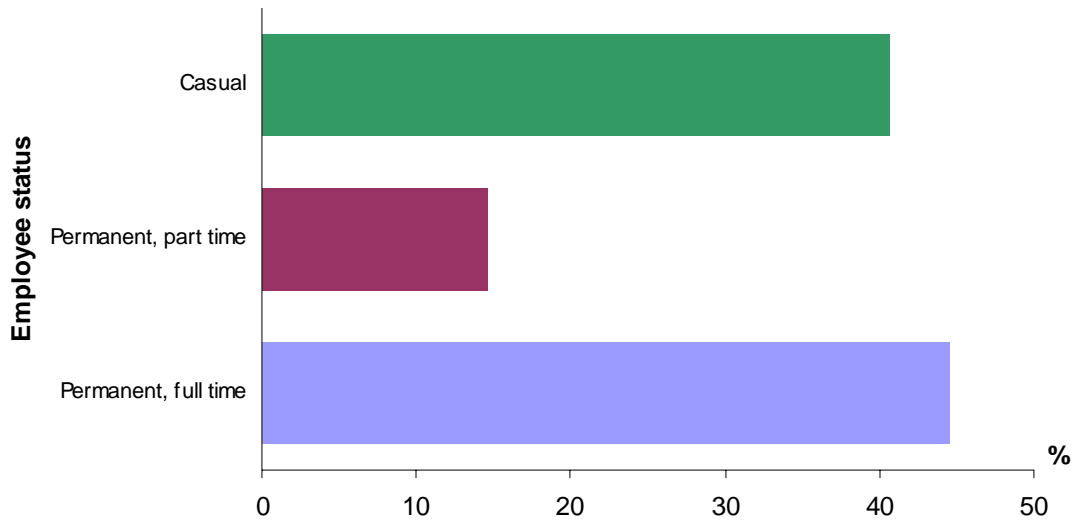
Response (Employee status)	Franchised units		Company-owned units		Franchisor head office	
	Number of employees	Percent	Number of employees	Percent	Number of employees	Percent
Permanent, full time	24474	41.0	3553	44.5	13516	89.7
Permanent, part time	11553	19.4	1175	14.7	1262	8.4
Casual	23643	39.6	3250	40.7	282	1.9
Total	59670	100.0	7978	100.0	15060	100.0

Notes: 1) A total of 216 franchisors provided a response to the number of employees in franchisor head office from an expected 217.

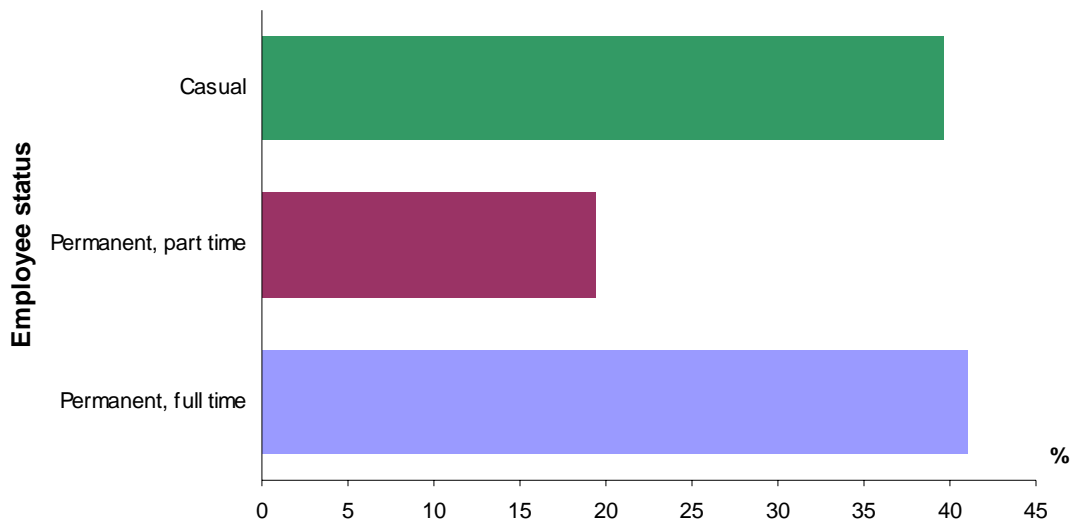
2) A total of 180 franchisors provided a response to the number of employees in franchise units from an expected 217.

3) A total of 123 franchisors provided a response to the number of employees in company-owned units from an expected 136.

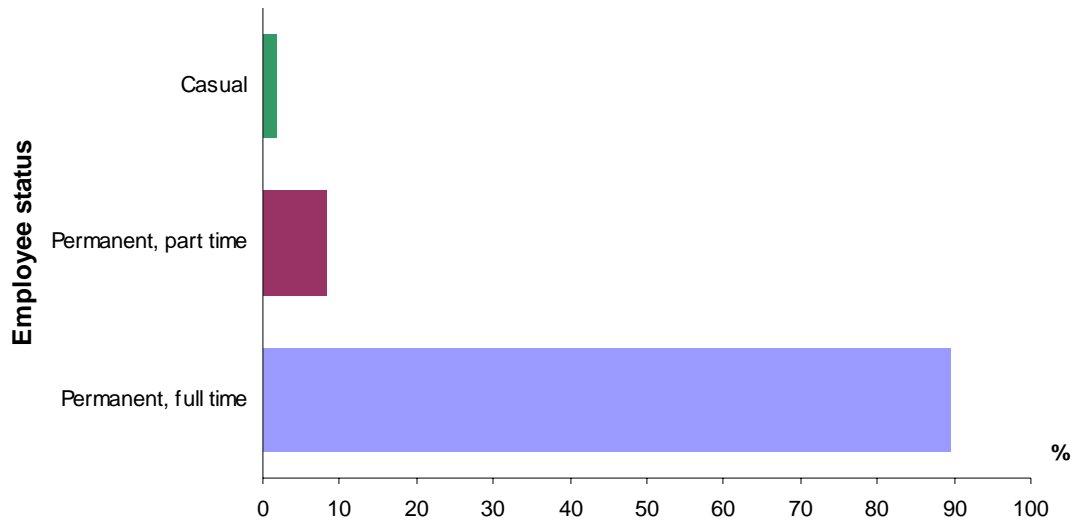
Employment in company-owned units



Employment in franchised units



Employment in franchisor head office



Legal structure

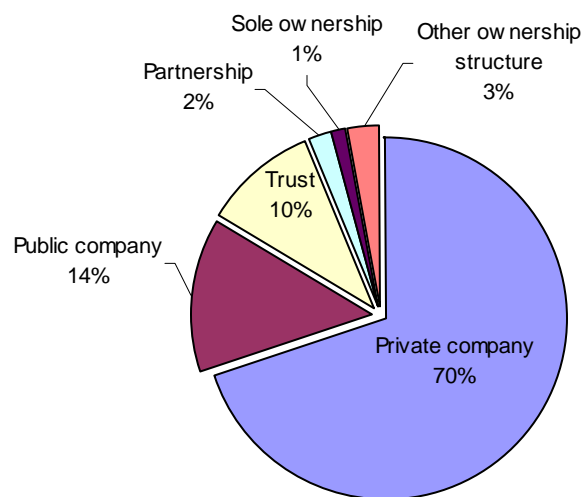
More than two thirds of franchisors (70 percent) are organised as private companies. A smaller proportion (14 percent) of franchisors operate as public companies and a further 10 percent are organised as trusts.

A19 What is the legal ownership structure of the franchisor?

Response (Franchisor ownership structure)	Number of responses	Percent
Private company	151	69.9
Public company	30	13.9
Trust	22	10.2
Partnership	4	1.9
Sole ownership	3	1.4
Other ownership structure	6	2.8
Total	216	100.0

Notes: 1) A total 216 franchisors provided a response from an expected 217.

Franchisor ownership structure



B. Franchise Operations

Franchised unit start-up costs

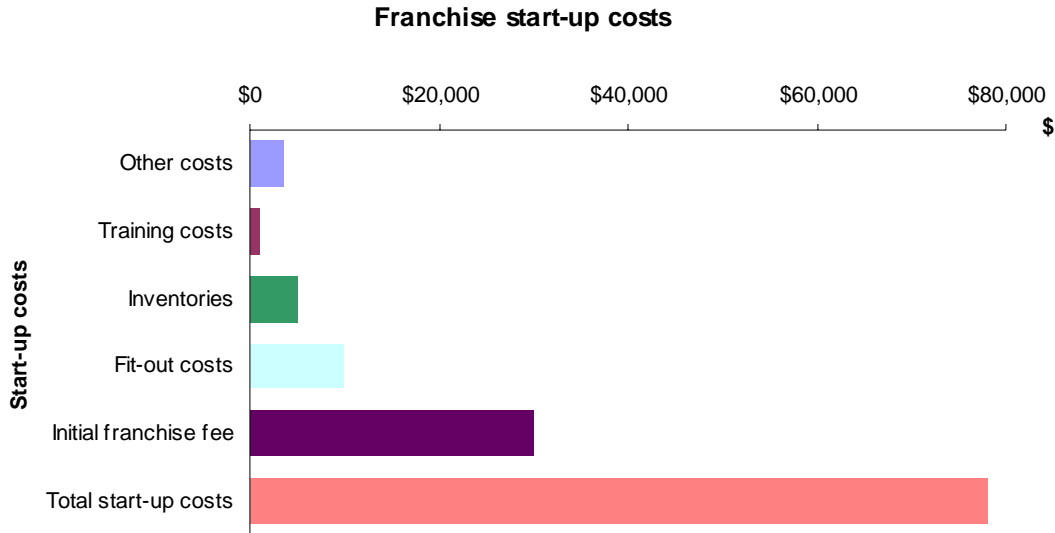
The total average start-up cost across all industries was \$78 000. The average start-up cost of a retail franchise unit has risen to \$262 500, reflecting increased fit out costs in that industry. In comparison, average total start-up costs in non-retail franchise systems have fallen slightly to \$50 500, possibly indicating a response strategy by this sector to attract scarce franchisees.

The average initial franchise fee was \$30 000. Slightly less than 5 percent of respondents did not require an initial fee. On average, retail franchises charged a higher initial fee (\$38 250) than non-retail franchises (\$26 250). More than 35 percent of franchisors did not apportion any costs for training.

B1 What is the total start-up cost of a new franchised unit (excluding GST)?

Response (Total start-up costs)	Average cost \$	Range \$
Initial franchise fee	\$30 000	\$0-140 000
Inventories	5 000	\$0-350 000
Fit-out costs	10 000	\$0-550 000
Training costs	1 000	\$0-100 000
Other costs	3 514	\$0-450 000
Total start-up costs	\$78 000	\$2100-960 000

Notes: 1) A total of 206 franchisors provided a response from an expected 217.



Turnover of franchised and company-owned units

Franchised units have an average annual turnover of \$300 000 compared with \$400 000 in company held units across all industries.

B2 Please nominate the average annual turnover (sales) per unit.

Average turnover for franchise units \$300 000
 Average turnover for company units \$400 000

Notes: 1) A total of 187 franchisors provided a response from an expected 217.

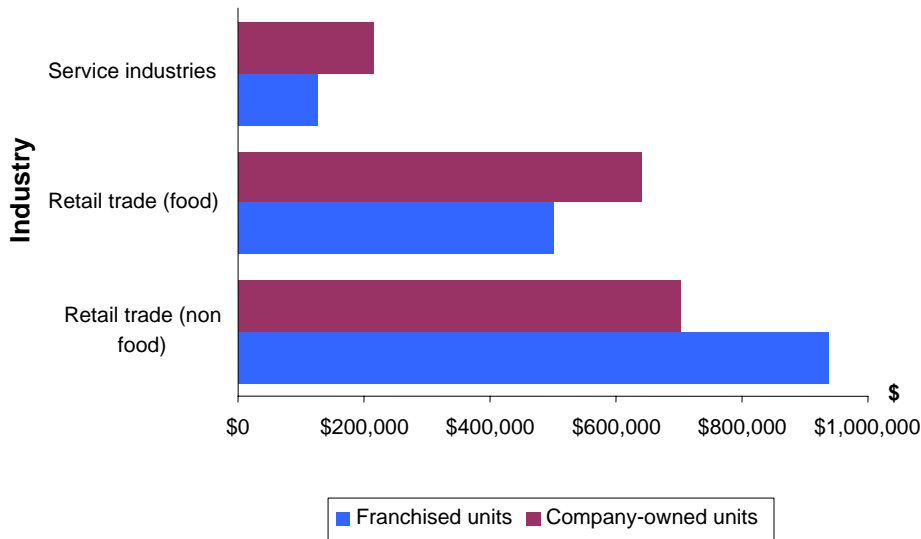
When broken down into industry segments, sales revenue per unit is higher in retailing than in service industries, reflecting associated higher overheads in the retail sector.

Sales revenue by industry segment

Industry	Franchised units		Company units	
	Number of responses	Average sales per unit	Number of responses	Average sales per unit
Retail trade (non food)	43	\$936 000	31	\$700 000
Retail trade (food)	27	500 000	17	640 000
Service industries*	81	128 000	45	216 600

* Includes Property and Business Services, Health and Community Services, Finance and Insurance, Education, Cultural and Recreation Services, and Communication Services.

Average sales revenue by industry segment



Franchise fees

Over 85 percent of franchisors charged ongoing franchise fees, and 62 percent charged marketing or advertising levies. Whilst 17 percent of franchisor respondents charged ongoing fees for IT services, only 7 percent of franchisors charged franchisees for training, suggesting that most franchisors may absorb training expenses so as to promote the professional development of their franchisees.

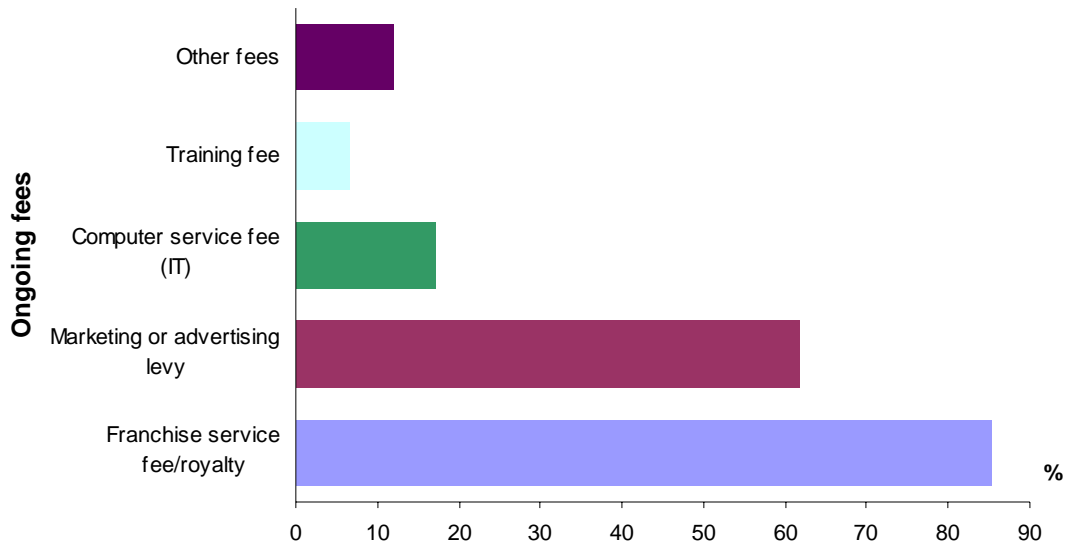
Some 12 percent of respondents charged fees for other services. Within this category, most fees were charged for the provision of administrative support, conference registration and attendance, and communications levies.

B3 What ongoing fees do you charge your franchisees?

Response (Ongoing fees)	Number of responses	Percent
Franchise service fee/royalty	185	85.3
Marketing or advertising levy	134	61.8
Computer service fee (IT)	37	17.1
Training fee	14	6.5
Other fees	26	12.0

Notes: 1) All 217 franchisors provided a response.
2) Multiple responses were recorded for some respondents.

Ongoing fees



Advertising/marketing

On average, franchisors spent \$91 000 on advertising and marketing promotion for the year ending 31st December 2005. Approximately 20 percent of respondents spent less than \$10 000 on promoting their business concepts, while more than one third of franchisors spent in excess of \$200 000 on this activity. Interestingly, 14 percent of respondents did not allocate any expenditure on advertising or marketing promotion.

The average expenditure on franchisee recruitment activities in the 2005 calendar year was \$10 000. Approximately 29 percent of respondents did not spend anything on recruitment. Some 36 percent of franchisors allocated less than \$5000, while approximately 20 percent spent in excess of \$50 000 in recruitment promotion.

B4 *How much did you spend for the year ended 31st December 2005 on the following?*

Response (Total expenditure)	Average \$
Advertising/marketing activities	\$91 000
Franchisee recruitment activities	\$10 000

Notes: 1) A total of 213 franchisors provided a response from an expected 217.

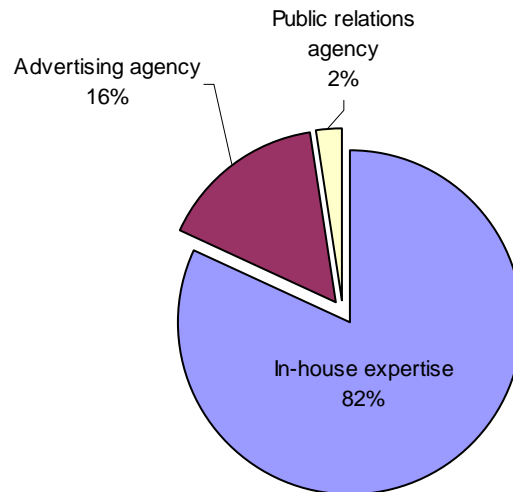
A majority of franchisors developed their marketing campaigns in-house (82 percent), while approximately 16 percent used advertising agencies. Fewer than 3 percent of respondents employed the services of public relations agencies.

B5 Which of the following do you use the most in your marketing activities?

Response (Marketing activities)	Number of responses	Percent
In-house expertise	173	82.0
Advertising agency	33	15.6
Public relations agency	5	2.4
Total	211	100.0

Notes: 1) A total of 211 franchisors provided a response from an expected 217.

Marketing activities



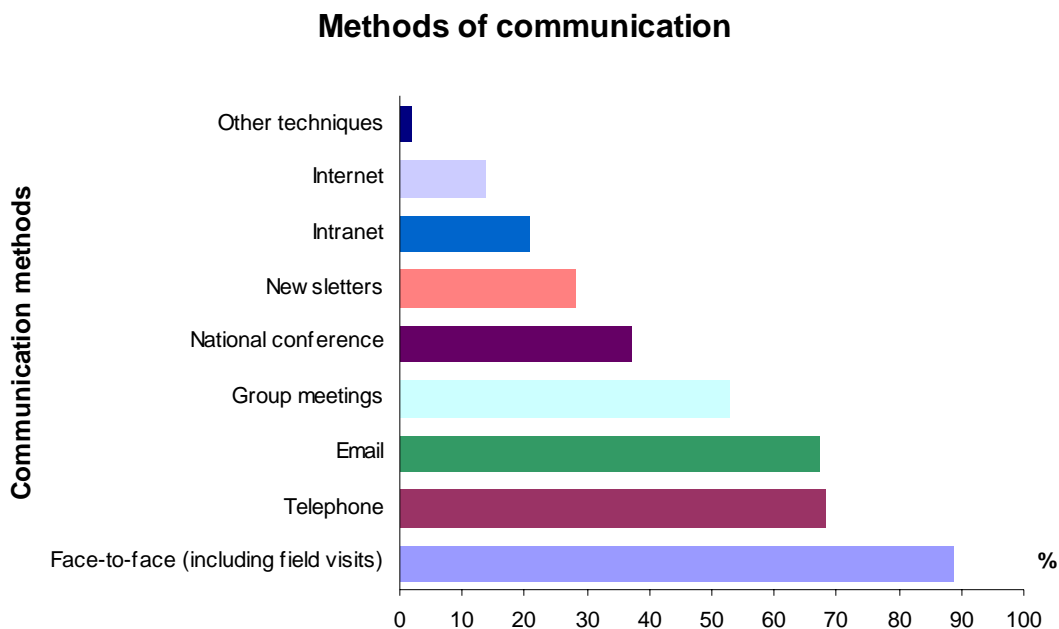
Communication

Franchisor respondents reported using a wide variety of methods in communicating with their franchisees, but clearly were more reliant on face-to-face meetings and field visits (89 percent), telephone contact (68 percent), email (67 percent) and group meetings (53 percent). In addition, more than a third favoured communicating with franchisees at national conferences. Newsletters and other electronic methods of interaction (internet, intranet and SMS) were the least common means of communicating with franchisees.

B6 *Please indicate which of the following methods are considered the most effective when communicating with franchisees?*

Response (Communication method)	Number of responses	Percent
Face-to-face (including field visits)	193	88.9
Telephone	148	68.2
Email	146	67.3
Group meetings	115	53.0
National conference	81	37.3
Newsletters	61	28.1
Intranet	45	20.7
Internet	30	13.8
Other techniques	4	1.8

Notes: 1) All 217 franchisors provided a response.
2) Multiple responses were recorded for some respondents.



Franchise relationship

Most franchisors believe that they have a healthy relationship with their franchisees. A majority of franchisors reported that their systems were characterised by high levels of cooperation, which is beneficial in managing the often competing demands of standardisation, local market innovation and system-wide adaptation. Most respondents agreed or strongly agreed that good levels of communication and a positive bond between franchisor and franchisees existed within their networks. Similarly, most franchisors believed that values and goals were clearly defined and communicated to all parties. Finally, a majority of franchisors agreed that mutual trust existed within their system, which is recognised as an integral part of successful franchise relationships.

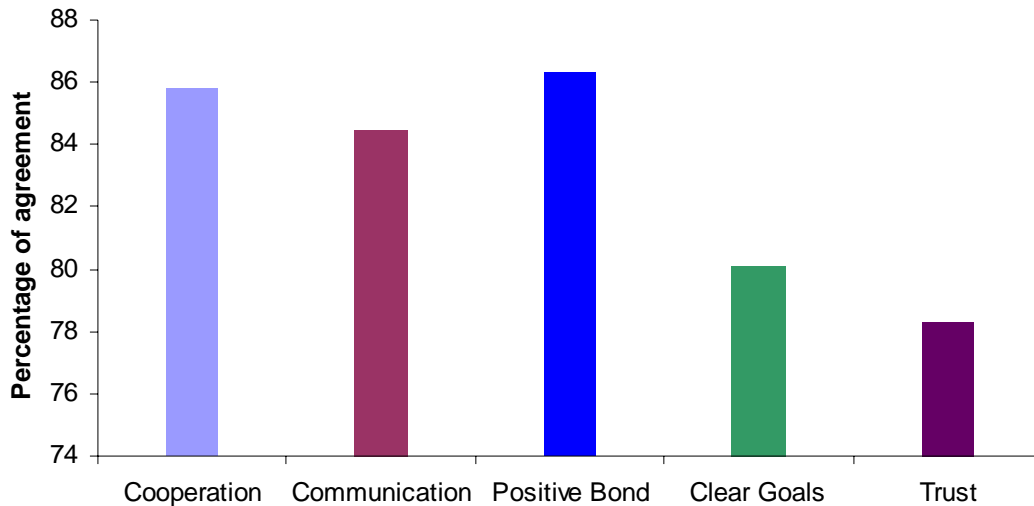
B7 *Please rate the following statements*

- a) Cooperation exists amongst all franchise owners in this franchise system.*
- b) Good communication exists within this franchise system.*
- c) A positive bond exists amongst the franchisor and franchisees.*
- d) There is a clear set of goals and values evident in this franchise system.*
- e) The franchisor management and franchisees trust one another.*

Response (Franchise relationship)	Strongly agree or agree	Percent
Cooperation	182	85.8
Communication	180	84.5
Positive Bond	182	86.3
Clear Goals	169	80.1
Trust	166	78.3

Notes: 1) A total of 211 franchisors provided a response from an expected 217.

Franchise relationship



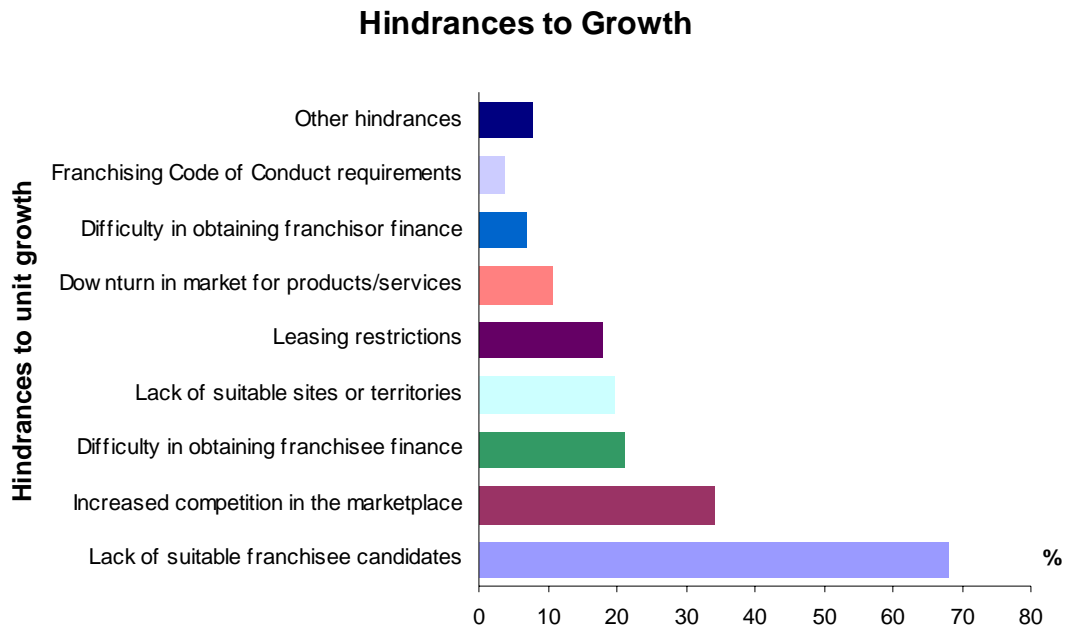
Hindrances to growth

Consistent with previous survey results in 2002 and 2004, most franchisors suggested that the main hindrance to growth was a lack of suitable franchisee candidates (68 percent). Other factors included increased competition in the marketplace (34 percent), difficulty in sourcing franchisee finance (21 percent), insufficient access to suitable sites or territories (20 percent), leasing restrictions (18 percent), and downturn in the market for the product and services offered by the franchise system (11 percent). Apart from common business growth problems, only a small proportion of franchisors nominated that they experienced difficulty in obtaining franchisor finance (7 percent) or found that Franchise Code of Conduct requirements hindered system growth (4 percent). Other hindrances nominated by franchisors were varied, with no comments overlapping.

B8 *Has the franchise system experienced any of the following major hindrances to unit growth over the past 12 months?*

Response (Hindrances to unit growth)	Number of responses	Percent
Lack of suitable franchisee candidates	148	68.2
Increased competition in the marketplace	74	34.1
Difficulty in obtaining franchisee finance	46	21.2
Lack of suitable sites or territories	43	19.8
Leasing restrictions	39	18.0
Downturn in market for products/services	23	10.6
Difficulty in obtaining franchisor finance	15	6.9
Franchising Code of Conduct requirements	8	3.7
Other hindrances	17	7.8

Notes: 1) All 217 franchisors provided a response.



Current issues of concern

Major areas of concern include difficulty in attracting suitable and committed franchisee candidates, high leasing costs and site-usage restrictions (especially within shopping centres), and costs associated with complying with the Franchising Code of Conduct. Other less frequently cited issues were negative portrayals of the franchising sector in the

mass media, high litigation costs, and a lack of professional financial support services. There was also evidence that some franchisors are concerned with the increasing number of franchisees 'free-riding' on their system tradename by reducing their unit level product and service quality. This was evident in more mature franchise systems and may suggest the need for increased levels of monitoring in these systems.

A minority of respondents suggested that macro-economic influences, including market saturation and difficulty in sourcing casual and permanent staff on account of high levels of national employment, were impeding system growth rates.

C.Franchisees

Gender and Age

As found in the 2004 survey, franchised units remain dominated by men, indicating that while there are opportunities available for women in franchising the incidence of male ownership remains significant. Almost 32 percent of all franchised units have male sole owners with female sole owners accounting for only 11 percent of operations. When combined with joint ownership involving spouses, the gender difference is even more pronounced, with male ownership/involvement being over two thirds (69 percent) of all franchises and female involvement in less than a quarter (20 percent). The proportion of women remains lower in franchising than small business ownership in general.⁴ Other ownership arrangements account for 11 percent of franchisee units.

Franchisees are concentrated within the 31 to 50 year age group with approximately 70 percent of franchisees fitting into this profile. This proportion is lower than small business operators in general who comprise 59 percent of this age group.⁵ While the trend continues for franchisors to favour prior industry and management experience in potential franchisees, there is also a need to source prospects with adequate finance as evidenced in questions C12 and C13. Only 8 percent of males and 14 percent of female franchisees were under 30 years of age (which may be related to lack of access to finance). Similar patterns were found in mature age franchisees with 22 percent of men and 15 percent of women aged over 50 years.

C1 *Approximately what percentage of your franchised units are operated by the following groups?*

Response (Franchisees)	Percentage of franchisees	Percentage by gender
Ownership with spouse/partner predominantly operated by male	36.8	
Male sole owner	31.8	68.6
Ownership with spouse/partner predominantly operated by female	9.3	
Female sole owner	10.9	20.2
Other ownership arrangement	11.2	11.2
Total	100.0	100.0

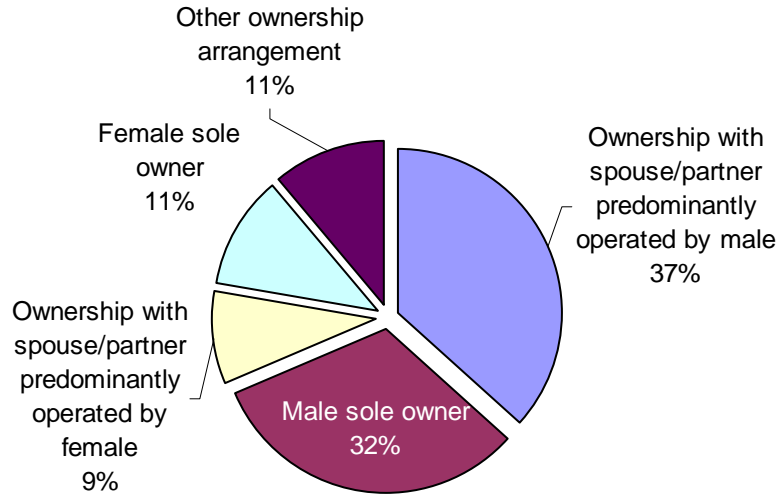
Notes: 1) A total of 216 franchisors provided a response from an expected 217.

2) As the data are normally distributed, the mean has been reported as the average.

⁴ Australian Bureau of Statistics 8127.0 Characteristics of Small Business, Australia (Reissue) 2004.

⁵ Ibid.

Ownership structure



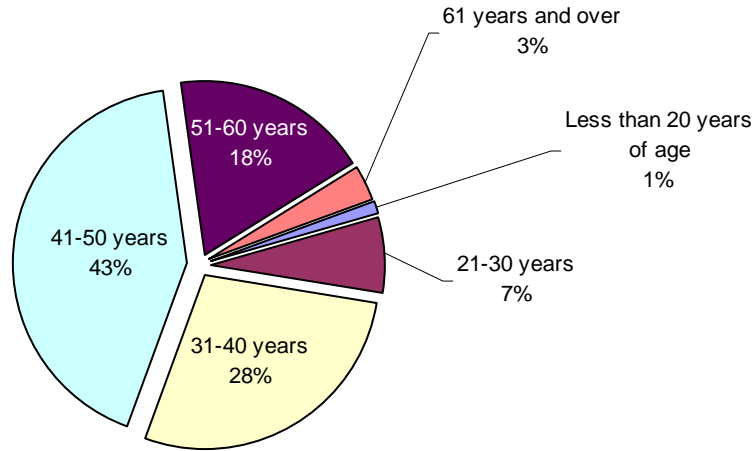
C2 *Approximately what percentage of your male franchisees (sole owners and partnered) fit into the following age groups?*

C3 *Approximately what percentage of your female franchisees (sole owners and partnered) fit into the following age groups?*

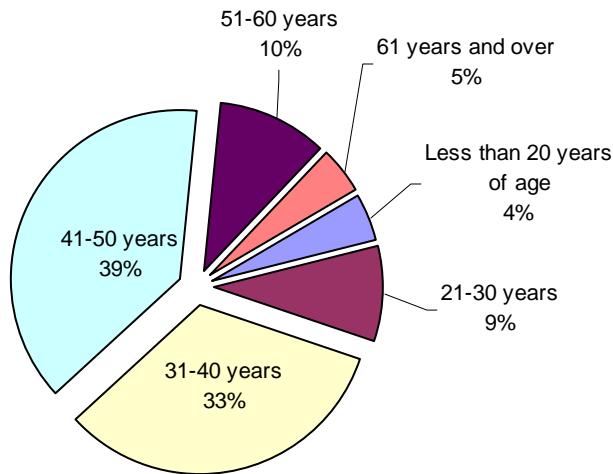
Response (Age of franchisees)	Percentage of male franchisees	Percentage of female franchisees
Less than 20 years of age	1.0	4.4
21-30 years	7.1	9.2
31-40 years	28.1	32.8
41-50 years	42.0	38.7
51-60 years	18.4	10.4
61 years and over	3.4	4.5
Total	100.0	100.0

Notes: 1) A total of 212 franchisors provided a response from an expected 217.
 2) As the data are normally distributed, the mean has been reported as the average.

Age of male franchisees



Age of female franchisees



Change implementation

Two thirds of the franchisor respondents (67 percent) reported that they had encountered difficulties with franchisees implementing required changes to their franchised units. Of the franchisors who encountered difficulties in implementing change 65 percent reported difficulty in motivating franchisees to accept change, 55 percent stated that it was difficult to cater to the differing needs of franchisees, 44 percent reported that it was difficult to monitor the system to ensure changes are implemented, 35 percent claimed that it was difficult to communicate the vision associated with the changes, and 36 percent found it difficult to train the franchisees to implement changes.

Several other issues were also listed as impeding implementation of changes, including reluctance to invest in upgrades, financial issues, difficulties converting from employee mentality to small business owners, and time issues.

C4 *Have you encountered difficulties in trying to ensure the implementation of required changes by franchisees to their franchised unit?*

Response (Difficulty with change implementation)	Number of responses	Percent
Yes	142	67.0
No	70	33.0
Total	212	100.0

Notes: 1) A total of 212 franchisors provided a response from an expected 217.

C5 *If you answered 'yes' please indicate the extent to which each of the following has caused these difficulties in ensuring franchisees implement required changes.*

Response (Change implementation)	Number of Responses	Percentage
Communicating the vision in relation to changes		
Very easy/Easy	45	32.0
Not difficult or easy	46	32.6
Difficult/Very difficult	50	35.4
Total	141	100.0
Monitoring the system to ensure the changes are implemented		
Very easy/Easy	37	26.2
Not difficult or easy	42	29.8
Difficult/Very difficult	62	44.0
Total	141	100.0

Training the franchisees to implement the changes		
Very easy/Easy	38	27.2
Not difficult or easy	52	37.0
Difficult/Very difficult	50	35.8
Total	140	100.0
Motivating franchisees to accept and believe in the changes		
Very easy/Easy	18	12.7
Not difficult or easy	32	22.5
Difficult/Very difficult	92	64.8
Total	142	100.0
Accommodating the differing needs of franchisees		
Very easy/Easy	19	13.4
Not difficult or easy	45	32.0
Difficult/Very difficult	77	54.6
Total	141	100.0
Other implementations difficulties encountered		
Very easy/Easy	3	10.3
Not difficult or easy	17	58.6
Difficult/Very difficult	9	31.0
Total	29	100.0

Notes: 1) From 29 to 142 franchisors provided a response from an expected 142.

Franchisee life span

As with the 2004 survey, the average time that franchisees are remaining in a system was once again reported to be 7 years. Industry differences were not apparent, with the average life span of a service sector franchisee being 7 years and 8 years in retail.

C6 *If you have been franchising for more than five years, what is the average length of time (years) that a franchisee remains in the system?*

Average length of time that franchisees remain in the system: 7 years

Notes: 1) A total of 136 franchisors provided a response from an expected 217.
2) The length of time ranged from 2 to 18 years.

Franchisee recruitment, selection and conversion

Despite the reported shortage of suitable franchisee applicants (question B8), 50 percent of franchisee applicants who submit a formal application are successful. This is a high conversion rate, unless franchisors are screening potential candidates carefully prior to encouraging formal applications.

Franchisors continued using a wide variety of methods to attract new franchisees, with their own websites remaining the preferred method (85 percent), personal recommendations from existing franchisees (65 percent), and use of print media advertising in newspapers (63 percent). Franchise business directories on the internet were used more widely than they were in 2004. Conversely, printed franchising directories and displays at business opportunity expos were used less often. A preference for internet based communication techniques was apparent.

Franchisors were asked to prioritise attributes that they considered to be important when selecting franchisees. Most franchisors considered passion and enthusiasm (84 percent) to be the most important trait followed by honesty and integrity (75 percent), then ability or willingness to follow system guidelines (70 percent), communication ability (65 percent), business/management or industry experience (50 percent) and sales or marketing experience (35 percent).

Franchisors estimated that 84 percent of franchisees were earning profits beyond employee wages. This finding corresponds with the length of time in a system (7 years) as it is unlikely that franchisees would remain in a system if they were not profitable. Some 20 percent of franchisors claimed that all of their franchisees were operating profitably.

Previous surveys in 1999, 2002 and 2004 indicated that franchisors were faced with the difficulty of recruiting suitable franchisee candidates. In 2006, the situation remains the same with 43 percent of franchisors responding that there were either no franchisees available or there were insufficient for their growth plans. However, the remaining respondents (57 percent) were satisfied with the current availability of suitable candidates.

C7 Approximately what percentage of potential franchisees who submit a formal application are granted a franchise?

Percentage of potential franchisees that are granted a franchise: 50.0%

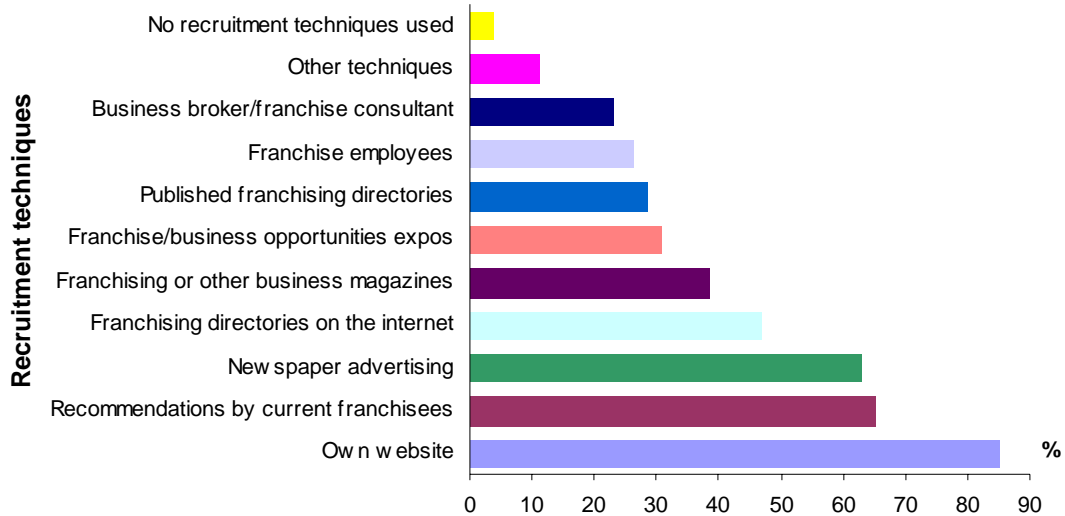
- Notes: 1) A total of 188 franchisors provided a response from an expected 217.
2) Percentages ranged from 1 to 100%.

C8 Which of the following techniques do you use for recruiting franchisees?

Response (Recruitment technique)	Number of responses	Percent
Own website	185	85.3
Recommendations by current franchisees	142	65.4
Newspaper advertising	137	63.1
Franchising directories on the internet	102	47.0
Franchising or other business magazines	84	38.7
Franchise/business opportunities expos	67	30.9
Published franchising directories	62	28.6
Franchise employees	57	26.3
Business broker/franchise consultant	50	23.0
Other techniques	24	11.1
No recruitment techniques used	8	3.7

Notes: 1) All 217 franchisors provided a response.
 2) Multiple responses were recorded for some respondents.

Techniques for recruiting franchisees

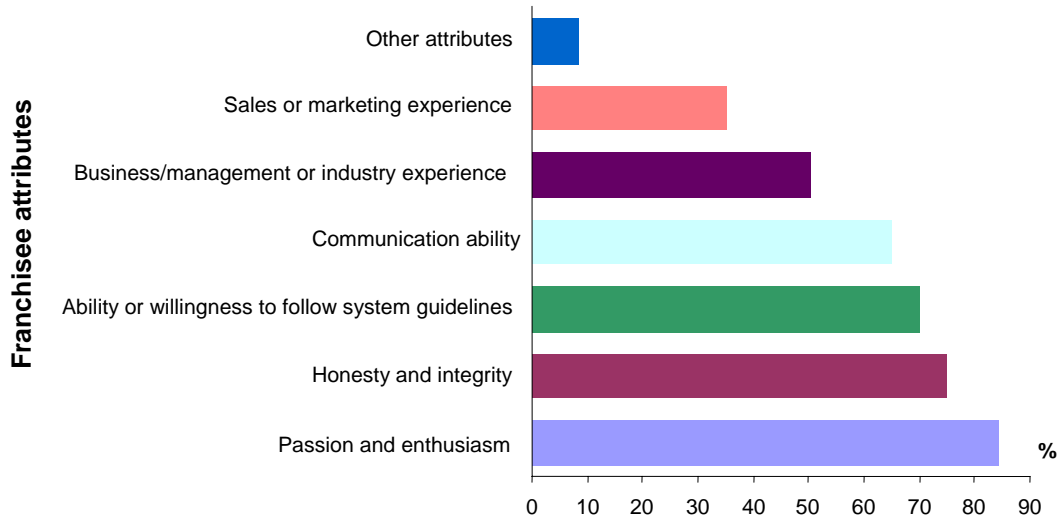


C9 *Excluding finance, what are the attributes you consider are the most important when selecting a franchisee?*

Response (Recruitment technique)	Number of responses	Percent
Passion and enthusiasm	183	84.3
Honesty and integrity	162	74.7
Ability or willingness to follow system guidelines	152	70.0
Communication ability	141	65.0
Business/management or industry experience	109	50.2
Sales or marketing experience	76	35.0
Other attributes	18	8.3

Notes: 1) All 217 franchisors provided a response.
 2) Multiple responses were recorded for some respondents.

Desirable franchisee attributes



C10 What proportion of your franchisees do you estimate are operating profitably (that is, earning profits beyond employee wages)?

Percentage of franchisees operating profitably: 84.0%

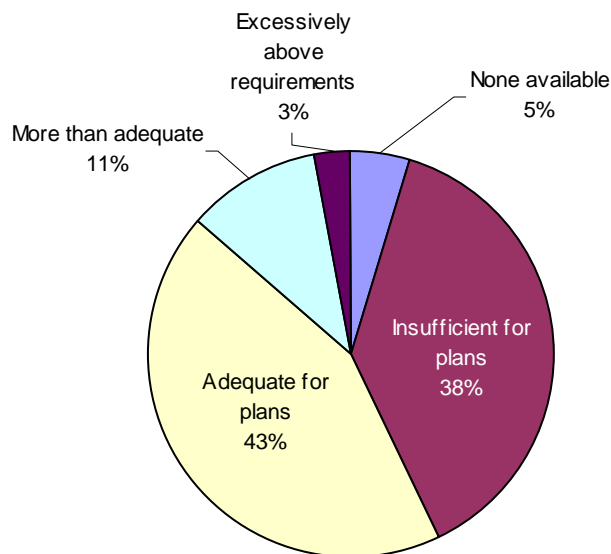
- Notes: 1) A total of 200 franchisors provided a response from an expected 217.
 2) Responses ranged from 3% (in one system) to 100% (in 40 systems).

C11 How do you rate the availability of suitable prospective franchisees over the next 12 months?

Response (Availability of franchisees)	Number of responses	Percent
None available	10	4.7
Insufficient for plans	80	37.9
Adequate for plans	92	43.6
More than adequate	23	10.9
Excessively above requirements	6	2.8
Total	211	100.0

Notes: 1) A total of 211 franchisors provided a response from an expected 217.

Availability of franchisees



Franchisee finance and security

Under a quarter of franchisor respondents (22 percent) reported that they provided finance to franchisees. The most popular method of providing finance options to franchisees is to attain finance from third parties (76 percent). The franchisors providing finance to franchisees tended to be larger and older systems.

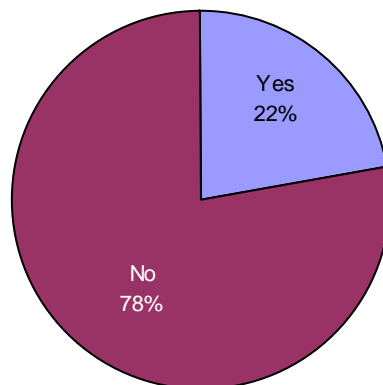
Some 75 percent of franchisors offering finance required a personal guarantee of the franchisee's directors, a charge over the items financed (15 percent) or security in other forms over the franchisee's assets (11 percent).

C12 Do you provide finance to franchisees?

Response (Provision of finance)	Number of responses	Percent
Yes	48	22.2
No	168	77.8
Total	216	100.0

Notes: 1) A total of 216 franchisors provided a response from an expected 217.

Provision of finance

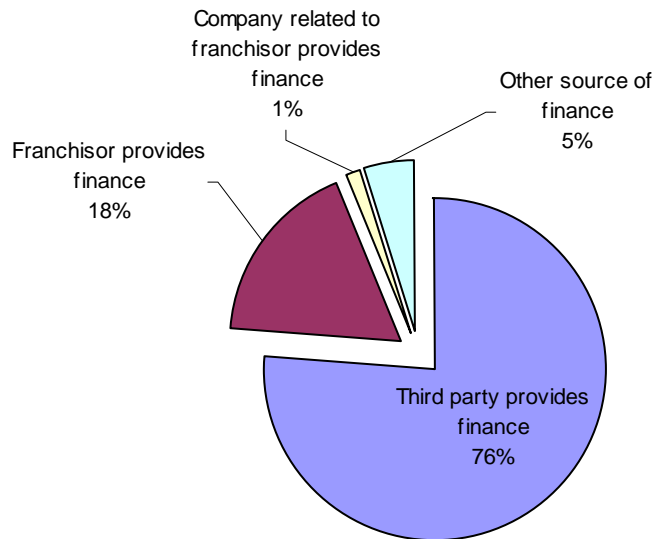


C13 *If applicable, what is the main source of finance offered to franchisees?*

Response (Source of finance)	Number of responses	Percent
Third party provides finance	112	76.2
Franchisor provides finance	26	17.7
Company related to franchisor provides finance	2	1.4
Other source of finance	7	4.8
Total	147	100.0

Notes: 1) A total of 147 franchisors provided a response from an expected 217.

Source of finance

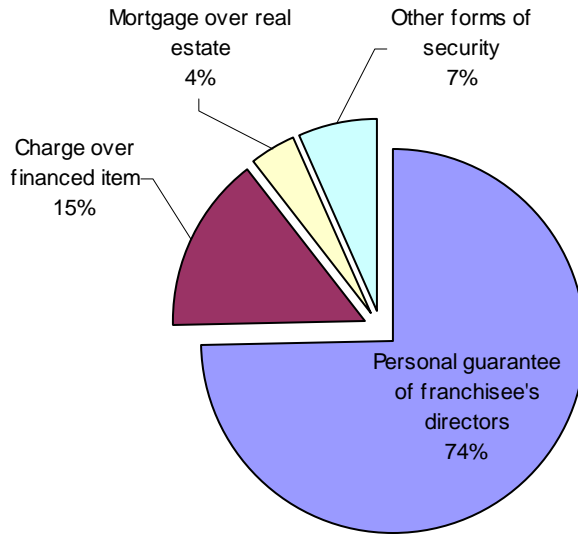


C14 *If applicable, what form of security do you require for a loan provided to a franchisee?*

Response (Type of security)	Number of responses	Percent
Personal guarantee of franchisee’s directors	56	74.7
Charge over financed item	11	14.7
Mortgage over real estate	3	4.0
Other forms of security	5	6.7
Total	75	100.0

Notes: 1) A total of 75 franchisors provided a response from an expected 217.

Security provided for franchisee loans



Franchising disputes

Some 35 percent of franchisors reported that they had been involved in a substantial dispute with a franchisee over the previous 12-month period (that is, a dispute with a franchisee referred to an external advisor for action). However, most of the disputes were with an average of 2 franchisees. Reported disputes were at the stage of correspondence with a solicitor (56 percent), mediation (29 percent) and litigation with a franchisee (14 percent). The larger proportion of disputes being resolved through mediation, rather than litigation, supports the effectiveness of the Franchising Code of Conduct. Franchisor initiated actions were only slightly higher than those initiated by franchisees.

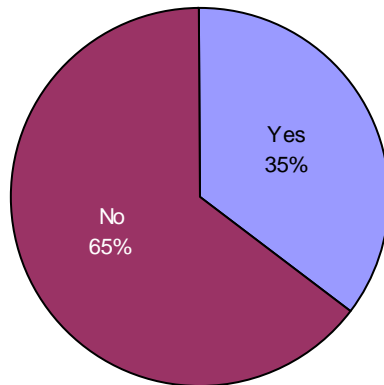
Major causes of substantial disputes were lack of system compliance (55 percent), communication problems (21 percent), misrepresentation issues (18 percent), and profitability (18 percent).

C15 *In the past 12 months, has your organisation been involved in any dispute with a franchisee that has been referred to an external advisor for action?*

Response (Disputes)	Number of responses	Percent
Yes	75	35.4
No	137	64.6
Total	212	100.0

Notes: 1) A total of 212 franchisors provided a response from an expected 217.

Disputes

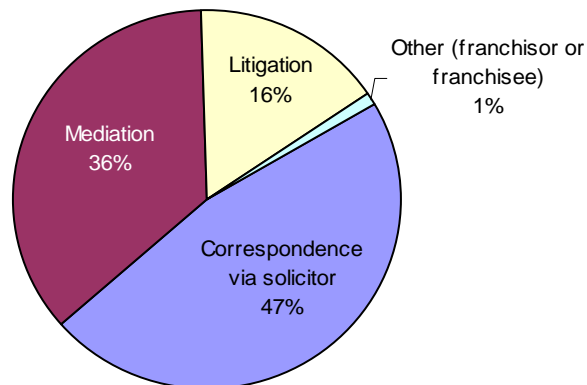


C16 Please indicate the number of franchisees involved in these disputes.

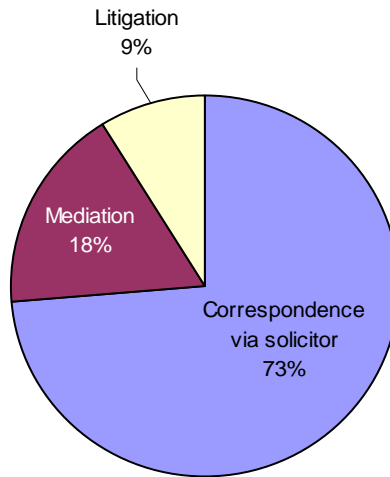
Response (Action)	Initiated by franchisor			Initiated by franchisee		
	Number of franchisors	Number of franchisees	Percentage of franchisees	Number of franchisors	Number of franchisees	Percentage of franchisees
Correspondence via solicitor	39	87	47.0	33	75	73.5
Mediation	23	66	35.7	14	18	17.7
Litigation	15	30	16.2	7	9	8.8
Other (franchisor or franchisee)	2	2	1.1			
Total		185	100.0		102	100.0

Notes: 1) A total of 72 franchisors provided a response from an expected 75.
 2) Multiple responses were recorded for some respondents.

Disputes initiated by franchisor



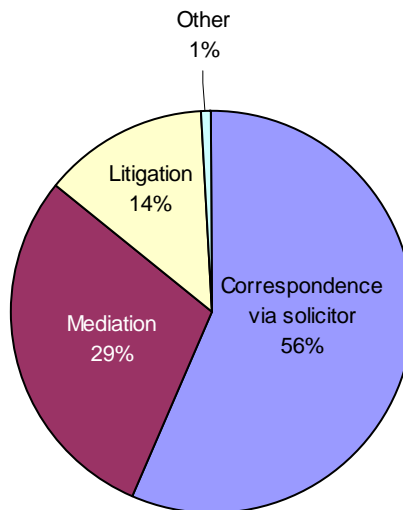
Disputes initiated by franchisee



Response (Action)	Total disputes	
	Number of franchisees	Percentage of franchisees
Correspondence via solicitor	162	56.4
Mediation	84	29.3
Litigation	39	13.6
Other	2	0.7
Total	287	100.0

Notes: 1) A total of 72 franchisors provided a response from an expected 75.

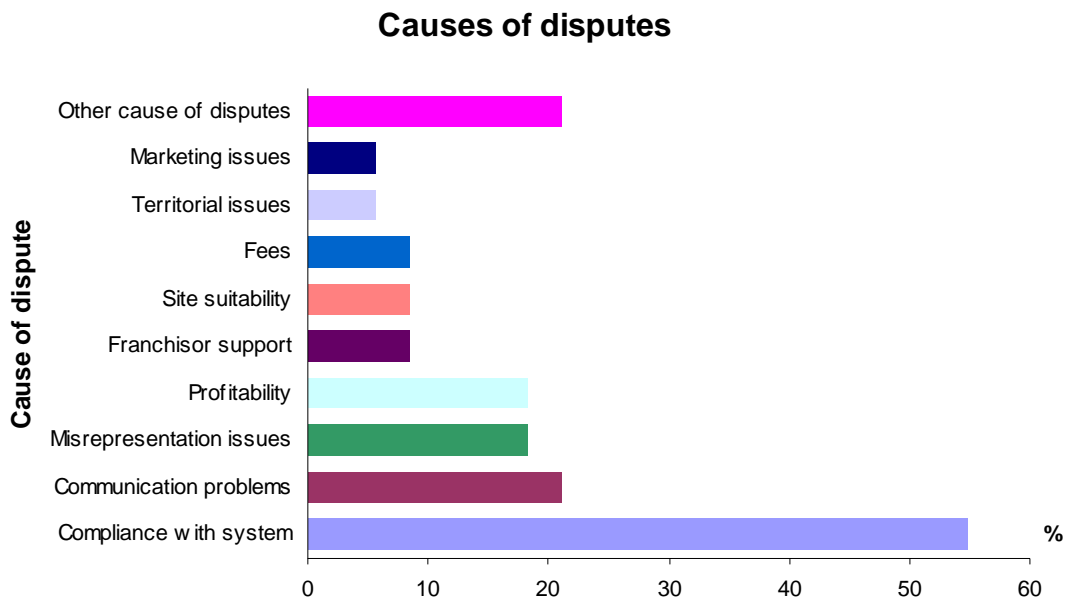
Total disputes



C17 What do you consider were the main causes of these disputes?

Response (Causes of disputes)	Number of responses	Percent
Compliance with system	39	54.9
Communication problems	15	21.1
Misrepresentation issues	13	18.3
Profitability	13	18.3
Franchisor support	6	8.5
Site suitability	6	8.5
Fees	6	8.5
Territorial issues	4	5.6
Marketing issues	4	5.6
Other cause of disputes	15	21.1

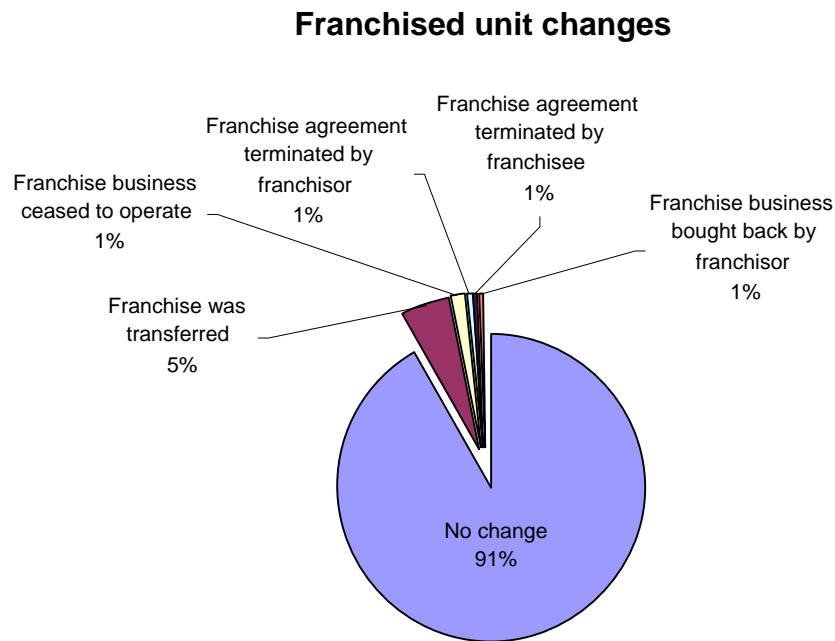
Notes: 1) A total of 71 franchisors provided a response from an expected 75.
 2) Multiple responses were recorded for some respondents.



Franchised unit changes

Data were gathered tracking ownership changes in franchised units over a three-year period from the disclosure documents of franchisors. The patterns were similar across the three years. While percentages have remained stable the increases correlate with the expansion of the sector.

In the 2005 financial year approximately 9 percent of total franchised units experienced some form of change in ownership. Thus, the majority of franchised units (91 percent) experienced no change of ownership. The most common cause of changes in franchised units was due to franchisees selling their businesses to new franchisees or the franchisor (6 percent of total units). Fewer than 2 percent of franchise agreements were terminated. Similarly, fewer than 2 percent of franchised units ceased to operate within this 12-month period, continuing to support the notion that franchising failure rates are low.



C18 *Please obtain data from your disclosure document to answer this question (Annexure 1 S6.4). For 2005, please state the number of franchise units involved in:*

2005

Response (Franchised unit change)	Number of franchisees affected	Percent	Percentage of total (15032) franchised units held
Franchise was transferred	764	58.5	5.1
Franchise business ceased to operate	201	15.4	1.3
Franchise agreement terminated by franchisor	80	6.1	0.5
Franchise agreement terminated by franchisee	87	6.7	0.6
Franchise agreement not renewed when expired	48	3.7	0.3
Franchise business bought back by franchisor	74	5.7	0.5
Franchise agreement terminated and franchised business acquired by franchisor	51	3.9	0.3
Total	1305	100.0	8.7

Notes: 1) A total of 213 franchisors provided a response from an expected 215.

C19 *Please obtain data from your disclosure document to answer this question (Annexure 1 S6.4). For 2004, please state the number of franchise units involved in:*

2004

Response (Franchised unit change)	Number of franchisees affected	Percent
Franchise was transferred	694	62.0
Franchise business ceased to operate	151	13.5
Franchise agreement terminated by franchisor	70	6.3
Franchise agreement terminated by franchisee	72	6.4
Franchise agreement not renewed when expired	40	3.6
Franchise business bought back by franchisor	58	5.2
Franchise agreement terminated and franchised business acquired by franchisor	34	3.0
Total	1119	100.0

Notes: 1) A total of 198 franchisors provided a response from an expected 200.

C20 *Please obtain data from your disclosure document to answer this question (Annexure 1 S6.4). For 2003, please state the number of franchise units involved in:*

2003

Response (Franchised unit change)	Number of franchisees affected	Percent
Franchise was transferred	641	67.4
Franchise business ceased to operate	124	13.0
Franchise agreement terminated by franchisor	46	4.8
Franchise agreement terminated by franchisee	54	5.7
Franchise agreement not renewed when expired	14	1.5
Franchise business bought back by franchisor	42	4.4
Franchise agreement terminated and franchised business acquired by franchisor	30	3.2
Total	951	100.0

Notes: 1) A total of 184 franchisors provided a response from an expected 186.

D. Current Trends in Franchise Operations

Franchise strategies

A minority of franchisors is utilising co-branded activities with another brand name, such as advertising jointly (15 percent), combining products or services (9 percent), and sharing retail space (6 percent).

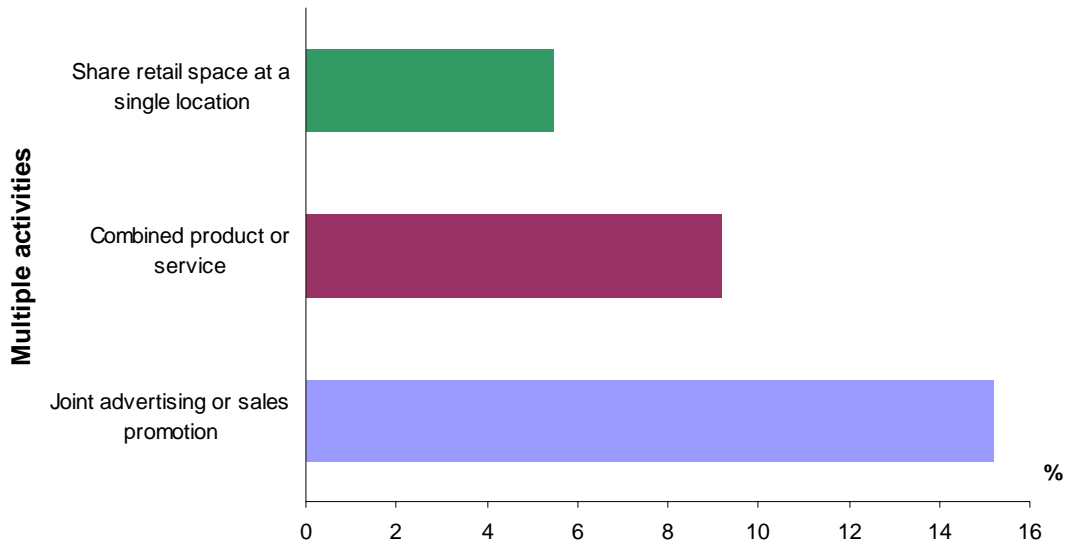
Many systems have adopted specific growth strategies, reflecting the ability of franchisors to focus on franchising opportunities. The most frequent strategy involved the use of exclusive territories (53 percent), then multiple unit franchising (36 percent) followed by master franchising (28 percent), area development agreements (11 percent), conversion franchising (10 percent), acquisition of another system (7 percent), multiple franchise systems (5 percent) and area representation agreements (4 percent). The trend toward operation of multiple franchise systems under different names and multiple concepts continued, enabling franchisors to diversify their portfolios and reduce operational costs. The above activities are evidence that franchisors are moving beyond single franchise concept offerings in order to stimulate system expansion in a limited market.

D1 *Do you conduct any of the following activities with another brand name? (e.g. Marty's Pizza with Action Video)*

Response (Multiple Activities)	Number of responses	Percent
Joint advertising or sales promotion	33	15.2
Combined product or service	20	9.2
Share retail space at a single location	12	5.5

Notes: 1) All 217 franchisors provided a response.
Multiple responses were recorded for some respondents.

Co-branding activities

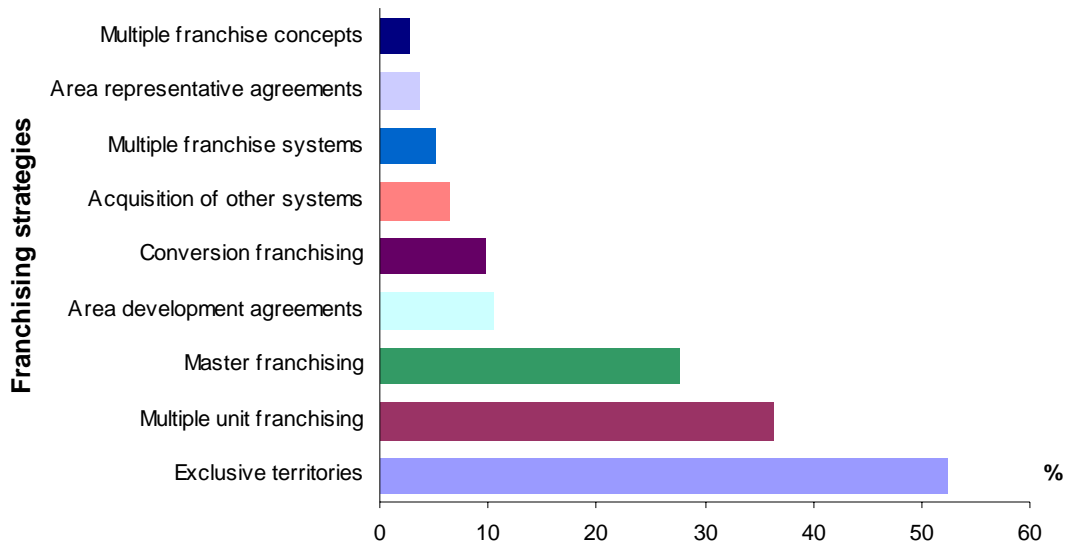


D2 Do you use any of the following franchising strategies?

Response (Franchising Strategies)	Number of responses	Percent
Exclusive territories	114	52.5
Multiple unit franchising	79	36.4
Master franchising	60	27.6
Area development agreements	23	10.6
Conversion franchising	21	9.7
Acquisition of other systems	14	6.5
Multiple franchise systems	11	5.1
Area representative agreements	8	3.7
Multiple franchise concepts	6	2.8

Notes: 1) All 217 franchisors provided a response.
 2) Multiple responses were recorded for some respondents.

Franchising growth strategies



International operations

As with the 2004 survey most franchise systems were Australian based (93 percent). This statistic continues to reinforce that the majority of franchises are home-grown systems rather than overseas imports.

Just over one quarter (27 percent) of eligible systems were currently franchising overseas. New Zealand remained the most popular destination (76 percent) because of its geographical, political and cultural alignment to Australia. Southeast Asian destinations remained popular and included Singapore (27 percent), China/Hong Kong (26 percent), Malaysia (22 percent), India (16 percent) and Indonesia (15 percent). Large English-speaking nations remained well favoured: United Kingdom (18 percent), United States of America (16 percent) and Canada (16 percent). European destinations were also selected (22 percent).

Of the 1984 franchised units reported by respondents as operating overseas, 59 percent can be found in the English speaking nations of United States of America, New Zealand, United Kingdom and Canada. A further 15 percent of units are located in the Southeast Asian region and 10 percent in Europe. As with domestic operations, only a small number of company units are held by franchisors overseas.

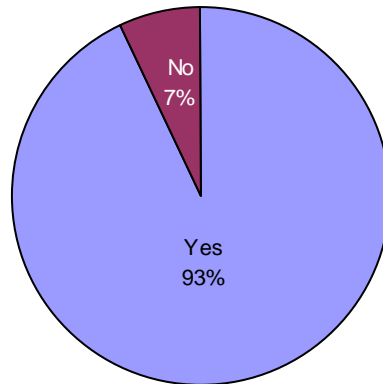
Franchisors are optimistic about their international expansion plans, anticipating opening an average of 5 new franchise units in 2007 and a further 8 in 2008.

D3 *Are you an Australian-based franchisor?*

Response (Australian-based franchisor)	Number of responses	Percent
Yes	201	93.1
No	15	6.9
Total	216	100.0

Notes: 1) A total of 216 franchisors provided a response from an expected 217.

Australian based franchisors

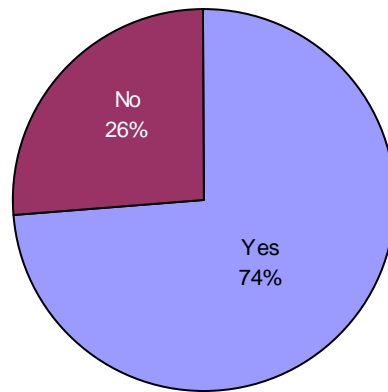


D4 *Do you have expansion rights outside Australia?*

Response (Expansion rights)	Number of responses	Percent
Yes	148	73.6
No	53	26.4
Total	201	100.0

Notes: 1) The expected total of 201 franchisors provided a response.

International expansion rights

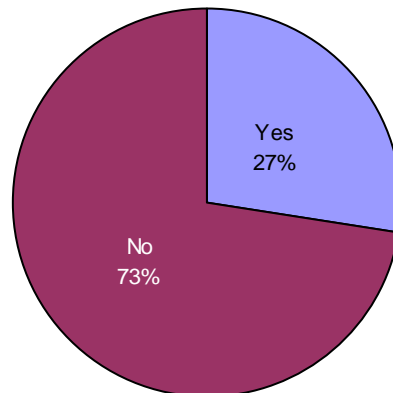


D5 Are you franchising overseas?

Response (Currently franchising overseas)	Number of responses	Percent
Yes	55	27.4
No	146	72.6
Total	201	100.0

Notes: 1) The expected total of 201 franchisors provided a response.

Franchising overseas

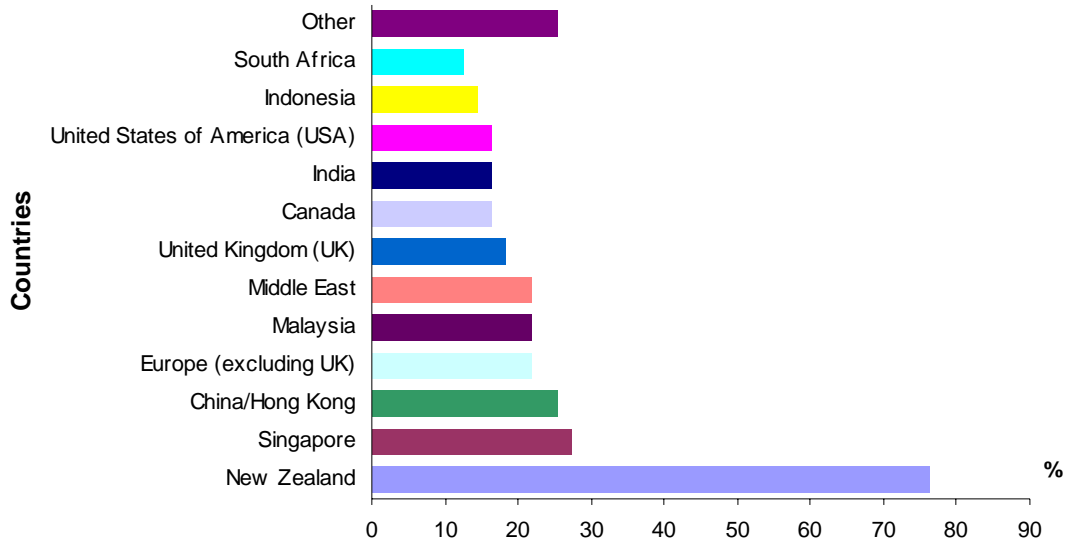


D6 *In which countries or regions are you franchising?*

Response (Countries)	Number of franchisors	Percent
New Zealand	42	76.4
Singapore	15	27.3
China/Hong Kong	14	25.5
Europe (excluding UK)	12	21.8
Malaysia	12	21.8
Middle East	12	21.8
United Kingdom (UK)	10	18.2
Canada	9	16.4
India	9	16.4
United States of America (USA)	9	16.4
Indonesia	8	14.5
South Africa	7	12.7
Other	14	25.5

Notes: 1) *The expected total of 55 franchisors provided a response.*
 2) *Multiple responses were recorded for some respondents.*
 3) *A range of other countries was reported by 14 respondents (Chile, Egypt, Fiji, Japan, Korea, Malta, Mexico, Morocco, Nigeria, Pacific Islands, Philippines, Russia, Thailand, Turkey).*

Franchising by country



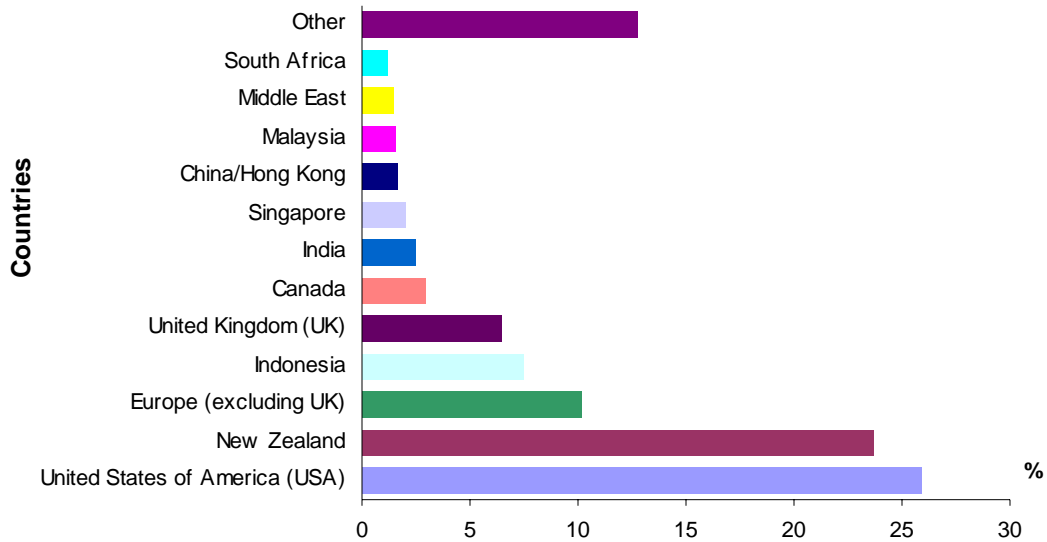
D7 *How many franchised units are held in these countries or regions?*

D8 *How many company-owned units are held in these countries or regions?*

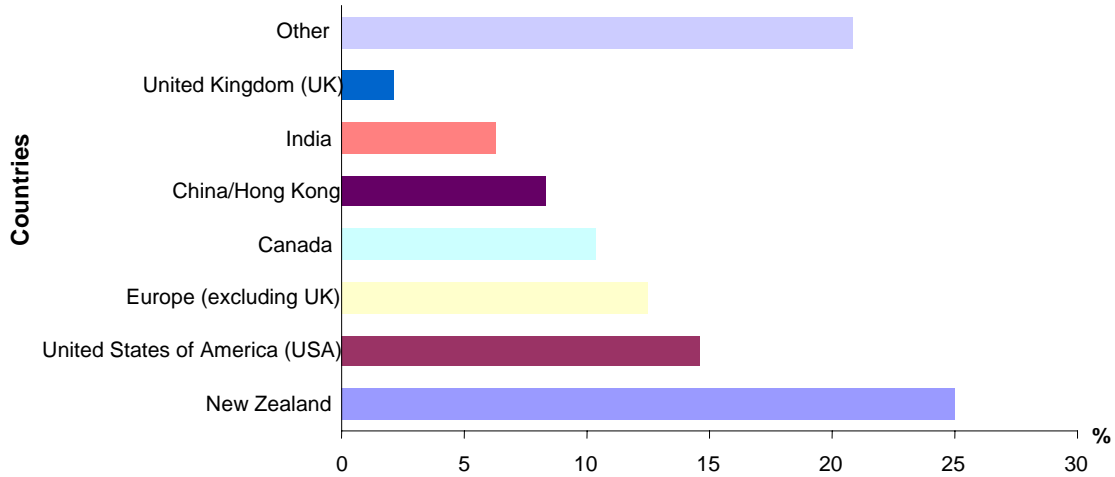
Response (Overseas units)	Franchised		Company owned	
	Number of Responses	Percent	Number of Responses	Percent
United States of America (USA)	513	25.9	7	14.6
New Zealand	471	23.7	12	25.0
Europe (excluding UK)	203	10.2	6	12.5
Indonesia	149	7.5	0	0.0
United Kingdom (UK)	129	6.5	1	2.1
Canada	60	3.0	5	10.4
India	49	2.5	3	6.3
Singapore	39	2.0	0	0.0
China/Hong Kong	34	1.7	4	8.3
Malaysia	31	1.6	0	0.0
Middle East	29	1.5	0	0.0
South Africa	23	1.2	0	0.0
Other	254	12.8	10	20.8
Total	1984	100.0	48	100.0

Notes: 1) The expected total of 55 franchisors provided a response.
 2) Multiple responses were recorded for some respondents.

Franchised units (by country)



Company-owned units (by country)

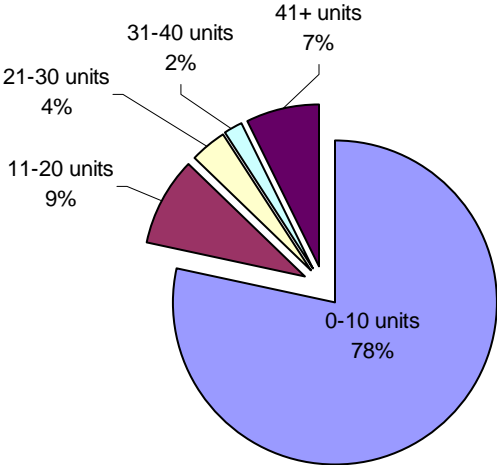


D9 *How many franchise and company owned units (in total) do you expect to open overseas over the next two years?*

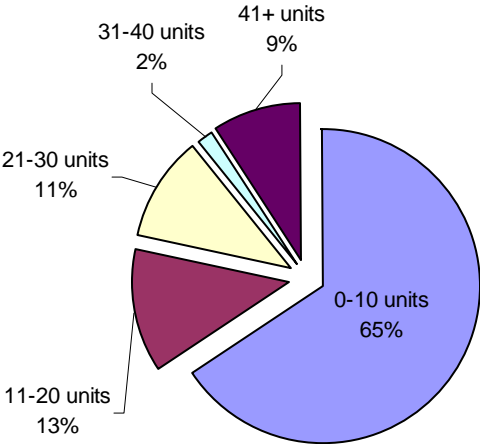
Response (Forecasted growth)	2007		2008	
	Number of franchisors	Percent	Number of franchisors	Percent
0-10 units	43	78.2	36	65.5
11-20 units	5	9.1	7	12.7
21-30 units	2	3.6	6	10.9
31-40 units	1	1.8	1	1.8
41+ units	4	7.3	5	9.1
Total	55	100.0	55	100.0

- Notes:
- 1) The expected total of 55 franchisors provided a response.
 - 2) Franchisors expected an average increase of 5 units in 2007 and 8 units in 2008.
 - 3) Seven franchisors expected no overseas growth in 2007 and 2008.
 - 4) Franchisors reported expected growth ranging from 0 to 100 units in both 2007 and 2008.
 - 5) The total projected growth was 616 units in 2007 and 882 in 2008.

Forecasted growth (international) 2007



Forecasted growth (international) 2008



Reasons for international expansion

Just under two thirds of franchisors (63 percent) began overseas operations from 2000 onwards, suggesting that international expansion is relatively new for the majority of franchisors. Indeed, franchisors held an average of only 29 franchised units prior to operating overseas, indicating that firms are proactively entering international markets prior to reaching domestic saturation. Almost three quarters (73 percent) of these respondents are involved in retailing (food and non food), property and business services or personal services.

Three quarters of franchisors (75 percent) suggested that they favoured international expansion in geographical regions that were culturally similar with their local market. Presumably, franchisors are minimising financial, performance and personal risk by entering host markets that share common economic and political characteristics with their home market. Other drivers of choice of destination included new opportunities in overseas markets (56 percent), requests by overseas investors (36 percent) and introducing new concepts in international markets (27 percent). Only 5 franchisors reported they expanded overseas to escape limitations imposed by domestic market saturation, in response to requests by suppliers to expand overseas, or to exploit product procurement savings.

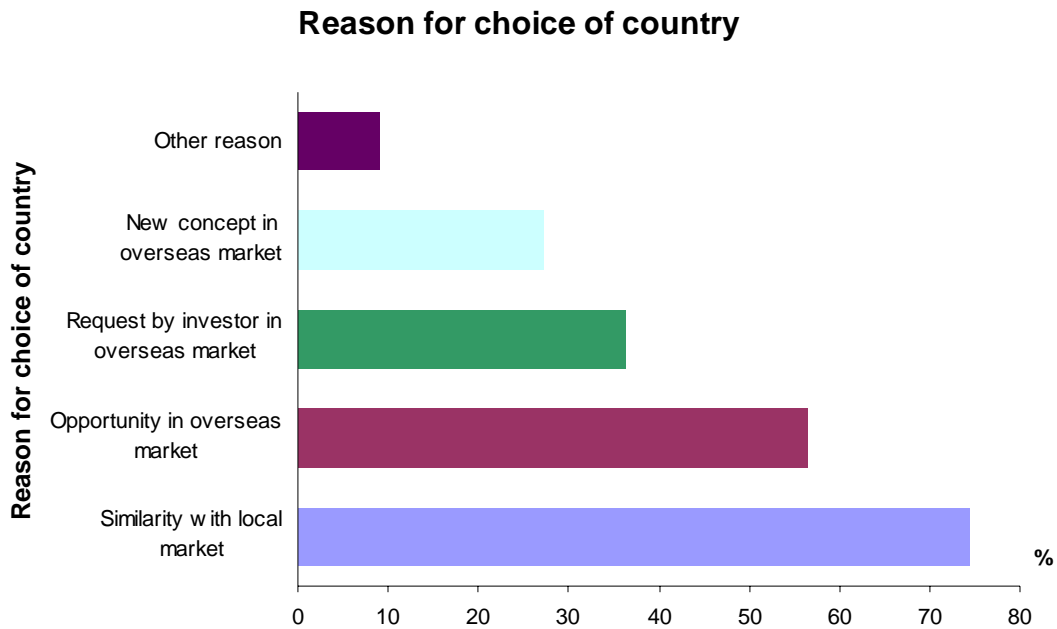
Three quarters of franchisor respondents indicated that they expanded overseas to facilitate system growth (75 percent). Australia's small population and high (per-capita) concentration of franchise systems may force franchisors in some industries to enter overseas markets in order to expand. Requests by overseas investors (51 percent) and success in domestic markets (46 percent) encouraged franchisors to examine international markets. Some 20 percent of franchisor respondents favoured international expansion as a means of accruing savings resulting from economies of scale. Less important motivations included increased domestic market competition (4 percent) and falling domestic demand (2 percent). Three respondents indicated that they minimised their financial risk through retaining (temporary) minority equity shareholding in new international master franchising arrangements.

Master franchising was favoured by one half of franchisors (51 percent) as a means of entry. Others favoured 100 percent company ownership (20 percent), joint venture arrangements (18 percent), area development contracts (15 percent) and wholly owned subsidiaries (2 percent).

D10 Why did you choose the above country/countries for your international expansion?

Response (Reason for choice of country)	Number of responses	Percent
Similarity with local market	41	74.5
Opportunity in overseas market	31	56.4
Request by investor in overseas market	20	36.4
New concept in overseas market	15	27.3
Other reason	5	9.1

Notes: 1) The expected total of 55 franchisors provided a response.
 2) Multiple responses were recorded for some respondents.
 3) A range of other motivations was reported by 5 respondents (domestic market saturation, international supplier request, and product procurement for existing franchise network).

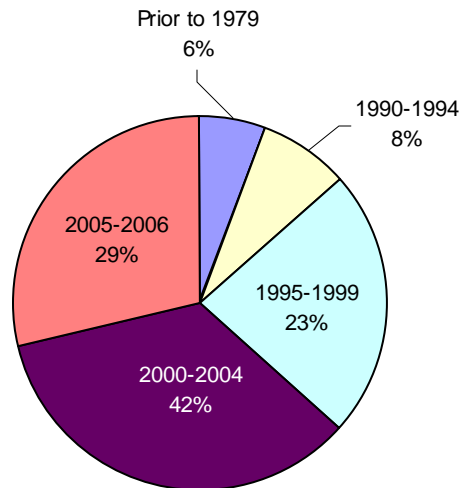


D11 *In what year did you commence international operations?*

Response (Year)	Number of responses	Percent
Prior to 1979	3	5.8
1980-1989	0	0.0
1990-1994	4	7.7
1995-1999	12	23.1
2000-2004	18	34.6
2005-2006	15	28.8
Total	52	100.0

Notes: 1) A total of 52 franchisors provided a response from an expected 55.

Year commenced international operations



D12 *How many units did you hold in Australia prior to franchising overseas?*

Average number of franchised units prior to overseas expansion 29
 Average number of company-owned units prior to overseas expansion 1

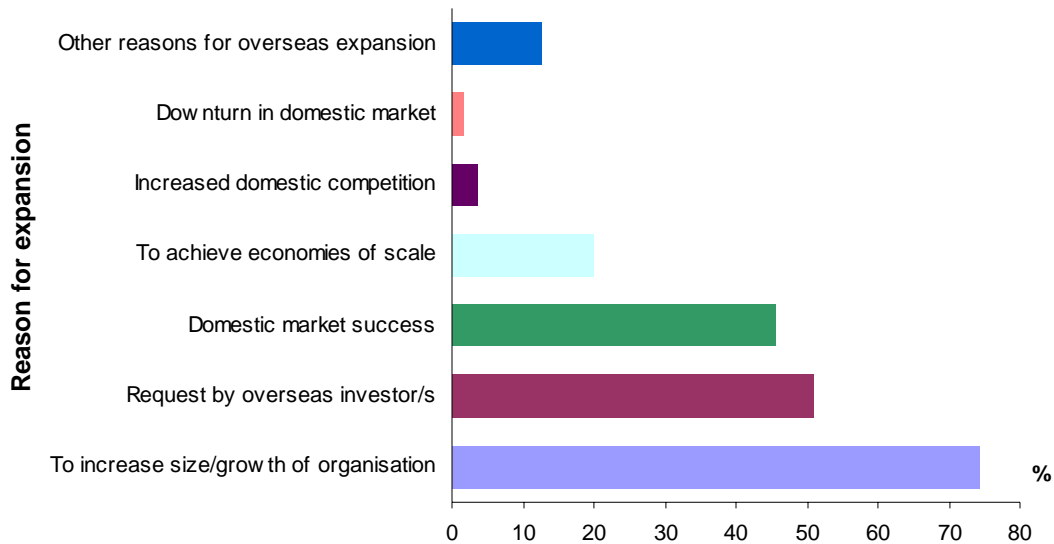
- Notes: 1) The expected total of 55 franchisors provided a response.
 2) The number of franchised units ranged from 0 to 930, while the number of company-owned units ranged from 0 to 50.
 3) Nine franchisors held no domestic franchised units prior to expanding overseas.

D13 Why did you expand your operations overseas?

Response (Reason for expansion)	Number of responses	Percent
To increase size/growth of organisation	41	74.5
Request by overseas investor/s	28	50.9
Domestic market success	25	45.5
To achieve economies of scale	11	20.0
Increased domestic competition	2	3.6
Downturn in domestic market	1	1.8
Other reasons for overseas expansion	7	12.7

- Notes: 1) The expected total of 55 franchisors provided a response.
 2) Multiple responses were recorded for some respondents.
 3) Other reasons given for expanding overseas included the provision of supply chains for local markets, request by onshore clients, or as part of a shareholder retention strategy.

Reasons for international expansion



D14 What method of entry did you choose for international expansion?

Response (Mode of entry)	Number of responses	Percent
Master franchising	28	50.9
100% company-owned	11	20.0
Joint venture arrangement	10	18.2
Area development arrangement	8	14.5
Wholly owned subsidiaries	1	1.8
Other arrangement	8	14.5

Notes: 1) The expected total of 55 franchisors provided a response.
 2) Multiple responses were recorded for some respondents.
 3) Other methods of entry given by franchisors included direct franchising and hybridised arrangements incorporating franchisor and franchisee equity combinations.

Methods of international expansion

