

Inquiry into Franchising Code of Conduct

Submission by Fibrecare Australia Group Pty Ltd dated 11.09.2008

- Franchisor of
- Drytron Carpet Dry cleaning
 - Bizzi Beez Residential Cleaner

Preamble

As an owner/franchisor who has been active in franchising for over 20 years I feel obliged to tender a submission to another franchising inquiry, the fifth in the past 10 years.

I have had the opportunity to be briefed on the submission by the Franchise Council of Australia. I wholeheartedly endorse the content of the FCA submission, which is very comprehensive and goes into detail as to the specific recommendations. There are a few bits in the FCA submission that particularly resonate with me based on my experiences, and I have listed them below.

However the purpose of my submission is to give the perspective of a franchising franchisor who supports best practice in franchising, but feels things are in danger of going too far. My concern is raised because it appears to me that observers from the sidelines somehow feel it is advisable and/or necessary to intervene to "clean up" the franchising industry. This is nonsense.

I believe I am a fairly typical franchisor. Much will be written and said about the "poor" franchisee and the "all powerful" franchisor as if the latter is some all devouring dinosaur that wishes to exploit franchisees, nothing could be further from the truth. Most franchisors are like me – small businesses, often family businesses, trying to compete in the marketplace. My competitors are large corporations, non-franchised companies and backyarders. I need to be able to compete against them without having one hand tied behind my back with excessive regulation that doesn't affect them because they are not in franchising. In my experience franchise companies are the most professional and compliant in terms of the laws disclosure of income tax, GST, payroll tax, workers compensation, OH&S etc because we are systemised. Yet, this is never publicly recognised.

Franchising in its simplest form is a method of doing business, where a franchisor/owner with a business idea or system that can be easily replicated offers others (franchisees) the opportunity to participate in the power of marketing and brand in a way the franchisee could not do as an individual. Franchising brings benefits to both the franchisor and franchisee and when both parties concentrate on the benefits that flow from this arrangement all parties grow and succeed and the legislation underpinning franchising (although necessary) fades into the background as the "core concern" of franchisees.

Once again elements of the media and few people with an axe to grind or a personal political agenda appear to me to be seeking to complicate what is generally a simple and powerful business concept. The Olympic games have just finished in Beijing and the press celebrate the 47 medals and their winners, why don't they talk about the other 400 team members that were there? They just don't. Well, in franchising there are 1,000 systems, 66,000 business units, 600,000 employees and we want to talk about the "parlous state" of the sector because a few have closely held ill feelings often caused by their own inability to understand the factors that have caused them grief. The governments of this nation should be celebrating their "team members" who contribute to this \$128 billion in annual turnover that enhances the lifestyle enjoyed in Australia.

As a franchisor, I do not deny that genuine disputes will rise from time to time but the current regulations and dispute mechanisms are already in place and they are proving adequate in gaining resolutions when people reasonably negotiate solutions that are well founded. As a franchisor that

has been at the coal face for 20+ years, therefore practised pre-Code as well, franchisors these days understand that they only prosper when franchisor and franchisee both understand the opportunities that can be gained from working together.

I get frustrated at the publicity generated by a tiny minority of disgruntled former franchisees. The good franchisees never complain, they make more money than their disconnected peers. The Franchising Code does not scare them, they are aware it is there but their primary aim is to maximise their personal return from the location or business and they work out very quickly that the fastest way to do this is to work with the franchisor, and this is true of 98% of our sector.

Of course not everyone can be successful, and there are no guarantees. It holds true that in all human endeavour, your personal attitude has a significant bearing on the outcome. If your attitude is bad you will look for someone to blame and you will seek out someone ready to listen, even if that someone does not really understand the business you are in.

I feel it is important that the members of the committee understand what a franchisor looks like and understands the challenges we meet on a day to day basis.

Hopefully, this submission will maybe convince you that franchisors are usually just small/medium business too, you will I trust learn that our business goals are directed at a successful outcome for ourselves as well as our franchisees, we do not make profit from disputes.

Our goal is to compete in the market place and our engine is our franchisee force, why would we intentionally sabotage it?

As to the FCA submission, I particularly agree with the following:-

- 98% of franchisors, and virtually all franchisees, are small businesses, and therefore very vulnerable to over-regulation and excessive compliance costs.
- Australia already has the most comprehensive regulatory framework in the world. It works well, and does not need to be changed. If prospective franchisees follow the existing Code process it is very hard for things to go wrong. There are laws to protect franchisees from every conceivable wrong. The balance is firmly in the favour of franchisees. Indeed I believe the current system encourages franchisees to pursue spurious claims because it is so easy to make broad allegations that sound credible but don't stand up to scrutiny.
- Statistically far fewer franchised businesses fail than other small businesses, but franchise failure is more easily identified. There are very few disputes, and mediation works very well.
- Many of the allegations that hit the press or are made to inquiries are untrue or grossly exaggerated.
- Many franchisees are not getting advice in accordance with the Code requirements. Part of the problem relates to the cost of advice – with disclosure materials regularly in excess of 100 pages, and sometimes much more, it is difficult to keep the costs down.
- some franchisees see franchising as a guarantee of success and do not understand normal business risk.
- It would be good if we could simplify the disclosure process so more people read disclosure documents and got advice. Training could also play a part assisting prospective franchisees to understand the disclosure document. We have introduced a summary document to make it easier for franchisees to understand the key points.

- We don't need risk statements, franchisor registration, more disclosure obligations or new courts or tribunals.
- There is no need for a new statutory good faith provision in the Code. State regulation of franchising in any form – franchising is a national activity that should only be regulated at a Federal level.

Geoffrey Cope, Managing Director
Dated: 11 September 2008

1. Information on the Fibrecare Group

1.1 Group history

Fibrecare is not a large international corporation it is a small family business. The Fibrecare Group is owned and controlled by myself, Geoffrey Cope and my wife Maureen. We also have 3 adult children in the business. Our son Daryn aged 39, a graduate of RMIT where he studied Visual Merchandising. He ran his own successful display company for 10 years. Our daughter Melissa is 37 years and she is a psychologist having graduated from Monash University with a masters degree in neuroscience. Our third family member Glenn is 35. He too was self employed for many years as a furniture designer/manufacturer. We have another 16 support staff across 3 States that offer our franchisees both in field and home office support. We believe our organisation is a well founded and efficient franchising group and as a result we would confidently suggest our franchisees are happy with their decisions to join and the returns they make.

Fibrecare commenced trading in 1977 to sell cleaning products to carpet cleaners. In 1985 it decided to organise customers into a cohesive brand and Drytron Carpet Cleaning was formed. We have 80 vans across Victoria and as such we are the largest fleet in our industry. The vans are operated by 30 franchisees. Drytron does not sell new territories and so the only way to become a franchisee is to buy from an existing franchisee.

It is pleasing to observe that all sales in the last 3 years have been to existing franchisees who have made decisions to increase their personal investment in the system. These days unless you are sourcing franchisees from existing franchisees or by referral from them it is very difficult to find franchisees. And because it is so easy for prospective franchisees to check you out using the information in the disclosure document unless you are keeping your existing franchisees happy you cannot hope to sell a franchise.

In 1989, Fibrecare commence a home cleaning franchise called Bizzi Beez which now operates in Victoria, South Australia and Western Australia. As at 30 June 2008 there are 348 franchised teams making Bizzi Beez the market leader and one of the largest franchised systems in Australia.

During the development of both of these systems, the company undertook extensive product development and now produces all the cleaning chemicals required by both systems. The products are citrus based and therefore environmentally friendly. We supply those products to the franchisees.

Additionally, the company runs small independent call centres for each system to ensure we maximise the retail opportunity for our franchisees. Importantly, it offers a service that many of our competitors don't offer, which is professional phone answering, a skill that is not always easily achieved by small business operators. The call centre is funded by the franchisor and by a user pays method. Ie: if you don't need work or you gain work by recommendation you don't incur any cost.

At Fibrecare we have assembled a total business concept that ensures that all the elements required by a franchisee are available from our group. This ensures continuity of supply, access to sufficient work through critical mass and brand awareness, provision of telecommunication systems, access to training in skills required. We have an in house psychologist who handles Bizzi Beez training, external marketing, personal and technical training for Drytron.

We have also recently employed Drytrons longest serving franchise (who recently sold out) as a field mentor for all franchisees, his services are free to the franchisees and he brings first hand market place experience to the Drytron work force. He was a multiple owner and franchisee of the year, his business was the largest of all territories. He is well accepted by our current franchise network and they recognise the expertise he can bring to their businesses.

Bizzi Beez is not territory based and growth is driven by consumer demand for out-sourcing services. In November 2000 there were 110 franchisees, now there are 348. The growth in franchisees has come largely from new arrivals to Australia. So we need to manage ethnic diversity and provide support often beyond purely business support.

The major statistic that underscores our system and its success is that 75% of all new franchisees are introduced to us by existing franchisees. Obviously they are happy with the support they receive and confidently advise their friends to take the same step as they did.

As stated earlier franchising works remarkably well when all parties understand that success comes from sound business ideas, hard work and mutual trust. This does not mean that there are never any issues from time to time, but like minded people can generally sort out problems.

We achieve these results under the Code, and we submit further tinkering at the edges will not make any difference to the success or otherwise of our franchises. And any of the more radical changes will simply add unnecessary cost and complexity for no value other than political appeasement.

1.2 Experience in Franchising: The CEO and Franchisor

As stated earlier we are not a multi national but a family company helping other franchises run businesses within our systems. I am 64 years of age and I have been a franchisor for over 20 years with expertise in accounting and marketing. Prior to joining Fibrecare I was General Manager of Muffin Break June 98 - December 99 which had 145 franchisees. Between February 1991 and June 1998 I was managing director of Brumbys hot bread chain. Brumbys had been in receivership in 1990 and a group of franchisees bought the franchise from TRI Continental Bank and the NAB. There were 42 stores just surviving and I was their first managing director. In the 8 years we grew from 42 stores to in excess of 250 in Australia and New Zealand. The original 42 franchisees were the shareholders in an unlisted public company they each had 2000 \$1.00 shares and a debt of \$1,750,000, the debt was repaid by year 4 and when I left in 1998 their \$1 shares were independently valued at \$120.80 each their company was worth \$18,000,000. I was approached to become managing director of the Fibrecare Group in January 1999 however I made an offer to buy the group and completed that transaction in November 2000.

It is important to illustrate the risk I was prepared to take to achieve the goal of ownership. My wife and I borrowed in excess of \$3,500,000.00 using the company and our home as security in addition we signed personal guarantees of \$2,000,000.00 each. I had had an operation for prostate cancer just 2 years prior to this and so it had to work, this company was underperforming and there were some issues with several franchisees. I believed I could turn it around. I submit this scenario, to offer some balance to the statement "poor franchisee" they are at the mercy of the "rich" franchisor. Many of my peers incur similar debts to grow their businesses and so we have a vested interest in building successful ventures. Many of us are small business families like them, we are not all McDonalds.

I have been in many sectors of retail and business and as franchisor I brought these services to my franchise. The big challenge is to be able to transfer these skills and

enthusiasm to other people. I needed to make changes when I joined Fibrecare, as the customers were not being properly serviced. Change management can be difficult.

Sadly, in the early days some old die hards of Drytron were not comfortable with this new regime and the emphasis on conformity and growth and we had our disagreements. They moved on but as stated earlier their peers bought their territories and became multi-territory owners. Sometimes franchisees get set in their ways and do not like change, but the team must be bigger than the individual. Otherwise everyone goes broke, like recently with Kleins. I had franchisees complain and threaten legal action, but I pushed through with the support of the silent majority and the proof is in the results we have achieved.

1.3 Philosophy of Fibrecare

Our philosophy is simple - we come to work to achieve realisable goals and hopefully enjoy what we do. We try to treat our franchisees as intelligent, enthusiastic people and we would like to receive the same courtesy. When this happens, and most times it does, franchise codes and franchise agreements never get discussed.

However, to be successful a franchise, or any business for that matter, must be consistent. In franchising that means that the franchisor, the keeper of the system, must where possible ensure that all franchisees adhere to the unique selling proposition of the business and work to maintain the image the brand is trying to sell to the consumer. Inevitably, that means there has to be a decision maker and that has to be the franchisor. The franchisor is responsible for global delivery of products or services, franchisees will be obviously interested in their individual success and may disregard the bigger picture.

We must act in the interest of the total chain and if that brings us into conflict with an individual so be it. Better to argue with one person than have to apologise to 300 if the business fails. We treat our franchisees with respect and patience. We recognise their financial goals may be smaller than ours, but it is our responsibility to help them achieve theirs. Our success is in the collective success of all those small businesses.

A lot is made of conflicts and disputes between franchisor and franchisee. As franchisor we do not seek conflict. It wastes time and energy and does nothing to pursue our goals and certainly does not advance the prosperity of the franchisee. Whenever possible we will try to negotiate a resolution of any dispute, as we cannot afford the time of management distraction or the cost of a dispute.

In every network there will always be someone who "just doesn't get it". They operate beside people who follow the system and cooperate with the franchisor but still are blind to their stubbornness. They may complain about the fees they pay, they may object to using the chemicals we supply or they may think they know best in relation to marketing or the way of doing things. We try to explain that customers want consistency, and that their efforts are best directed to servicing the customers rather than trying to do our job for us. We have been able to exit them from the system by encouraging them to sell their businesses, but if we didn't they would end up in major dispute with us or going broke or both. In my experience these are the type of people who give rise to this new inquiry. Yet if we do not take action to enforce system compliance the people who suffer, and would then quite rightly have cause to complain, are the good franchisees.

Instead of embracing their inadequacy the community should look to assisting the team players, the ones who happily co-exist and bring value to the nation. So lets work for the successful majority and educate the others.

2. Perspectives on the current regulatory environment

2.1 Structure

Obviously once again the regulatory processes are under the microscope.

Frankly, I become concerned when once again we talk about adding more obstacles to our businesses. As mentioned previously I have worked in franchising pre-Code and the various stages up to the Mathews Report.

The right advice is stop now, because nothing that may be added will improve the opportunity of an individual to succeed.

The document regime is now immense and I am sure, as the sun rises and sets every day, 90% of franchisees cannot read or absorb the information we are required to supply. Take our companies as an example, our documents have been constantly reviewed and updated by a leading franchise legal firm. As a result an incoming franchisee is given these documents:

- (a) Copy of the Franchising Code;
- (b) Our Disclosure Document; and
- (c) Our Franchise Agreement.

Our prospective franchisees have just received 168 pages of information. On top of this they have at the minimum 2 x 1 hour meetings, they are encouraged to talk to other franchisees, they are offered the opportunity of a field visit and then they are urged to see a lawyer or accountant. They don't need more information, they need simplification and clarification, in the documents we provide, we also try and give them pointers to their important rights and responsibilities they will acquire if they sign. Some of our franchisees are new to Australia. We encourage them to seek legal and business advice, but for a franchise like ours where the cost is relatively low they are reluctant to spend the money to get advice. With such a massive lot of documents the cost of advice is getting higher, which is understandable

What we currently have is almost overkill, adding more layers will only confuse them more. Remember my consistent theme, I need happy successful franchisees and that is built on service, trust and respect, if they don't exist another 10 pages of paper won't fix it. We reject franchise applicants if we feel they won't measure up, and they get upset. But we know if they cannot succeed, nor can we. And the cost of exiting a poor franchisee is much more than the fees obtained in putting them on.

To truly understand franchising, the committee needs to sit in on the hundreds of perfectly reasonable exchanges that take place between ourselves and our franchisees every week and then sit in on the millions of discussions that happen every year between franchisors and franchisees across Australia. You will learn that we discuss, business conditions, competitors activities, marketing strategies, product problems, rental problems etc etc. We also probably discuss football, fishing, family illnesses, new babies, new cars, interest rates, in other words the sector is not in dispute 24/7 and it is about time we all acknowledge that.

We don't need more structure, we are already top heavy.

2.2 Imbalance between franchisees and franchisors

As a long suffering franchisor, I have complained long and hard, to no avail, about the imbalance between franchisor and franchisees.

The popular myth is that the franchisor is all powerful and the franchisee is a threatened species. In my view the opposite exists, please let me explain.

The Code was written to among other control the maverick franchisor, they are now long gone. But the code remains and the ACCC is our watch dog.

Good franchisors have well written agreements and they have been well schooled by the lawyers to recognise their rights, responsibilities and the reasonable limits they can go to, to manage the system.

On the other hand in my experience the franchisee often sees the agreement as a means to an end, it gives them entry to the "gravy train" and if it all gets to hard I'll ask the authorities for help and relief. Like we have now, if the franchisor decides to take action to enforce system compliance or in relation to a breach of the franchise agreement the franchisee can at no cost run to a legislator or the ACCC and get a free run, even if their complaint is ill based. Meanwhile we have to incur the cost and management distraction of responding, as if we are guilty until proven innocent. For example the recent [REDACTED] incident which must have cost [REDACTED] a fortune, but in the end the ACCC found [REDACTED] had no case to answer. And that franchisee still seems to get a hearing. What about the many hundreds of successful franchisees in that system?

If you have one or two people fail in a successful system it is in my experience not a franchisor issue, it is a franchisee problem or just unfortunately the normal incidence of business failure due to under-capitalisation, extra strong local competition or generally poor operating and customer service skills. Some people seem to think that if a franchisee fails it is automatically the franchisor's fault, but in my experience it normally isn't.

My on the ground experience tells me once I sign an agreement I must meticulously honour my commitments, some franchisees believe everything is negotiable even after signing.

The media and legislators keep breathing life into this perception through action based on untried and untested acceptance of the grievance.

3. Compliance Costs

One of the probably unintended consequences of constant reviews is the ever increasing compliance costs. The inequity is magnified when you realise that a franchisor with just 20 franchises has to provide the same documents as ourselves with 380 or Australia Post with many 1000's.

These costs are not small, as you are all aware the Mathews recommendations became law in March which made considerable alterations to our disclosure and consequently our franchise agreements.

As we have two systems the work was considerable and we have to date spent \$18,000 on legal fees to meet the new regulations, these costs cannot be recovered.

Additionally, we now have to have Drytron's advertising fund audited annually, prior to that it was at the discretion of the members the cost is now \$4,500.00 annually paid by the fund, which previously was spent on advertising.

4. Disputes

As I have mentioned previously we do not seek conflict and by and large we are a peaceful and productive group. However, with 380 franchisees you are bound to have one or two fighters. In 8 years we've had 2.

This was a frustrating and costly exercise. In the end no one was found to have committed serious breaches of this agreement and as per the Code we took it to mediation. In mediation the franchisee admitted the breaches and had no explanation to why he had previously refused to attend meetings with us. Under further questioning from the mediator he admitted he was suffering from depression. Solution, we bought him out on the spot and resold his territory 10 days later.

However, correspondence and attempts to meet had spread over 9 months cost in legal fees to us \$20,000. This could have been solved in 1 hour if we had been able to get the franchisee to be reasonable earlier. But emotions get involved and it is not as simple as it appears. That franchisee, probably like many franchisees that the Committee will hear from, insisted publicly we had done him wrong. But in the end it was not the case.

I feel there is a view amongst franchisees that if they aren't happy they can get out of their agreements if they cause a bit of a stir. This is because the law is in their favour and they only have to make allegations of being misled or mistreated to cause problems for the franchisor. Like most franchisors we can't afford expensive litigation, so we will usually try to settle even if we are 100% in the right. This is manageable under the current regime and mediation helps. However if franchisees are given more legal remedies through vague concepts like "good faith" and "fair dealing" that will just encourage spurious claims and I fear the consequences.

5. Conclusion

Members of the committee, as you by now know, I have been in franchising for 20 years, I like what I do and I believe our franchisees are happy. My usual response to these enquiries has been to sit and observe, but this time I can't.

I am concerned that some people have been encouraged to get in and sort out "the mess". What mess? A few people with a barrow to push to settle a score is not a reason to turn franchising on its head once again. More regulation, more rules, more paper will not make up for the short comings of a few malcontents.

As I have pointed out I am a small business operator who just happens to be in franchising, but the regulation surrounding my business is more onerous than other businesses outside our sector. I can live with what we've got but we don't need anymore.

This advice is from someone who has seen this sector evolve over 20 years and in particular this last 8 or so years. Listen to someone whose company deals with 380 plus franchised teams day in and day out. Franchising is a business of relationship management and its skills are developed over 10 or 20 years not 10 or 20 days.

I hope I have given you a snapshot of a professional franchisor, and why the sector does not need more regulation. The current framework operates well and protects everybody. Governments should listen organisations like the Franchise Council of Australia, who represent franchisors and franchisees and have the best interests of the whole sector at heart, rather than a few people with an axe to grind. Hopefully you will also listen to me from the perspective of an experienced franchisor.