Submission by **Franchisee Association of Craveable** to the Inquiry into Franchise Code of Conduct and Other Matters

Executive Summary

Archers Capital funds Craveable Brand. It operates over 570 restaurants across 3 iconic Australian brands: Red Rooster, Oporto and Chicken Treats.

Franchisee Association of Craveable was formed nearly a year ago to protect the interests of Craveable franchisees and share proficiency, to help each other grow.

The registration number for the association is INC1700867. NSW Fair Trading issued the registration on 26th June 2017.

Recently there have been many franchisees in distress due to the poor business model of craveable. There have been recent insolvent franchisees (Red Rooster Mt. Pritchard and Red Rooster Parklea) There are many more on the verge of bankruptcy. The business model needs to be questioned and rectified prior to more franchisees becoming bankrupt.

The association can be contacted on rrfrassociation@gmail.com for further queries and clarifications.

Franchisee Association of Craveable is questioning whether Archers Capital and Craveable Brand have met the following from Franchise Code:

1. Obligation to act in good faith
2. Disclosure requirements before entry into a franchise agreement
3. Franchisor Obligations, Subdivision A and Copy of Lease
4. Franchisor Obligations, Subdivision A and Copy of Financial Statements
5. Franchisor Obligations, Association of franchisees or prospective franchisees

Obligations to act in Good Faith

The code states, each party to a franchise agreement must act towards another party with good faith, within the meaning of the unwritten law from time to time, in respect of any matter arising under or in relation to:

- the agreement; and
- this code.

The association is alleging that the Franchisor is not acting in good faith in regards to the Franchise Agreement which has resulted in a poor Business model.

This is highlighted by the following points:

1. Cost of Goods and unreasonable rebates from suppliers
2. Customer Loyalty Program and cost to Franchisee against contribution from Franchisor
3. Conflict of interest within own brand
4. Red Rooster Delivery
5. Lack of appropriate Marketing
6. Costly and unmanaged promotions

Cost of Goods and unreasonable rebates from suppliers

The association has done significant research on Cost of Goods (COGS) for the Craveable Brand and compared with other similar organisations:

Red Rooster COGS is suggested to be 38%. This is significantly higher than our competitors, which has a direct impact upon store profitability.

- Subway run at 32% GOGS (Franchisee with 2 stores)
- Coffee Club run at 28% COGS (Franchisee with 1 store)
- KFC run at 33% COGS (Store manager)
- Hungry Jacks run at 30% COGS (Store Manager)
- Domino's run at 30-32% depending on product mix (Franchisee owns 7 stores)

Some comparisons have been done with goods;

- Beverages can be bought at much cheaper prices these days at local super market. Many stores are running heavily discounted prices on beverages. It begs the question "where is national purchasing power gone for Craveable?" A very good example is Mount Franklin Water carton which

can be bought for $11 every day price at IGA and costs $18 through Craveable suppliers
- Recently significant research has been done around chips (a product that is heavily used) where one can get chips at much lower prices.
- Packaging which has inflated prices from suppliers:

Generic Item	PFD Price	Open Market Price	Price Difference
PLASTIC FORK (4000)	$70.92	$40.00	$30.92
PLASTIC KNIFE (4000)	$70.92	$40.00	$30.92
PLASTIC SPOON (4000)	$70.96	$39.00	$31.96
120 L GARBAGE BAG	$55.65	$42.50	$13.15
76 L GARBAGE BAG	$28.15	$23.00	$5.15
MEAL PACKS (Knife+Fork+serv)500	$40.13	$25.00	$15.13
CLING WARP ROLL	$15.91	$13.65	$2.26

It should be noted that Franchisee pays over 95% of all COGS, however has no presences or contribution to negotiations with suppliers. Neither are any rebates disclosed or shared with franchisee. It is the belief of franchisee that the franchisor is not acting in good faith whilst determining prices. The Franchisees hands are tied, as the Franchisor determines the cost price and the selling price.

Customer Loyalty Program and cost to Franchisee against contribution from Franchisor

Franchisor started a customer loyalty scheme approximately 3 years ago. This scheme is a direct hit to franchisee without any contribution from franchisor. It was introduced without disclosure and franchisee were forced to implement in their stores.

The loyalty program offers the customers, to earn a $1 reward for every $15 dollars spent. This can be used in any restaurant of the same brand. Often customer will earn reward at one restaurant but redeem at another. This means the Franchisees are not offered any compensation for the items redeemed; which negatively impacts their cost of goods.
If the customer chooses to redeem via home delivery, it further raises the cost, in the form of the driver, fuel and insurance.

Franchisees were also forced to purchase scanners, which was again an added cost not disclosed to Franchisees.
The customer Database is actually owned and kept by the Franchisor, whilst all costs are incurred by the Franchisee.

There has been no reconciliation provided to Franchisee with regards to the costing of the program, it is a conservative estimate, that the average store has lost over $25000, to this program. Further the Franchisor does not provide any data as to how much the Franchisee owes in not redeemed dollars, to the customer.

When the loyalty program was introduced, the franchisor charged the Franchisee royalty for approximately 12 months, on the redeemed dollars, a sale which was in fact a discount; and not an actual sale. Franchisees were also made to pay GST on the same as well, because the Franchisor did not program the POS units correctly. This error was repeatedly raised by the Franchisee, but the Franchisor refused to correct it. Eventually the error was rectified but franchisees have not received any reimbursements till date.

It is alleged that the program is flawed as there is no contribution from the franchisor. No cost benefit analysis has been provided to the franchisee. Furthermore, it appears the Franchisor is over generous in providing discounts to customers, as there is no direct cost to Franchisor.

Conflict of interest within own brand

Red Rooster and Oporto are very similar businesses that sell chickens. Product innovation has been an issue for both these brands. The franchisor is not able to do justice to either brand product innovations. The common complaint for Red Rooster chicken has been "it is the same chicken, which is available at the local super market for half the price." A simple move like adding flavors and sauces cannot be done because that competes directly with Oporto; Red Roosters sister brand.

The conflict is not just in product innovation. The Franchisor has opened both brands within proximity to each other putting the franchisee at direct disadvantage. This has caused great concern and confusion as it is noted that the marketing resources are shared for both brands, but site opening decisions are made with both brands competing each other for the same market share.

Home Delivery

Home Delivery was introduced two years ago. This has caused further financial stress on the business model for franchisees.
All Franchisees are expected and pressurized to introduce delivery within their stores as a total brand direction. This has burdened them with the added cost of vehicle ownership (insurance, registration, maintenance, finance), plus and a higher wage bill.

Stores that are not doing delivery are made to miss out on marketing and media spend (which franchisee has contributed towards) Stores that do not do delivery also negatively affected by close proximity doing delivery taking their market share and revenue. Forcing delivery was not disclosed as part of business model when stores were sold.

The delivery model, was not implemented efficiently, which caused the cannibalization of sales from the core business (i.e. instore sales), which has resulted in huge cash flow issues for all franchisees. This was further enhanced by lack of marketing and poor execution.

It appears not a lot of research has gone in to the costing of delivery model prior to starting it.

It is alleged that delivery was introduced to increase the top line, to make the brand more suitable for an IPO by the Franchisor, which continues to result in huge cash flow problems for the Franchisee.

Marketing

There has been a lack of transparency of the spend on the marketing fund, despite repeated requests by franchisees over the last 30 months.

Historically the brand had a presence on free to air TV, which always resulted in a boost in sales. The franchisees made contributions to the marketing fund, under the impression that the Franchisor would continue to spend on free to air TV. Over the last 3 years the Franchisor has refused to spend on free to air TV. Upon questioning the Franchisor has no satisfactory response as to why this decision was made.
This has had a huge impact on the negative sales of all franchisees.

It is alleged that the lack of transparency indicates there is unethically behaviour on the part of the Franchisor, with regards to the marketing fund.

Disclosure Document for Franchisee or Prospective Franchisee (Supply of Goods or Services to a Franchisee)

The code mentions that Franchisor must provide disclosure documents to franchisees.

However, Craveable Brands, has failed to meet its obligations under this code, as there are many costs which the Franchisee incurs but are not disclosed upfront.

These include but are not limited to:

1. GetSwift upfront and on going costs
2. Finger Scanners
3. Media Player Licenses
4. Unreasonable IT Costs
5. Software licenses including zuus and office 365.
6. Digital menu boards upfront and ongoing licensing
7. Micros upfront and ongoing licensing
8. Telstra DOT, inferior and more expensive

The cost of the above appears to be astronomical when compared to the open market, which suggests rebates may have been a driving force behind the decisions; further highlighting lack of good faith from the Franchisor.

Franchisor Obligations, Subdivision A and Copy of Lease

The code states "If a franchisee leases premises from the franchisor or an associate of the franchisor for the purposes of a franchised business, the franchisor or the associate must give to the franchisee:

(a) either:

(i) a copy of the lease; or

(ii) a copy of the agreement to lease; and

(b) details of any incentive or financial benefit that the franchisor or associate is entitled to receive as a result of the lease or agreement to lease.

The Franchisor holds the majority of leases in their name and has not disclosed the original rent in the form of a direct invoice from the landlord. This has led Franchisees to believe that the Franchisor may be obtaining un disclosed rebates from landlords.

The Franchisor forces the Franchisee to pay building insurance under an umbrella insurance package which covers the whole brand. The logic behind this is to ensure all parties are covered correctly, as a requirement of the lease. However, Franchisees have evidence which confirms that the same level of cover is available for 35% less premium, with 20 times less excess in play.

The Franchisees are confident that the Franchisor has not acted in good faith, in this instance, as they have failed to provide original invoices for the insurance.

Franchisor Obligations, Subdivision A and Copy of Financial Statements

The code states that if a franchise agreement provides that a franchisee must pay money to a marketing or other cooperative fund, the franchisor must:

(a) within 4 months after the end of the last financial year, prepare an annual financial statement detailing all of the fund's receipts and expenses for the last financial year; and

(b) ensure that the statement includes sufficient detail of the fund's receipts and expenses so as to give meaningful information about:

(i) sources of income; and

(ii) items of expenditure, particularly with respect to advertising and marketing expenditure; and

The association has held four meetings with senior executives over the last 30 months, in which a key item of the agenda has been the lack of transparency with regards to marketing funds. Till date this has not been provided.

It is alleged that the lack of transparency indicates there is unethical behaviour on the part of the Franchisor, with regards to the spend of marketing funds.

Franchisor Obligations, Association of franchisees or prospective franchisees

The code clearly states that A franchisor must not engage in conduct that would restrict or impair:

(a) a franchisee or prospective franchisee's freedom to form an association; or

(b) a franchisee or prospective franchisee's ability to associate with other franchisees or prospective franchisees for a lawful purpose.

The association alleges that the members of the association have started to feel victimized and bullied since the association has been formed.

Some of these bullying includes but is not limited to:

1. Interfering in the Sales process by lowering the price on restaurants in order to remove the franchisee quickly
2. Breach notices on items that were not taken up previously
3. Constant harassment by brand management over minor issues
4. Experienced Franchisee with impeccable records, are placed on a back foot