

Trade Practices (Industry Codes – Franchising) Regulations 2007

Business Cost Calculations

The Trade Practices (Industry Codes – Franchising) Regulations 2007 (amending regulations) take effect from 1 March 2008. The amending regulations amend the Trade Practices (Industry Codes – Franchising) Regulations 1998 (the Code) to increase the transparency, quality and timeliness of disclosure by franchisors to existing and prospective franchisees.

Background

A review of the disclosure provisions of the Code was undertaken in 2006. The recommendations of the Committee which undertook the review and the previous Government's response to the recommendations were announced in February 2007. Subsequently, relevant departments and industry stakeholders were extensively consulted on the Committee's recommendations and the Government's response. The amending regulations implement the outcomes of the review and the subsequent consultation.

Business cost analysis and assumptions

As part of the previous Government's consideration of the Committee's recommendations following the review, the Department undertook an analysis of the estimated costs to business of implementing all of the Committee's recommendations. It was estimated that some of the Committee's recommendations, if implemented, would involve compliance costs for business.

Supported by industry consultation, the Department considered that many of the Committee's recommendations reflect common industry good practice and the information that needs to be disclosed to franchisees by franchisors would readily be available to the franchisor. Therefore, the recommendations would not involve substantial additional compliance costs for business. The Australian Competition and Consumer Commission (ACCC) also issues user friendly guidelines and fact sheets to assist business to understand the effect of amendments to the Trade Practices Act, including franchising code amendments. For these reasons, it was expected that extensive specialist business and legal advice would not be necessary to comply with the recommended changes.

The 2006 Franchising Australia Survey estimates that the total number of business format franchisors in Australia in 2006 was around 960. According to the same survey there were an estimated 62,000 franchise units in operation and the sales turnover in 2005 of the entire franchising sector was estimated at \$128 billion.¹

Estimations of the costs of the recommendations have made use of ABS wage statistics² and the application of a 1.5x multiplier to arrive at the full cost to the business (to account for non-wage costs of holding an employee).

¹ Frazer, Lorelle, Weaven, Scott, and Wright, Owen, *Franchising Australia 2006 Survey*, Griffith University, 2006.

² Australian Bureau of Statistics Cat. No. 6306.0 Employee Earnings and Hours, Australia, May 2004, 2005

The costs of implementing the Committee's recommendations were based on the assumptions and key statistics listed above.

The recommendations where compliance costs were estimated for businesses are listed below, including the Department's analysis. Where it is estimated that a recommendation results in negligible or low business costs, it has not been included below.

Recommendation 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.

Analysis

If implemented, this recommendation would involve franchisors producing a Risk Statement, using a template provided by the ACCC, identifying risks that should be considered by the franchisees when entering into a franchise agreement. The franchisor would need to focus on issues relevant to the franchisor's individual business model, but not necessarily specific to any site.

Cost

It was expected that the franchisor would need to allocate administrative resources to understanding, developing and distributing the risk statement. The cost to industry of implementing this proposal was estimated to be \$134,000.

Recommendation 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.

Analysis

The Code already requires franchisors to disclose whether the franchisor or an associate will receive a rebate or other financial benefit from the supply of goods or services to the franchisee, and whether any benefit is shared with franchisees. Therefore, related information including the amounts or methods of calculation should be readily available to the franchisor. The provision of the related information would not involve substantial additional costs to the franchisor.

Cost

The cost to industry of retrieving the method of calculation of a rebate from files and adding this information to disclosure documents was estimated to be \$19,000.

Recommendation 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.

Analysis

It is expected a substantial number of existing franchisors already undertake an annual audit of their marketing and co-operative funds. Many franchisors do not have such funds in any case.

Cost

If this recommendation is implemented, the franchisor would need to engage the services of an external auditor to undertake an audit of the fund. The additional costs to industry of complying with this proposal are estimated to be \$131,000.

Recommendation 8: More information about past franchisees

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.

Analysis

The contact and location details of past franchisees can be an important source of information for prospective franchisees. If this proposal is implemented, it will be the responsibility of the franchisor to contact past franchisees (over the last 3 financial years) and seek consent for their contact details to be disclosed. Following implementation, this information may be recorded on the franchisee's exit. It is noted that maintaining information and detail of past franchises is likely to be an existing business activity of the franchisor. It is also noted that the Australian Taxation Office requires that business records be kept for 5 years.

Cost

If this recommendation is implemented, the franchisor would need to allocate administrative or other staff to the process of searching existing records or publicly available information to ascertain the contact details of past franchisees. The franchisees would then need to be contacted so that their approval may be sought for making their details available to prospective franchisees. The initial additional costs to industry of complying with this proposal are estimated to be \$69,000.

Recommendation 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).”

Analysis

Information regarding the business experience of persons with managerial duties in relation to a franchise business is usually made available to the franchisor as part of the recruitment of such persons. Therefore, it is not expected that substantial

resources would need to be allocated to producing a summary of business experience of such persons over the last 10 years.

Cost

In the event information regarding the business experience of persons with managerial duties in relation to a franchise business is not readily available, the franchisor would need to seek that information directly from those persons. Administrative resources could then be allocated to producing a summary of the relevant persons' business experience. The estimated cost to industry of complying with this proposal is estimated to be \$19,000.

Recommendation 11: Opt out clause from providing information requested from Annexure 1

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

Analysis

Generally, the short form disclosure document (Annexure 2) applies to franchised businesses with an expected annual turnover of less than \$50,000. However, if a franchisee, when provided with the Annexure 2 document, asks for information referred to in Annexure 1, that information must be disclosed to the franchisee. However, the franchisor does not need to provide this information if it is reasonable to withhold the information (current Part 2, clause 6C). Removing this opt-out clause would mean that the franchisor cannot withhold information that is generally available to the franchisor.

It is estimated that a very small percentage of franchisors have an annual turnover of less than \$50,000. Industry consultation indicates that a number of franchisors provide Annexure 1 (long form disclosure document) even when only Annexure 2 is required. Therefore, it is estimated that implementing this proposal is unlikely to result in substantial compliance costs for franchisors.

Cost

In the event that additional information requested by the franchisees under Annexure 1 is not readily available, administrative resources would need to be allocated to searching for and presenting this information. The estimated cost to industry of complying with this proposal is \$12,000.

Recommendation 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.

Analysis

For franchisors that are part of a consolidated entity, they will be required to provide the financial details of the whole entity. The Code already requires franchisors to disclose the franchisor's annual financial statement. It is expected that information about the consolidated entity to which a franchisor belongs would be readily accessible. Therefore, if implemented, this proposal is unlikely to result in substantial additional compliance costs for franchisors.

Cost

Costs may be involved in collating information about the consolidated entity to which a franchisor belongs. The estimated cost to industry of complying with this proposal is \$10,000.

Recommendation 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.

Analysis

If implemented, this proposal would involve the franchisor registering their current disclosure document with the ACCC annually and paying a registration fee to cover costs associated with record keeping, monitoring and auditing.

Cost

Based on comparable registration systems in other jurisdictions such as the United States and calculation of the administrative costs that may be involved in filling out the registration documents and submitting them to the ACCC, the estimated cost of implementing this proposal is \$451,000.

The total business cost to industry of implementing all the above proposals is estimated to be \$845,000.