

# **‘COMMUNICATION FAILURE’ and ‘UNDERSTANDING DEFICIENCY’**

**SUBMISSION by the OFFICE OF THE AUSTRALIAN SMALL BUSINESS  
COMMISSIONER to the REVIEW of the FRANCHISING CODE of CONDUCT**

*A fundamental cause for disputes in the franchise relationship appear to stem from ‘**communication failure**’ on the part of the franchisor interacting with ‘**understanding deficiency**’ on the part of the franchisee.*

## **INTRODUCTION**

This is a submission by the Office of the Australian Small Business Commissioner (the ‘ASBC’) to the Review being undertaken by Mr Alan Wein for the Australian Government into the Franchising Code of Conduct (the ‘Review’).

The discussion paper issued in relation to the Review appropriately addresses key components of the franchise relationship, such as disclosure, contractual terms, dispute resolution and enforcement of the Code.

The office of the ASBC commenced operation on 2 January 2013. Having regard to the very short period of its existence, the ASBC has not had any direct experiences with the franchising sector sufficient for it to contribute to the Review from an evidence based platform.

However, the ASBC is able to make observations which may assist the Review. These observations are formulated through the experiences of the Commissioner, Mark Brennan, who for a substantial period held the office of the Victorian Small Business Commissioner.

Whilst disclosure requirements and clear articulation of rights and obligations, particularly covering end of term arrangements and dispute resolution, are crucial to franchise success, it is also the behaviour of the parties which provides substantial scope for improving the franchise environment. It is in the context of observations about behaviour of the franchise parties that this submission is centred.

A striking theme underpinning behaviour is the incidence of communication failure by the franchisor and understanding deficiency by the franchisee. This cocktail of mismatch contributes to disputes and business failure.

In making observations about franchise behaviour this submission does so by reference to case examples.

The submission also makes observations about the responsibilities of government when intervening in the franchise sector, particularly in the context of education and information and justice and dispute resolution. Further, the submission comments on an approach to enforcement of the Franchising Code.

## **OBSERVATIONS ON FRANCHISE BEHAVIOUR**

In the franchise sector, information is vital to the success of the franchise. In the first place both franchisor and franchisee should source information that is relevant generally to running a business and, specifically, about the subject matter of the business. Disclosure requirements are important for due diligence.

### **Case Example A**

By way of illustration, the ASBC is aware of a problem that arose in a franchise relationship where resolution of the problem was achieved through more comprehensive education of the franchisee. The franchise involved the provision of retail services by over 70 franchisees. All of the franchisees and the franchisor became disgruntled about poor business returns.

With the assistance of the Victorian Small Business Commissioner, the fundamental cause of the problem was diagnosed as a failure by the franchisor to adequately educate the franchisees about the retail product. The problem was solved by the franchisor devising a revised information and education program for the franchisees.

In this case, there was communication failure by the franchisor through its initial inadequate training program and understanding deficiency by the franchisees in not having available relevant training materials.

### **Case Example B**

Another pertinent example of the importance of information and education in the franchise relationship is afforded by the case of a franchise of kiosk delivered products.

The franchisees concerned operated multi franchises. That is to say, as well as the kiosk franchise they also sold one or two other products under separate franchise arrangements. At the commencement of the kiosk franchise, the franchisor had communicated to the franchisees that the essential elements of the franchise agreement were for the franchisees to:

- Comply with all laws;
- Maintain clean and tidy premises;
- Abide by the franchisor's customer service standards; and
- Make a profit.

Towards the end of the period of the franchise agreement, the franchisor met with the franchisees, who were expectant that the franchise agreement would be renewed. Their expectations were founded on the confidence that they had:

- Complied with all laws;
- Had the cleaners in the premises each night to clean and tidy;
- Had been smiling and courteous in customer relations; and
- Had made a profit.

However, their confidence was shattered by the advice they received from the franchisor that the franchise agreements would not be renewed for the reason that, although they had returned a profit, the profit they had made was insufficient. The franchisor had expected a profit some five times that made by the franchisees.

However, the franchisor had not communicated a quantum of profit at the commencement of the franchise. The franchisees complained that had they been aware of the franchisor's expectation, they would have balanced their energies towards achieving this against the resources they devoted to the other components of their business.

Again, this case is illustrative of communication failure by the franchisor and understanding deficiency by the franchisees.

## **OBSERVATIONS ON GOVERNMENT AND FRANCHISING**

The franchise sector is an area of business where there has been Government intervention.

Observations on Government intervention to regulate business generally reveal two enduring core responsibilities for government, namely education and justice.

### **Education**

*'No franchise business should fail through lack of access to information.'*

The facilitation of access to, or the provision of information to the business sector, including the franchise sector, is a core responsibility of government. It is appropriate for Government to commit resources to information services, especially where the behaviour of businesses participating in a particular sector is regulated.

The concept of a Small Business Commissioner is a popular modern mechanism for advocating government intervention, encouraging education and resolving disputes, particularly through mediation.

A key educative theme for a Small Business Commissioner is to:

- encourage franchisors and franchisees to improve their professional and commercial behaviour ('you get the customers you deserve'); and
- promote improvement in their business to business conduct in the franchise relationship.

## **Justice**

The second enduring core responsibility of government when intervening to regulate business is to provide an appropriate system of justice.

In ancient times, provision of justice focussed on placing wrongdoers in prisons. Refinements and sophistications over time have developed various means of providing systems of justice, which are not confined to punishment of offences against the Crown but extend to finding justice for those in private conflicts. In particular, alternative dispute resolution has emerged as an appropriate measure of according justice in business dealings.

Speedy, inexpensive resolution of disputes and fair dealings are crucial to business efficacy in the franchise sector. Government responsibility for the provision of justice in private commercial conflicts in the franchise sector is provided through the Office of the Franchising Mediation Adviser. The various State Small Business Commissioners also have scope to resolve franchising disputes.

A key contribution to justice for a Small Business Commissioner is to advocate speedy and inexpensive resolution of disputes between franchisor and franchisee:

- imbalances in the franchise relationship are conducive to disputes arising;
- a fundamental cause for disputes in the franchise relationship appear to stem from 'communication failure' on the part of the franchisor interacting with 'understanding deficiency' on the part of the franchisee.

## **ENFORCEMENT OF THE FRANCHISING CODE**

Putting aside the content of what is to be enforced under the Franchising Code, the ASBC considers, as a general proposition, that a facilitative approach to regulation is most appropriate in regulation of business.

By and large, businesses want to comply with the laws that regulate their activity. Non-compliance, especially in the case of small business is frequently associated with unawareness or poor management practices. A crackdown on non-compliance by pecuniary or disciplinary measures may be effective in certain circumstances. However, where the business environment is one where business efficacy is served by certainty of rights and obligations and unfettered by prescriptive compliance, as should be aspired for the franchise sector, non-compliance incidents may better be addressed by a facilitative approach tending to educate to comply rather than punishing non-compliance.

In this regard consideration may well be given to providing for, at least in the case of first time non-compliance, a requirement to undergo, at the offender's expense, a course of training in compliance with the Franchising Code. In this way, rather than solely being punished for non-compliance, the offender learns about compliance and the likelihood of a repeat incidence of non-compliance is reduced.