2013 REVIEW OF THE FRANCHISING CODE OF CONDUCT

Mr Alan Wein

KFC Independent & Corporate Franchisee Association of Australia (IndCorp)

As outlined in the Discussion paper regarding the Review of the Franchising Code of Conduct, This review is an inquiry broken into the three following sub categories:

1/ Good faith in franchising;

2/ The rights of franchisees at the end of the term of their franchise agreements, including recognition for any contribution they have made to the building of the franchise; and

3/ The operation of the provisions of the Competition and Consumer Act 2010 as they relate to enforcement of the Code.

Disclosure under the Franchising Code of Conduct.

As far as direct disclosure relates to the sharing of franchisee information with new or potential franchisees, – Yum have always been good in this area and this was not part of our submission in 2008, nor is it part of our submission now. Yum have been happy to provide potential franchisees with information about many operational aspects of the KFC brand and operation.

As far as the disclosure section of this review relates to 'Unilateral Contract Variation', the KFC franchisee network has huge concerns in the regard.
The main aspect affecting franchisee/franchisor goodwill relates to the one-sided ability of the franchisor to make changes to the franchise agreement. Whilst these changes are not made directly to the franchise agreement, they are instead made via an annexed document referred to as the 'Operations Policy's Manual'. This loophole is recognised in the Guidelines and Commentary for this review on Page 12.

Whilst in our specific case the YUM management of today are sure and stable, it will only be changes to the Code which protect future generations of franchising in this country.
This juncture and this specific review of the Code is crucial for the safety and continued evolution of the franchising sector in Australia.

It is through this instrument or 'loophole' that the franchisor can change system standards, increase costs and fees passed onward to the franchisee, and determine how the franchisee should adhere to the franchise agreement. This is outside of the terms set out in the original agreement signed by both parties.
Whilst it is accepted that whereby issues such as Health & Safety and work care and other safety mechanisms need to be regulated for the ensuring of the longevity and betterment of the system, this loophole also opens the door for franchisors to do a lot more than just change systems policy's and safety procedures.

It does not identify that this Operations Policy's Manual is the vehicle for imposing changes in unforeseen infrastructure investment, unilateral changes to recruitment and hiring policies, additional equipment and capital purchases or additional administration cost recovery from the franchisor. The way that this is accessed is via wording in the franchise agreement which states that policy's fees and costs are as per the Operations Policy's manual.

Whilst our concerns arise in relation to our experience with Yum Restaurants, moreover this is a flaw in the franchising code as a whole. We remain at a loss to identify another legal agreement in Australia whereby following the execution of a legally binding agreement, provisions then allow only one of the two party's the ability to change this agreement as they see fit, without affording the other party the rights or ability to do the same.

The ability of this one-sided agreement speaks directly to the 'Disclosure' section of this review, but more specifically to the need for good faith provisions to be included in the Franchising Code, or alternately the need to prevent only one party from modifying the agreement without the consent of the other.

'Unforeseen Capital Expenditure' is also outlined in the Review Document and Further disclosure concerns related to the Code.
Large franchise chains have the ability to increase the amount franchisees must spend on store upgrades every five (5) years, without this amount having been factored into the original business plan or finance plan from the Bank.
This is often due to what the management at the time sees as their interpretation of the 'direction of the brand'. Often, these managers move on to other companies, leaving behind them franchisees with increased debt on top of their original investment as a result of having to comply with the temporary wants of the franchisor. Again, whilst the franchisor can potentially make an argument for the betterment of the system overall, we have recently seen some decisions taken to implement products which have failed, with their only legacy being the remaining capital and equipment payments that the franchisees are left with.

It is the aforementioned changes that are not only upsetting to the franchisee community, but also to the banking sector where the main franchising sector lenders Westpac and Commonwealth Banks see this as creating great uncertainty.
Accordingly funding has become hard for existing and potential franchisees and the systems are seen as too 'unpredictable'. In a most basic example of this, a new Quick Service Restaurant may cost M$2.1 to build, but is only valued by Westpac or Commonwealth Bank at M$1.7.
The franchisee can then only borrow 70% of the bank valuation price (M$1.7) – M$1.2, which is only about half the building cost.
This means franchisees have to put their house on the line to buy into a franchise, but then face the uncertainty about store upgrades and unbudgeted capital costs that are referred to above. The franchisees then have the worry that they will lose their business value once the 20 year term expires, assuming they have been able to keep on borrowing or funding the 5 year upgrades etc. It is a cycle even in a proven system like KFC leaves franchisees totally exposed to decision-making by Yum management, which is determined by the business pressures on the industry at the time, but can have long lasting costs and effects. If you want to fix franchising you have to create certainty for franchisees about how decisions are made (ie. good faith) and protect our investment when the term ends (ie. Property rights rights).

Good Faith in Franchising

Whilst already touched upon above under the Disclosure section of the review, the ability of one of the party's to change the agreement holds concerns for the KFC franchisees.
As outlined in the Review guidelines "Franchisors and franchisees are bound by written and unwritten laws relating to contracts" (P22) . It would seem odd that with this as the premise, that this duty is not clearly spelt out in the Code, which franchisees could then point to in discussions with their franchisors when it comes to some of the more controversial decisions affecting franchisees. At the moment the franchisor can point to its agreement and enforce this or that - but other than trusting that there is a good and healthy franchisee/franchisor culture to lean upon, there is no recourse for the franchisee. Discussions always come down to "show me where it is in the agreement or the Code". Franchisees also don't want to have to spend money getting legal opinions about the unwritten law.
Yum to their credit are fair in dealing with things that are written down in the contract or the Code. The problem is that the key points raised in this submission are all "unwritten" and so the franchisor can do what it does because it's standard form agreement is totally in its favour, and it can basically make changes at any time through the Operations Policy's manual.

Traditionally the Royalty which a franchisee takes from the sales of the franchisee was a fee for administering the system – not simply a profit stream.
Increasingly franchisors are passing more and more additional costs onto the franchisee which are additional to the royalty, which in effect changes the royalty into a pure profit stream for transferring back to the USA.
Again we can provide examples confidentially if required. However the key point is that all of the changes are currently being driven through changes to the Ops Manual, and we have no recourse to stop them.

End of Term Arrangements for franchise agreements

End of agreement uncertainty, has led to our franchisees referring to the end of the 20 year term as the "20 years drop dead" clause, because there is no certainty that we can recoup our investment at the end of the 20 year term. - As per our submission in 2008, the KFC franchisees have concerns about the lack of 'end of term' protections for our investment in the business – whereby franchisees have mortgaged our homes to buy and build, as stated above.
The situation currently exists whereby franchisors have the authority to come in after the expiry of the 20 year franchise agreement and take the KFC store from the franchisee without any compensation to the franchisee at all.
This may present situations whereby the franchisee enters an immature marketplace and incurs losses for many years, and over time and exhaustible hours of hard work may bring the business to a position of breakeven or even profitability. Over time and years, the suburb or township grows and the population base increases and the business grows with it up to a point where the business may for a small number of years be profitable. Then at the point of 20 years, after all of the years of losses, stress and family commitment that goes into a small business operation, the franchisor can walk straight in and assume control of the business - without offering any financial compensation to the family who has built the business. This is wrong and needs to be stopped, with proper protection for the franchisee's property rights.

Whilst we understand that you will be receiving many submissions from franchisees and franchisor groups of all shapes and sizes, some of them large multinational corporations, we as small scale franchisees would ask that you consider our position on the above mentioned issues. Each and every one of our franchisees would be available for any questions, concerns or clarification you may need.

KFC Independent & Corporate Franchisee Association of Australia (IndCorp)
Address:
[redacted]
IndCorp KFC Franchisee Association
[redacted]
Email:
[redacted]

Franchising Code Review Secretariat
Department of Industry, Innovation, Science, Research and Tertiary Education
Small Business Division
GPO Box 9839
Canberra ACT 2601