

Submission by Mr. Ken Billot

to

The Ministry of Economic Development

Review of franchising regulation in New Zealand

Relevant background of submitter – Ken Billot

- In 1989 I initiated a small group of separate companies called “Signwise”.
- In 1995 I franchised this group consisting of 8 companies, retaining ownership of the franchisor company Signwise Industries (Group) Limited. Hence I have experienced the initiation and development of a franchise system as franchisor.
- From 1990 to 2006 I was contemporaneously the General Manager of the Paper Plus franchisee for Taumarunui. Hence I have experienced the growth of a co-operative buying group into a franchisee-owned-franchisor, as a franchisee.
- After ceasing my involvement in both Signwise and Paper Plus in 2006, I co-purchased the Home Care Regional Franchise of “@ Your Request” through Integra Management Limited. Hence I have experienced a franchise system from the dual franchisee/ franchisor role peculiar to a regional franchisee.
- In 2000, while involved in the Signwise franchise, I re-entered tertiary education by studying a G.Dip. Business Studies at the University of Auckland.
- In 2003, having completed the G.Dip. creditably, I commenced a Master of Management degree at the University of Auckland. After the first year (A+) I left the course to commence a Ph.D at Griffith University, Brisbane, Australia due to the existence there of a franchising research stream led by my principal supervisor, Professor Lorelle Frazer.
- I am currently in the final stages of my Ph.D, during which I have written and presented academic papers, both nationally and internationally. The focus of these papers and my doctoral research is brand within New Zealand franchises.

The above information positions me as a New Zealander, researching franchise systems in New Zealand, while being actively engaged in the management of one of those systems as a Regional Franchisee. My experience of franchising in New Zealand spans nearly 20 years in the roles of franchisor, franchisee and more recently as an academic.

Though a PhD candidate at Griffith University, a member of the Asia-Pacific Centre for Franchising Excellence, a Director and shareholder of Integra Management Limited, the views expressed in this submission are my own.

Introduction

The answers that I have provided are qualified by awareness that all submissions, including my own, will be excessively based on assumptions as opposed to data. There is little independent and objective data on the subject matter to which the 10 questions in the discussion document are directed. Little independent research has been completed on franchising in New Zealand. A comprehensive survey, called “The Survey of Franchising” was organised by the Franchise Association of New Zealand (FANZ), principally sponsored by the National Bank and completed by Colmar Brunton in 2003, but no similar survey of the franchising sector has since been replicated. I submit that there needs to be some effort directed at collecting data that informs the 10 questions posed by the Ministry, prior to selecting one of the canvassed options.

I submit that independently verified data is not available to answer questions that are contributory to the 10 posed by the Ministry. A small sample of these questions is included below:

- What is a franchise system in New Zealand in terms of any proposed legislation or co-regulation framework?
- How many of these franchise systems are operating in New Zealand at this time?
- How many franchisee units does each franchise system have?
- How many individuals are directly employed within franchising?
- What contribution does the franchising sector make to the GDP of New Zealand?
- What is the average franchisor and franchisee investment in their franchising business?
- What are the average legal fees paid by a franchisee who does seek accredited professional legal and accounting advice?
- What proportion of franchisees sought accredited professional legal and accounting advice before executing the franchise agreement?
- What is the demographic profile of franchisors and franchisees?
- How many franchise systems ceased to operate in New Zealand during 2006, 2007 and 2008 and why?
- How many franchisees ceased to operate in New Zealand during 2006, 2007 and 2008 and why?

Though independent research is sparse, there is a great deal of helpful information available. I am in no way diminishing the contribution of FANZ or other service providers in producing a number of informative documents, for prospective and current franchisors and franchisees, but I submit that knowledge of the information’s existence is not common amongst prospective franchisees, some of whom have limited spoken and written English.

FANZ is one of the few organisations that seek to provide leadership, guidance and information to prospective franchise stakeholders and claims a penetration of the franchise sector of “40 – 50% of active franchise systems”. Thereby FANZ is able to support a significant part of the franchise sector, but I would doubt that the availability of this support is known to franchisees and prospective franchisees of the type who were allegedly disadvantaged in the publicised cases over 2007 and 2008.

My answers to the 10 questions posed reflect a consistent personal empathy with franchisees and a bias against government legislation unless it is essential and can act as a catalyst, as opposed to an inhibitor, to effective growth. My preference is for the provision of independently verified information that is readily accessible to potential franchise stakeholders, combined with education across the whole spectrum of the franchise sector. I would also promote the availability and systematisation of early conflict resolution. I submit that these processes should be provided by an organisation that is representative of all aspects of the franchise sector; prospective and current franchisors and franchisees, employees and service providers. This organisation will require adequate governance, structure and resourcing.

Q1.

Franchise contracts are usually drawn up by, or on behalf of, the franchisor or the owner of the franchise system as one of the essential and preliminary steps to establishing a franchise. Not surprisingly they place many more obligations and responsibilities on the franchisee than the franchisor. They also allow the franchisor to terminate the contract for a wider range of reasons and breaches than are available to the franchisee. They effectively protect the franchisor and the franchisor's intellectual property. These contracts are intended to be one-sided. This, by itself, could hardly sustain an imperative for legislation as many contracts in many commercial situations are similarly one-sided. Nevertheless it accentuates the need for education and advice prior to the execution of the contract and supports the role of a "cooling off" period, subsequent to execution, to mitigate the effects of this one-sidedness on the franchisee.

According to the Winter 2008 edition of the "Franchise New Zealand" magazine, there are nearly 4,000 franchisees whose total capital outlay for their franchise was less than \$50,000. I submit that a significant proportion of these franchisees would seek information and advice from family, ethnic and religious networks. My submission is that legislation is not required to protect the franchisee, but franchisees do require access to independent and cost-effective advice, particularly in the pre-execution phase.

Q2.

I submit that the problems have been defined in a realistic and thorough manner.

There are three additional areas where I believe there is a restriction to ensuring that prospective franchisees are adequately informed.

Firstly, present sources of information are specific and focussed; they are not readily available in languages other than English and receive little coverage or introduction in mass media. In the particular regional franchise in which I am involved, of 35 franchisees and an additional 30 authorised persons, over half are immigrants to New Zealand within the last 10 years. Their sources of information will tend to be mis-matched to the current patterns of information supply.

The second aspect which I submit is relevant to the protection of franchisees is the length and complexity of many franchise agreements and disclosure documents. The length of these documents is increasing and, if the Australian experience is to be reflected in New Zealand, will lengthen even further if specific legislation is enacted. Obtaining necessary

advice on the basis of a franchise contract that typically runs to 40 pages and a Disclosure Document of 20 pages can add sufficient expense to a franchisee to persuade them to dispense with the necessity to obtain adequate advice. I am not qualified to comment on the legal structure of franchise agreements and cannot argue the benefit of individual clauses, but consider that it is unfortunate that a 40 page document is needed to protect the interests of a franchisor who is selling a franchise for \$10,000.

There is a third important aspect that is not, to my knowledge, specifically covered by franchise contracts or legislation and that is the protection of franchisees on the failure of the franchisor. There is significant controversy in Australia concerning the effect of liquidation of the franchisor on what may be effective and profitable franchisees, due to their dependence on the franchisor for the intellectual property, trade marks and supply chains associated with the franchise. Many franchise contracts include a right of a franchisee to terminate the agreement on the liquidation of the franchisor, but this could be argued to be inadequate protection as the financial losses suffered by the franchisee on such termination represents a relatively uncontrollable risk on the franchisee's part.

Q3.

I submit that my earlier comments relating to the lack of independently verified data place doubt on any reliable quantification of the magnitude of these problems. I also submit, albeit anecdotally, that franchises that require capital investment in excess of \$100,000 can be expected to attract recently immigrated or resident New Zealanders who can and will get the essential advice necessary before signing a contract. The necessity of some form of protection of franchisees is accentuated for franchises where the capital required is relatively low. These types of franchises are particularly attractive to immigrants who may find it more difficult to enter the New Zealand labour force through usual employment channels. I submit that these franchisees or prospective franchisees are extremely unlikely to use any of the normal association or professional channels to express their discomfort or grievances.

Q4.

Option 1: Status Quo I submit that the status quo is inadequate. Franchisors and franchisees who are either not FANZ members, or who are FANZ members but do not follow the FANZ Code of Conduct have only formal legal remedies or the Small Claims Tribunal to seek redress. The former is beyond the resources of many franchisees and the latter is limited by statute with respect to the upper dollar limit of disputes that it can handle.

Option 2: Education I certainly advocate "education initiatives targeted toward both franchisees and franchisors", but would cast some doubt on the suitability of existing providers to supply such a service in a way which is readily available in a meaningful way to all stakeholders in the franchise sector. I accept that part of the present problem of information supply and education initiatives, both pre and post contract execution is the limited resources directed at these aspects of the franchise sector by both participants and government.

Option 3: Franchise-specific legislation I am reticent to suggest franchise-specific legislation. The Australian experience is that legislation adds to costs and initially acts as a

disincentive to franchise. Specific legislation also begins a process of statutory intervention that is difficult to contain.

I am not experienced in law, but as a layman, would offer the suggestion of legislation to support a co-regulatory structure that would incorporate the elements of registration, minimum disclosure, minimum contractual provisions (including a “cooling-off” period and specific protection for franchisees on the liquidation of the franchisor) and access to enhanced and systematised conflict resolution processes.

Q5.

I submit that the options forwarded are sufficient.

Q6.

I am no expert in information disclosure, but the guidelines produced by FANZ are a good place to start. However, I would add that information disclosure needs to be an ongoing process in that the franchisor should disclose certain information such as a report on the number, nature and resolution of disputes, the names and contact information for franchisees who have terminated in the previous year and details in relation to any court actions in which the franchisor is engaged.

Q7.

The option of maintaining the status quo has the benefit of involving the least commitment of cost, effort and thought, but it is timely to consider if the franchising sector requires greater support and intervention and I submit that it does, partly in order to protect the reputation and growth prospects of the sector, partially to protect responsible franchisors and franchise systems and certainly to protect vulnerable franchisees.

No matter which option or options are finally selected, I submit that education initiatives are a critical part of the future growth of the franchise sector. These initiatives need to be planned for the full range of franchise stakeholders throughout the life-cycle of the franchise system.

The option of franchise-specific legislation, other than to enact a co-regulatory regime, is, I submit, too far too fast and lacks the flexibility needed to respond to rapidly changing market conditions.

Q8., Q9. and Q10.

I do not consider myself sufficiently qualified to comment.