



AUSTRALIAN COMPETITION
& CONSUMER COMMISSION

Disclosure practices in food franchising

**Key findings of targeted compliance checks
of franchisors in the food services sector**

August 2019

Why we are releasing this report

This report summarises the key findings of targeted compliance checks conducted in 2019 by the Australian Competition and Consumer Commission (ACCC) on franchise systems in the food services sector.

All participants in franchising must comply with the Franchising Code of Conduct (Franchising Code) and the Australian Consumer Law. The Franchising Code requires franchisors to disclose certain information to a franchise buyer, and this information must not be misleading or deceptive.

We are concerned that many franchisors aren't providing adequate information to prospective franchisees when it is clear they are required to. All franchisors need to take this report into account when preparing disclosure documents for their existing and prospective franchisees. This report also serves as a warning to anyone thinking of buying a franchise that you might not be getting the information you need.

The ACCC receives around 400 reports about franchising each year. Inadequate disclosure by franchisors is consistently one of the top two Franchising Code issues reported to the ACCC. From July to December 2018 the most common franchising reports were about the food services sector. The food services sector includes cafés and restaurants, and takeaway food industries. This type of franchise can require a high level of investment.

We conducted compliance checks on 12 different franchisors from the food services sector. Our checks focused on disclosure of information we consider important to someone thinking about buying a franchise, such as former franchisee contact details, supply restriction details, and key unavoidable costs.

Franchising is very different to other types of business. Operators of a franchise business can face restrictions imposed by the franchisor, and this is often not realised early enough. Disclosure is intended to make this clearer. This information assists a prospective franchisee with their due diligence so they can thoroughly consider if franchising is suited to them, and if a particular franchise is a suitable investment.

In our checks we found concerning disclosure practices by franchisors that limited a potential purchaser's ability to conduct due diligence. We also found low rates of independent advice seeking by prospective franchisees. Some of the key findings of targeted compliance checks of 12 franchisors involved in the food services sector were:

- most made it too difficult to contact former franchisees
- most did not adequately disclose what essential goods were subject to supply restrictions
- almost all had supply restrictions, did not share rebate benefits directly with franchisees, and could set maximum retail prices. These are generally legal, but can combine to limit a franchisee's ability to make a profit.
- some did not sufficiently disclose key unavoidable ongoing costs, such as wages, rent or inventory
- 40 per cent of prospective franchisees did not get any independent advice before buying a franchise.

We consider the above findings to be particularly concerning. In some instances, franchisors may have breached the Franchising Code and/or the Australian Consumer Law. We are continuing to assess each trader's individual compliance, including whether any enforcement action may be warranted. Only a court can determine whether someone has breached the Franchising Code or the Australian Consumer Law.

We have issued this public report to increase transparency and the quality of information provided to prospective franchisees in disclosure documents. Most franchisors in Australia must complete mandatory updates to their disclosure documents by 31 October each year. We strongly encourage all participants in franchising to use the findings to improve their disclosure practices.

Process

The Franchising Code is a mandatory industry code.

Under the Franchising Code all franchisors must maintain a disclosure document and provide this to someone thinking about buying a franchise before a franchise agreement is entered into. The ACCC enforces the Franchising Code and can issue section 51ADD notices to conduct compliance checks.

Twelve franchisors were selected based on reports to the ACCC about the industry and/or the franchisor, and intelligence from industry stakeholders.

In February 2019 we issued a [media release](#) outlining which disclosure areas we were targeting, and that our focus would be on the food services sector.

Each franchisor was then issued a separate section 51ADD notice. The notices focused on documents that would enable the ACCC to assess what was disclosed to a prospective franchisee prior to entering a franchise agreement.

While the 12 franchisors who were issued notices are a small sample of the estimated number of franchises operating in Australia (over 1,300) they are from the same sector (food services) and provide a robust sample of practices in that sector.

We then assessed the documents against the requirements of the Franchising Code and the Australian Consumer Law, and from the point of view of a prospective franchisee. Following the publishing of this report we will engage directly with the traders in relation to their individual compliance.

Key findings

Most of the franchisors made it too difficult to contact former franchisees



8 out of 12 franchisors made it **difficult to contact** former franchisees

Contacting former franchisees is an important step someone should take if they are thinking about buying a franchise. However, we found 8 out of 12 franchisors did not disclose contact details for former franchisees in a way that allowed contact to be made easily or at all.

Personal email addresses and mobile numbers allow for the quickest and simplest contact method, but only 4 of 12 franchisors consistently supplied these to prospective franchisees.

The remaining franchisors primarily supplied one or more of the following: contact details for the former franchise location, residential or postal addresses, occasional landlines, or no contact details at all. Some franchisors may not provide longer than a 14 day disclosure period, so providing residential or postal address means contact may not be possible in practice.

Only supplying contact details for the former franchise location is unlikely to satisfy the requirement under the Franchising Code to provide 'contact details' where the former franchisee no longer operates the business.

Under the Franchising Code franchisors must give a prospective franchisee a disclosure document at least 14 days before entering into a franchise agreement. The contact details of former franchisees must be listed in the disclosure document. A former franchisee can opt out if they don't want their details listed, but the franchisor must not influence them to do this.

Franchisors

Review the contact details of former franchisees in your disclosure documents so that it is not difficult for prospective franchisees to make contact.

Franchisees that have realistic expectations are likely to be more satisfied with their franchise experience.

If you are not disclosing contact details then you must have evidence of the former franchisee opting out.

If you're thinking of buying a franchise

You are unlikely to get a realistic idea about franchising without talking to former franchisees.

Most small business owners in Australia have a personal mobile and email address. If phone numbers or email addresses of former franchisees aren't in your disclosure document or it is difficult to contact them, this can be a big warning sign to walk away.

Franchising can be very different to other types of business. If you aren't taking the time to contact former franchisees you should reconsider franchising altogether.

Most franchisors did not adequately disclose what essential goods were subject to supply restrictions



7 out of 12 franchisors did not adequately disclose what essential goods were subject to **supply restrictions**

Franchisors usually control what can be sold through a franchise and where it must be sourced from. Even though they can limit choice for franchisees, such restrictions are usually not against the law.

Under the Franchising Code franchisors must disclose the details of supply restrictions. This allows a person buying a franchise to understand whether or not they can shop around for essential goods before they sign up, amongst other things.

We found 7 of 12 franchisors were not adequately disclosing what essential goods were subject to supply restrictions. This means, for example, someone buying a café franchise can't tell whether they can shop around for coffee beans or whether they have to buy them from a specific supplier. This can have significant consequences for a franchisee's business if they are paying more than their competitors for essential high volume goods.

While most franchisors had terms in their agreements that allowed franchisees to source goods from elsewhere subject to approval from the franchisor, it is unclear how often this happens in practice. The ACCC consistently receives reports and enquiries about supply restrictions from current franchisees.

Franchisors

You need to disclose the details of supply restrictions to franchisees, including what type of goods and services are subject to supply restrictions.

This is particularly important for goods and services that are unavoidable and essential to running a franchise, such as coffee beans in a café franchise.

It is not enough to simply refer to an operations manual or a definition of approved products without actually listing details of the type of goods and services.

If you're thinking of buying a franchise

Supply restrictions are common in franchising and are generally legal.

It is important to know before you buy a franchise whether you can shop around for the goods and services that are important to running the franchise.

If the franchisor doesn't clearly tell you, then you should reconsider the franchise. You should also verify what a franchisor says about supply restrictions by speaking to current franchisees.

If you don't like the idea of supply restrictions then you should reconsider whether franchising is right for you.

Most franchisors had supply restrictions, did not share rebate benefits directly with franchisees, and could set maximum retail prices



Most franchisors had **supply restrictions**, **did not share rebate benefits**, and could set **maximum retail prices**

Franchising can be extremely restrictive and this is often not understood early enough by prospective franchisees.

Of the 12 franchisors we looked at, the vast majority had the following in their franchise agreements:

- restrictions on where a franchisee could source essential goods
- the franchisor received rebates or financial benefits from purchases made by franchisees, and did not share these directly with franchisees
- the franchisor could set maximum retail prices for products sold by franchisees.

These are generally permitted in franchising and are usually legal. However, these three things can combine to limit the capacity of a prospective franchisee to make a profit. While details of supply restrictions have to be disclosed, it will be difficult for prospective franchisees to assess this risk if they don't know what type of goods are subject to supply restrictions. As set out previously, 7 of 12 franchisors did not adequately disclose what essential goods were subject to supply restrictions.

Here is a hypothetical example to demonstrate. A café franchise only permits a franchisee to buy coffee beans from a certain supplier (supply restriction). The price of these beans is more expensive than coffee beans from other sources and the franchisor gets a financial benefit (rebate) every time a bag of coffee beans is sold to a franchisee. This adds to the franchisee's costs of doing business, especially if the rebate isn't shared with them directly. Then, as part of a marketing push, the franchisor limits the maximum price a franchisee can sell a cup of coffee to \$3 (maximum retail price). The franchisee still has to pay the same price for the bag of coffee but the promotion, in combination with higher coffee bean costs, is likely to impact on the profitability of the franchise business.

Details of supply restrictions and rebates have to be disclosed in a disclosure document. The ability of a franchisor to set maximum retail prices does not have to be disclosed in that document, but franchisees should look for such a term in the franchise agreement itself.

Franchisors

Unfair contract term laws apply to many standard form agreements, including in franchising.

Where it applies, you need to ensure that your franchise agreements, including terms covering restrictions, rebates and maximum retail prices don't contain unfair contract terms.

A term may be an unfair term if it causes a significant imbalance in power, goes beyond what is reasonably necessary to protect a franchisor's legitimate business interests and causes detriment to franchisees if it were relied upon.

If you're thinking of buying a franchise

Franchising can be extremely restrictive. In a franchise you won't have the same level of control compared to a business you run independently.

To understand how franchising works in real life call current and former franchisees, and get professional independent advice. Disclosure only tells you about some parts of franchising.

If you don't like the idea of rebates or maximum retail prices then you should reconsider whether franchising is right for you.

Some franchisors aren't sufficiently disclosing key unavoidable costs such as wages, rent or inventory



A third of franchisors aren't sufficiently disclosing **key unavoidable costs** such as **wages, rent or inventory**

It is common for franchises in the food services sector to have key unavoidable costs such as rent, wages, and inventory. These are recurring costs that are an essential part of the business. To get a realistic idea about a franchise these costs and the amounts need to be in disclosure documents.

Of the 12 franchisors we looked at, a third didn't sufficiently disclose inventory, rent and property costs, or labour costs (wages, superannuation). This included referring to wages but not listing any figures, or referring to market rates for lease costs.

If these costs are within the knowledge or control of the franchisor or are reasonably foreseeable, they must be disclosed to prospective franchisees. This is important as payment of costs are often specific terms of a franchise agreement, and inability to pay can result in breaches or termination.

Franchisors must comply with both the Franchising Code and the Australian Consumer Law. Under the Australian Consumer Law a business may be liable for engaging in misleading or deceptive conduct if it makes a representation that is false or misleading. This includes representations made in a disclosure document about estimated future costs.

Franchisors

You must disclose payments a franchisee must make, including to a person other than you or your associate where the costs are within your knowledge or control or are reasonably foreseeable.

For many franchises in Australia costs such as wages, rent and inventory are unavoidable recurring costs.

Disclosure of costs must comply with the Franchising Code and must not be misleading.

If you're thinking of buying a franchise

If wages, rent or inventory are not properly disclosed then you're not getting the true picture of the costs of running a franchise.

You should get independent professional advice about costs for your particular situation. Make sure the advisor has experience providing franchising advice.

Too many people do not get independent advice before buying a franchise



Over 40% of prospective franchisees did **not seek any independent professional** advice before entering a **franchise agreement**

It is not compulsory for persons purchasing a franchise to obtain independent advice, but it is highly recommended.

Under the Franchising Code a franchisor must advise a prospective franchisee to get independent legal, accounting and business advice. A prospective franchisee can choose not to get advice.

For the franchisors we looked at over 40 per cent of prospective franchisees did not seek any independent professional advice before entering into a franchise agreement.

Franchises can have set up and running costs that range from hundreds of thousands to millions, and agreements with very restrictive terms and conditions. Getting advice is very important so the risks and limitations of franchising are properly understood.

Franchisors

Encourage prospective franchisees to get independent professional advice, and give them time to take action based on that advice.

If you're thinking of buying a franchise

Get advice from independent professionals experienced in providing advice about franchising. They will see risks you can't.

You should get legal, accounting and business advice. Getting one type of advice is usually not enough.

Leave enough time between getting advice and signing an agreement to consider if you should still go ahead with the franchise or to negotiate changes.

ACCC assessment

Disclosure of certain information to someone thinking about buying a franchise is a key requirement of the Franchising Code, however this information needs to be useful to a prospective franchisee.

The ACCC found differing disclosure practices across the 12 franchisors. The practices outlined in this report are particularly concerning.

The purpose of a disclosure document is to give a prospective franchisee information to help them make a reasonably informed decision about investing in the franchise, and give current information that is material to the running of the franchised business.

In our assessment we identified many instances where disclosure may fall short of the requirements of the Franchising Code.

What will the ACCC do?

The ACCC enforces the Franchising Code. In line with our [Compliance and Enforcement policy](#) we use a range of tools to encourage compliance and prevent breaches of the *Competition and Consumer Act 2010* (Cth) and the Franchising Code.

We are concerned about the poor disclosure practices identified amongst the group of 12 franchisors, and that these may be indicative of practices within the food services sector or the broader franchise industry.

We are also very concerned about the low rates of advice seeking amongst prospective franchisees connected with these franchisors.

Some disclosure practices we have identified may be a breach of the Franchising Code and/or the Australian Consumer Law.

We are continuing to assess the 12 franchisors and to engage with these traders. In line with our Compliance and Enforcement policy, where we see a risk of widespread small business detriment as a result of disclosure practices, we can take enforcement action.

We have produced this report to encourage better transparency and information for prospective franchisees, and to encourage more prospective franchisees to seek independent advice.

We remind all prospective franchisees that disclosure is only one aspect of considering whether franchising is suitable. The nature of franchising as a business system needs to be clearly understood before committing significant time and money. Another step to take to assist with understanding this is to talk to current and former franchisees.

What can the franchising industry do?

Franchisors are responsible for keeping disclosure documents up to date in accordance with their obligations under the Franchising Code, and are in the best position to improve disclosure practices in the franchising industry.

A successful franchise system relies on the success of its franchisees. Selling a franchise to someone who is not suited to, or doesn't understand franchising risks setting them up for failure. It is in franchisors' interests to be helpful and transparent in their dealings with people looking to buy a franchise and to provide clear and meaningful information in disclosure documents.

The ACCC offers a range of resources for [franchisors](#) and prospective franchisees such as our [Quick Guide to a Franchise Disclosure Document](#) and [short videos](#) to support better disclosure by franchisors and better due diligence by prospective franchisees.

We encourage the franchising industry to use this report to review and improve their disclosure practices.

Prospective franchisees can use this report and other ACCC tools to identify poor disclosure practices and, if necessary, to reconsider the franchise or getting into franchising at all.

If someone is concerned about the practices of a franchisor they can make a report to the [ACCC](#). Each report is individually assessed. While we can't take action in relation to every report, each report allows us to better direct our resources towards addressing the greatest harm.

Franchisee or prospective franchisees with individual disputes can contact the Australian Small Business and Family Enterprise Ombudsman who can assist in the resolution of franchising disputes. See [Resolving franchising disputes](#) for more information. The ACCC does not provide legal advice or individual dispute resolution services. See [What we can and can't do for small business](#) for more information.



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