

## Overview – Franchising sector and the current issues

Franchising is one of the most robust forces in the Australian economy. Representing over \$130 billion in revenue and employing over 700,000 people, the Australian franchise sector has outperformed the economy to date. Recent reports indicate that despite the global financial crisis the sector has recorded positive growth over the last two financial years and expects continued growth for the current financial year.

### Franchising as a Business System

Franchising presents a highly successful format to develop and grow a business despite the current global financial crisis. Franchising can assist a franchisor to build value in their business by:

- assisting businesses to realize a greater level of operational performance;
- producing a higher quality customer experience in the business as the (franchisee) owner has a higher level of day to day involvement with customers and incentive to prioritize customer service;
- making it easier to recruit representatives that are more motivated and focused than employees (franchisees are motivated as an increase in sales, efficiency or increased value in the brand directly impacts their bottom line);
- allowing quick market penetration due to better access to a wider geographic area and increased resources;
- shifting the capital demands of a business to the franchisees.

### Challenges facing the Franchise Sector

Steve Wright, the executive director of FCA commented earlier in the year that “franchise systems typically respond more quickly and effectively to changed market conditions, as the dual dynamic of having franchisor and franchisees close to the market and focused on meeting changed consumer expectations produces a synergistic response.”<sup>1</sup>

Despite this positive outlook, the franchise sector now faces a number of challenges as a consequence of the global financial crisis. According to the PWC Franchise Sector Indicator<sup>2</sup>, the most notable potential impediments to franchised business growth are:

- the difficulty of obtaining finance for incoming franchisees; and
- the scarcity of suitable candidates to be franchisees.

With over 1100 business format franchise systems currently operating in Australia, there are more franchise systems aggressively seeking new franchisees than ever before. Competition to recruit the best applicants as franchisees during the downturn has forced successful franchisors

---

<sup>1</sup> "Franchising showing strong growth in first months of 2009", FCA Media Release, 10 May 2009.

<sup>2</sup> Price Waterhouse Coopers, *Franchise Sector Indicator*, First Edition, September 2009.

to refine their focus to ensure that what they offer to franchisees is financially rewarding and is based on a business that is attractive to the ultimate consumer.

In a climate of economic instability potential franchisees are typically more interested in established franchise brands rather than brands that are new to the market. Franchisees see established brands as more likely to be financially stable and successful. Despite this, franchisors with established brands have not reported any significant increase in the quantity or quality of inquiries from prospective franchisees. This is because in comparison with previous periods of economic downturn, the current global financial crisis has not resulted in the same number of capable workers being made redundant, armed with redundancy payouts, ready and eager to invest in franchise systems.

## Coping with the Financial Crisis

The franchising sector has not escaped the reach of the global financial crisis. A number of high profile franchise systems have collapsed in the last 12 months including Kleins, Kleenmaid, Samsara and Beach House. Commentators have been quick to highlight both the shortcomings of the individual franchisors and the risks involved in business format franchises.

It has been reported that it is the action of the Australian franchisors that have enabled the majority of the sector to both survive and thrive in these difficult times. Instead of reducing marketing budgets, cutting staff numbers, delaying critical capital expenditure or passing on costs to franchisees, franchisors appear to have taken a hands on approach to help their franchisees. In stark contrast to the typical cost cutting attitude of the less stable non-franchise small business models in Australia, franchisors are helping their franchisees navigate the economic downturn by:

- assisting franchisees to increase consumer demand;
- closely monitoring franchisees for signs of financial distress;
- increasing marketing expenditure where possible;
- negotiating better deals from suppliers (including landlords); and
- focusing on improving franchisee recruitment.

Norm Hunt, co-founder of the Cold Rock Ice Creamery franchise which had revenue of \$27.54 million for the 07/08 financial year, said that he believes the formula for franchising success is based on a franchisor's relationship with its franchisees and commitment to keeping everyone happy<sup>3</sup>. This sentiment is echoed by Simon Crowe, whose Grill'd burger franchise entered the BRW Fast Franchise List 2009 at rank #6, demonstrating an impressive 87.55% growth spurt over the past three years. Crowe is reported to have revealed that the secret to franchising success revolves around the people, the brand and the product<sup>4</sup>. Crowe says that his achievement stems from his careful approach to franchisee selection and his subsequent provision of franchisee support through good branding and services.

While franchisors are not recession-proof, franchised businesses are universally considered less risky than start up businesses. This is because in a franchised business the franchisee has

---

<sup>3</sup> Blackie, T 2009, 'One More Time', *Business Review Weekly*, 29 January 2009, viewed 21 September 2009 at <http://www.brw.com.au>

<sup>4</sup> Blackie, T 2009, 'One More Time', *Business Review Weekly*, 29 January 2009, viewed 21 September 2009 at <http://www.brw.com.au>

access to a well established brand, training, on-going support and a tried method of operating the business.

The franchising sector continues to evolve and improve. Recommendations borne out of the recent state and federal inquiries into the franchising sector calling for the Government and other industry participants to develop and fund a comprehensive pre-franchise education program provide evidence of the sector's effort to minimise its risks. These inquiries have brought greater attention to the franchising sector and will ultimately result in better protection for franchisees.

## Plans for expansion

Franchisors expect their profits to increase by up to 24% over the next 3 years, and that they will need to employ more staff to keep up with expected demand<sup>5</sup>. Current surveys suggest that franchisors will focus on domestic growth and development through franchisee recruitment, multiple unit franchising and expanding their product and service range, rather than international opportunities and acquisitions which typically gain momentum in times of economic boom.

Previously, strong performing franchise systems regularly tried to buy similar networks as a means of expansion. BRW reported that while 69% of franchisors have been approached by potential buyers, only 6% of the franchisors approached planned to sell in the next 24 months (majority basing their decision on the global financial crisis)<sup>6</sup>. The preferred approach is to outlast the economic downturn and maximise the projected growth in the foreseeable future.

There have been some voluntary sales and acquisitions in the franchise sector. Franchisors hoping to acquire other franchise systems at a bargain price, as a result of the economic slowdown, will need to reconsider the price they are prepared to pay to attract interest from mature successful systems or shift their focus to newer, smaller systems.

## Looking to the future

Despite the global financial crisis, the outlook for Australia's franchising sector remains upbeat as it continues to make a vital contribution to the national economy. The franchising sector is confident that the government position is relatively supportive. Short of any unforeseen significant change to the current regulatory environment, franchising is set to carry on this upward course.

For enquiries regarding this  
handout, please contact:

**Anna Trist | Senior Associate | Middletons**  
Level 25 South Tower, 525 Collins Street, Melbourne VIC  
3000, Australia  
T: (03) 9640 4381 F: (03) 9205 2055 M: 0409 856 641  
anna.trist@middletons.com  
[www.middletons.com](http://www.middletons.com)

*This material is copyright and may not be reproduced without permission of the author.*

---

<sup>5</sup> Price Waterhouse Coopers, *Franchise Sector Indicator*, First Edition, September 2009.

<sup>6</sup> Lindhe, J 2009, 'Chains of Gold', *Business Review Weekly*, 29 January 2009, viewed 21 September 2009, <http://www.brw.com.au>