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Franchising Review Secretariat Unit  
Small and Family Business Division  
The Treasury  
Langton Crescent  
Parkes ACT 2600

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Individual submission: Review of the Franchising Code of Conduct

Dear Dr Schaper:

I am an Associate Professor of Marketing at Monash Business School, Monash University, where I have worked for six years. Before my current position, I worked in the United States for ten years. I have a PhD in Marketing from Ivey Business School, Western University, Canada. My research expertise is in the governance of inter-firm relationships and its performance implications. In particular, I adopt a quantitative approach to study how organizations initiate and maintain formal ties (for example, franchisor-franchisee relationships) to improve performance. My research on the governance of inter-firm relationships has been published in the #1 (*Journal of Marketing*), #3 (*Journal of Marketing Research*) marketing journals, and #3 (*Strategic Management Journal*) strategy journals and other well-reputed journals.

My journey to influence public policy started with an initial submission to the Parliamentary Inquiry into the Operation and Effectiveness of the Franchising Code, 2018. Based on my research on franchising, my submission focused on increasing transparency in Australia. "6.24... Dr Sudha Mani informed the committee that research about the relationship between franchisors and franchisees was being conducted on data obtained from overseas ... [Public access to disclosure documents] also enables prospective franchisees to engage in adequate due diligence of more than one franchise system if needed, before engaging with the franchisor. The Report cited my recommendations in six instances, four of which were related to creating a public franchise disclosure registry. Regular engagement with the government from 2018 to 2021 came to fruition in 2021 when the Australian Govt. committed to create the first public mandatory "Franchise Disclosure Registry to enable prospective franchisees to make an informed decision before entering a franchise agreement".

I also made recommendations to amend the Competition and Consumer (Industry Codes – Franchising) Amendment (Fairness in Franchising) Regulations 2021 and Franchising Code of Conduct 2021. Specifically, the Key Facts Sheet and Information Statement related to Schedule 2 of the law include several of my research-based recommendations. I recommended adding information on — the amount of ongoing franchisee payments to franchisors, the number of franchisee-owned outlets, prior franchisor bankruptcy, and how long the franchisor has operated their franchise system in Australia.

I was a Member of the Australian Competition and Consumer Commission's (ACCC) Small Business and Franchising Consultative Committee from January 2020 to Dec 2022. There were four academic members on ACCC's committee, and I was the only one with a non-law background.

In addition to influencing policy in Australia, I have provided my research-based recommendations to the Federal Trade Commission (FTC) on the provisions of the *Franchise Agreements and Franchisor Business Practices* in June 2023. Finally, I regularly engage with the Franchise Council of Australia and its members, and my expert column on franchising has appeared in *Business Franchise Australia and New Zealand* magazine.

The unintended benefit of the registry is that it can inform public policy in other jurisdictions. Before the Australian registry, it was nearly impossible to answer specific questions regarding certain franchisor practices without access to franchise disclosure documents. The FTC, in its review of franchising in June 2023, raised questions about the prevalence of specific provisions in the franchise agreement. I used the information in the Australian Franchise Disclosure Registry to inform U.S. policy. Particularly, the FTC was interested in the prevalence of the following:

- Does the franchisor's standard form franchise agreement allow the franchisor to vary the agreement without franchisees' consent?
- Does the franchise system restrict franchisees from choosing suppliers?
- Are franchisees entitled to compensation for goodwill in the business?
- Are franchisees subject to a restraint of trade (or similar) clause?

Increasing transparency in Australia also paves the path for better franchise regulations in various Asian markets, which do not have franchise-specific regulations.

## **Recommendations in response to Q 9. of the Review.**

### *Franchisee bankruptcy (insolvency) disclosures*

My co-authors and I have published<sup>1</sup> a large-scale study of over 1100 franchisors over ten years using franchise information from the United States in the *Journal of Marketing Research*. In this study, we find that current-year franchisee bankruptcy (insolvency) significantly increases the likelihood of other franchisees filing for bankruptcy in the subsequent year. A brief summary of the findings and implications can be found here

- <https://www2.monash.edu/impact/articles/buyer-beware-greater-bankruptcy-disclosure-required-for-franchisees/>.

Compared to franchisor bankruptcy, which receives adequate media attention and is also noted in the Franchise Disclosure Documents, information on franchisee bankruptcy is hard to find. In the U.S., all civil and criminal cases are in a searchable court database (PACER). We used this database in our research to find franchisee-related bankruptcy. Our efforts identified 7,242 franchisee bankruptcies across 761 franchise systems, as some systems had zero franchisee bankruptcies.

Despite access to the court database, finding franchisee bankruptcy is a complex process because franchisees are independent entities with their own business names. This makes it very difficult for prospective franchisees to identify insolvent franchisees (and their locations) using publicly

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<sup>1</sup> Kersi D. Antia, Sudha Mani, and Kenneth H. Wathne (2017) Franchisor–Franchisee Bankruptcy and the Efficacy of Franchisee Governance. *Journal of Marketing Research*: December 2017, Vol. 54, No. 6, pp. 952-967.

available information. The difficulty of finding information on franchisee bankruptcy is challenging in Australia, as well.

**Recommendation 1:** I recommend that the franchise disclosure document in section 4.1 should be modified, and franchisors should also report the number of franchisee bankruptcies (insolvencies), if any, with location. This information would provide evidence of systematic churning, if any.

#### Role of franchisee associations

Franchisee associations play a pivotal role in fostering mutual support between franchisors and their franchisees. They improve communications between the parties. In this context, a franchisee association acts as a cohesive group that can support franchisees and negotiate on their behalf. This collective strength can help mitigate the power imbalance in franchisor-franchisee relationships.

**Recommendation 2:** I recommend that the Franchise Disclosure Registry include information on the franchisee association. Is there an active franchisee association? And, what per cent of franchisees are members of this association? This will provide additional information on the franchisees' ability to negotiate with the franchisor on an ongoing basis.

#### **Recommendations in response to Q 19. of the Review.**

##### Franchise Disclosure Registry

The Franchising Code of Conduct ensures “fairness and transparency in the franchisor-franchisee relationship.” The Franchise Disclosure Register has increased transparency, especially for prospective franchisees in Australia. However, there is a greater need to communicate the registry's availability so prospective franchisees can access it before making a decision. I am concerned that very few prospective franchisees are aware of the registry and how they can put it to use.

**Recommendation 3:** I recommend that the ACCC, the Australian Small Business and Family Enterprise Ombudsman, and relevant industry associations actively promote the availability of the Franchise Disclosure Registry. Availability of the registry can also be promoted at franchisee recruitment events.

##### Public access to franchise disclosure documents and contracts

The Review has raised some very good questions: How effective are the requirements of the Franchising Code that ensures franchisors make information available to franchisees prior to entry into a franchise agreement? Or, how have the changes to the unfair contract terms laws impact franchise agreements? And, how effective are the 2021 reforms which restricted franchisor's capacity to require a franchisee to undertake significant capital expenditure? Or, how have changes to unfair contract terms laws impacted franchise agreements?

The public disclosure registry is a step in the right direction. However, further action is needed to provide clear answers raised in this Review. At this stage, the registry offers summary

information so that we can document the prevalence of certain provisions. Unlike the U.S., where the disclosure documents and the franchise agreements are public, at this stage, only 60 franchisors/ master franchisees have provided the disclosure documents. In comparison, there are 1,719 franchisors/ master franchisees listed on the registry as of September 25, 2023. Therefore, we cannot offer any research-based evidence on the effectiveness of changes to government regulation at this stage. Or assess the veracity of the summary information provided by the franchisors.

Areej Alshamrani's PhD thesis<sup>2</sup> examines how franchisees' roles and responsibilities and flexibility in a contract affect franchisor growth. She studies over 350 U.S. franchise contracts and uses the state-of-the-art machine learning algorithm (Bidirectional Encoder Representations from Transformers – BERT) to code the contracts. On average, there are 170 clauses on franchisee's roles and responsibilities. In contrast, references to franchisors offering flexibility to franchisees are limited to only 18 clauses in a contract. She finds that contracts are overwhelmingly about franchisees' responsibilities and provides evidence of the one-sidedness of franchise contracts. However, these findings are limited to franchises in the U.S.

Increased transparency through public availability of disclosure documents and contracts will benefit various stakeholders:

1. Prospective franchisees can compare franchise systems and make an informed decision.
2. It will create better institutional norms for franchisors and help weed out offenders and improve the sector's credibility.
3. It will enable not-for-profit institutions, researchers, and policymakers to study Australia's franchise systems to prevent future harm and make effective recommendations that help improve the sector.

**Recommendation 4:** I recommend public access to the disclosure documents and contracts.

I am happy to discuss these recommendations and thank you for your kind consideration.

Kind regards,  
Sudha

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<sup>2</sup> Alshamrani, Areej, Sudha Mani, Shanfei Feng (2022) Effective Franchise Contracts: The Role of Contractual Relational Norms, Editors: Paul Harrigan and Greg Brush, *ANZMAC Conference 2022 Proceedings*, ANZMAC.