



Submission to the Australian Government Franchising Taskforce

Franchising sector reforms Regulation Impact Statement

Contents

1 Introduction.....	2
1.1 About the Accommodation Association.....	2
1.2 About the Accommodation sector.....	2-3
1.3 About Franchising in the Accommodation sector.....	3-5
2 Policy Response to Regulation Impact Statement	
2.1 Principle 1	
2.1.1 Problem 1.1. Disclosure can be hard to comprehend; critical information may be hidden in detail and some information not provided.....	6
2.1.2 Problem 1.2. The reliability of information provided to prospective franchisees may be difficult to assess.....	6-7
2.2 Principle 3	
2.2.1 Problem 3.1. Disclosures around marketing funds, including how such funds are to be audited and their use reported to franchisees annually	7
2.3 Principle 4	
2.3.1 Problem 4.1. Supplier rebates can lead to conflicts of interest	8
2.3.2 Problem 4.2 & 4.3. Conflicts of interest in the context of capital expenditure and unilateral variations.....	8
2.4 Principle 6	
2.4.1 Problem 6.1. reasonable exit arrangements may or may not be perceived to be available or accessible for some franchisees.....	9
2.4.2 Problem 6.3. There are different expectations around the treatment of goodwill in franchise arrangements.....	9
3 Conclusion.....	9-10

1.0 Introduction

The Accommodation Association of Australia is pleased to provide the following submission to the Franchising Taskforce in response to the call for submissions on the Franchising Regulation Impact Statement.

We note the comprehensiveness of the Parliamentary Joint Committee on Corporations and Financial Services report into *'The operation and effectiveness of the Franchising Code of Conduct'* and welcome the committee acknowledgment 'that many franchisors have developed franchise systems that operate to the mutual benefit of the franchisor and their franchisees'. We also note in the same paragraph of the report, the stated intent of the committee 'to avoid imposing unnecessary burdens on franchisors who treat franchisees fairly'.

The tourism accommodation sector operates a wide range of franchising models, from providing hotels with a toolkit to maximise the potential of their investment, by leveraging branding and distribution strengths to full-service integration.

This submission seeks to provide greater clarity on franchising in the tourism accommodation sector to ensure that there is recognition that a 'one size fits all' policy response has the potential to reduce investment, particularly in regional areas.

We are cognisant also of the view from the Committee that the franchise association input was largely biased towards franchisors and seek to ensure that our feedback considers the franchisee viewpoint. In that context we welcome the opportunity to respond to the core principles outlined in the Regulation Impact Statement.

1.1 About the Accommodation Association

The Association is the peak body representing 3,500 accommodation operators and over 100,000 rooms across Australia. Members of the Accommodation Association include major hotels, resorts, motels, motor inns, serviced and holiday apartments, bed and breakfasts and guesthouses that directly contribute \$6.6 billion in GVA to the Australian economy.

Our members include a number of chains who have franchising, either wholly or as part of their operations. These include AccorHotels; Intercontinental Hotels Group (IHG); Hilton; Wyndham Hotel Group; Choice Hotels and Quest Apartment Hotels. Pro-Invest, a franchisee of IHG and a significant investor in hotels, is also a member of the Association.

About the Accommodation sector

The accommodation sector is a dominant player in the tourism industry with \$6.6 billion directly contributed in GVA in the 2017-18 year and 88,800 people directly employed in the sector¹. In 2018-19 a total of 296,452 rooms and 5,535 properties made up the sector (50% hotels and resorts; 21% motels, guest houses; 25% serviced apartments).²

¹ TRA, State Tourism Satellite Account, 2017-18

² TRA, Accommodation Monitor, 2018-19

	Rooms 2018-19	Properties 2018-19	Revenue 2018-19
Hotels & Resorts	147,657	1706	\$7,853 million
Motels/Private Hotels/Guest Houses	61,436	2221	\$2,143 million
Serviced Apartments	74,266	1228	\$3,539 million

Source: STR Accommodation Monitor 2018-19

Conservatively there are over 500 franchised tourism accommodation properties in Australia with approximately 32,000 rooms³. Of this number nearly 300 hotels and 15,000 rooms are in regional areas of Australia, testament to the importance of franchising for regional investment and employment.

However, the recently released TRA report *'Tourism Businesses in Australia'* pointed to a decline in accommodation businesses in the period between June 2013 and June 2018.

TABLE 1: CHANGE IN BUSINESS NUMBERS BY INDUSTRY, JUNE 2018 ON JUNE 2013

	Share of total businesses	Small (0 to 19 persons)	Medium (20 to 199)	Large (200 or more persons)
	(%)	(No.)		
Accommodation	4.2	-356	-50	-12

The report points to the fact that *'Despite increased tourism activity, this industry has seen a reduction in business counts over the last five years, likely due to the less regulated sharing economy. Further, platforms such as Airbnb allow individuals to provide accommodation services without registering as a business, which means these additional services are not included in national business counts'*.

The short-term rental accommodation industry in Australia has been permitted to grow with minimal transparency and regulations. While the recent ATO data matching is ensuring that individual providers are now required to pay their fair share of tax, various levels of government throughout Australia are doing little to put in controls around safety, amenity and protection of consumers. Additionally, this part of the economy does not contribute to the growth in employment.

Franchising on the other hand is a legitimate, highly regulated global business model that has been an important contributor to the attraction of investment, the growth of accommodation options in Australia and the growth in employment.

1.3 About Franchising in the Accommodation sector

The franchising expansion model in the accommodation business was launched by Holiday Inn (UK) campaign in the 50's of the last century, but until the 80's it was rarely used for expansion (McGuffie, 1996). Today, the franchising model of expansion is confirmed by the success of individual global networks: Marriott International, Wyndham Hotels, Choice, Accor, IHG and Hilton.

³ STR AMPM report 03122019

Recommendation 1

The franchising model is critical to encouraging continued investment in accommodation in Australia from well-respected brands in a way that ensures strong employment and dispersal beyond capital cities into secondary cities and regional Australia.

However, over-regulation can harm the franchising model in the accommodation sector, therefore as an industry association we would advocate strongly that for the sake of the minority it should not be necessary to over burden the majority.

These companies all operate a range of models inclusive franchised, managed, owned or licensed properties. Importantly they are all highly regulated and abide by Fair Work Principles. The majority of hotel chains in this sector have a global footprint. As a result, there are a number of significant advantages for the franchisee inclusive of a variety of world-recognised brands in a variety of price segments, access to information networks, reservation systems, loyalty and marketing programs. Franchisors also provide access to training programs and advice on expected service standards.

As outlined in a 2017 research study⁴ on the Franchising expansion model as it relates to three of the hotel chains – Hilton Hotels, Marriott International and Wyndham Worldwide Corporation, their success is based on a number of key factors. They have a solid reputation, well recognised brand, and a commitment to a culture of service delivery, mission and values. Expansion is based on ‘adherence to high standards of service quality, careful recruitment, franchisee perceived as an equal partners and well-earned client loyalty....’.

Most of these hotel chains are publicly listed companies that have shareholders they report to. Therefore, reputation is paramount and there are significant controls in the way they operate and manage franchising. One of these controls is the robust and thorough franchisee selection processes put in place, as well as the transparent communication processes to support the partnership.

Examples – Global Franchise Chains

Choice Hotels

Choice Hotels International (NYSE: CHH) is one of the largest and most successful accommodation franchisors in the world. Choice currently franchises more than 7,000 hotels, in more than 40 countries and territories. Choice Hotels does business under the following primary Choice Hotels trademarks among others: Comfort Inn, Comfort Inn & Suites, Comfort Suites, Cambria Suites, Quality Inn, Quality Inn & Suites, Quality Suites, Quality Hotel, Quality Resort, Clarion Hotel, Clarion Inn, Clarion Inn & Suites, Clarion Suites, Clarion Resort, Clarion Collection Hotel, Sleep Inn, Econo Lodge and Ascend Collection.

Its flagship brands include Comfort Inn, one of the largest limited-service brands with about 2,400 properties; and Quality Inn, which serves the midscale hotel segment through more than 1,200 locations. Its Econo Lodge chain offers lodging primarily for budget-minded travellers.

There are close to 200 Hotels across Australia, primarily in regional areas.

⁴ ‘Franchising model for expansion of the international travel business’, Oleksandr P. Krupysk, Nataliia V. Stukalo, Naliya, A Karsnikova and Ylina A. Falko (2017). *Problems and Perspectives in Management*,

Examples – Global

Accor

Accor is a global hotel operator & franchisor, as well as a market leader in Europe, Latin America, Middle East & Africa and Asia Pacific. They currently operate 2,520 hotels under direct management contract and an additional 2,380 hotels under franchise contract. Accor operates in nearly 100 countries with approximately 280,000 employees worldwide.

Accor offers the largest brand portfolio in the hotel industry, ranging from the most affordable to the most luxurious. Their brands are international, standardised or non-standardised, regional and adapted to local markets. Brands include Pullman, Sofitel, Novotel, Mercure, MGallery, Quay West, The Sebel, Ibis, Ibis Styles, Ibis Budget and Grand Mercure.

Franchising has been an integral factor in Accor's development in the past few decades and is a key priority for the future. Franchisees benefit from access to 153 million Loyalty members and over 400,000 Accor Plus members in Australia, a dedicated sales team, powerful distribution and more. Almost 50% of Accor franchises are in regional Australia.

<https://www.accorfranchise.com.au/Becoming-an-Accor-Franchisee/What-you-Get>

IHG

IHG® (InterContinental Hotels Group) [LON:IHG, NYSE:IHG (ADRs)] is a global organisation with a broad portfolio of hotel brands, including InterContinental® Hotels & Resorts, Kimpton® Hotels & Restaurants, HUALUXE™ Hotels and Resorts, Crowne Plaza® Hotels & Resorts, Hotel Indigo®, EVEN® Hotels, Holiday Inn® Hotels & Resorts, Holiday Inn Express®, Staybridge Suites® and Candlewood Suites®.

IHG franchises, leases, manages or owns more than 5,000 hotels and 742,000 guest rooms in almost 100 countries, with nearly 1,400 hotels in its development pipeline. IHG also manages IHG® Rewards Club, the world's first and largest hotel loyalty programme with nearly 94 million members worldwide.

Franchisees benefit from a powerful loyalty programme and strong reservation system. IHG also provide a comprehensive set of tools such as revenue management and marketing programmes to drive business and new demand.

<https://www.ihgplc.com/about-us/how-our-business-works>

2.0 Policy Response to Regulation Impact Statement

2.1 Principle 1

Prospective franchisees should be able to make reasonable assessments of the value of a franchise before entering into a contract with a franchisor

2.1.1 Problem 1.1 *Disclosure can be hard to comprehend, critical information may be hidden in detail and some information is not provided*

As outlined above, Franchising Models in the accommodation sector vary considerably from investing directly and paying royalties to accessing a menu of marketing, technology and distribution advantages.

We support common sense recommendations that are aimed at ensuring transparent disclosure of financial information where the franchisee buys into a business. Ensuring that franchisees are making an informed decision about the business they buy into is central to a good working relationship however we would recommend that the information provided is not prescriptive because assessing value means different things to different franchisees.

For example, Pro-Invest as part of their portfolio, build, operate and manage Holiday Inn Express franchises in Australia. Holiday Inn Express is a brand franchise of IHG. In their view, from a commercial perspective, 'entering into a franchise which accesses the brand equity and distribution of a global brand is far more important than obtaining financial statements of the local entity'.

In terms of other hotel chains where the model is largely brand services that the franchisee opts into, once again the requirement for financial information is largely moot, as they are not actually buying the business. In fact, they have often been operating an existing business before entering into a franchising arrangement.

Recommendation 2

Option 1.1.1 The accommodation sector supports the existing disclosure document format as prescribed by the Franchising Code. The industry believes that the disclosure requirements in the Code are comprehensive, without being prescriptive and importantly broadly follow the same framework used worldwide.

2.1.2 Problem 1.2 *The reliability of information provided to prospective franchisees may be difficult to assess*

As outlined above there is no one size fits all franchise agreement in the hotel sector. In many global hotel chains, the agreement and investment range are determined by the hotel's location, guest room configurations, amenities, and specific build out. The royalties vary subject to the nature of the property.

In others, there are a menu of options that the franchisee can opt into. Ultimately a national franchise register, because of the variations in agreements, could result in confusion and more importantly may be misleading because of the limitations on inclusions.

Recommendation 2

Option 1.2.1 The accommodation sector supports the Status Quo. The existing provisions relating to the disclosure of financial information about the franchisee business ensure that the prospective franchisee is reasonably informed about the business investment decision.

Option 1.2.3 We support the encouragement of pre-entry education for franchisees where warranted and endorse options being available to potential franchisees.

2.2 Principle 3

Each party to a franchise agreement should be able to verify the other party is meeting its obligations and is generating value for both parties.

2.2.1 Problem 3.1 *Disclosures around marketing funds, including how such funds are to be audited and their use reported to franchisees annually*

All franchisors and franchisees in the accommodation sector viewed this as critical. All franchisees want to know where their contributions are going and how the money is being used.

The Franchising Code states the brand fund can only be used for *legitimate marketing or advertising expenses*. Hotel chains advise that best practice here is audited statements of the sales and marketing fund with many chains undertaking quarterly reviews. Additionally, franchisees can meet with the franchisor representative to obtain an update on local and regional sales and marketing activities.

However the understanding of what is a legitimate marketing or advertising expense can vary, with one chain pointing to the fact that while they have co-operative marketing campaigns for managed hotels, they no longer do for franchised hotels, as with co-operative campaigns it is difficult to provide a direct accounting of return on investment on an individual basis.

There is agreement that it is in both the Franchisor and Franchisee's interest to ensure that the partnership is as transparent as possible.

Recommendation 3

Option 3.1.1 The accommodation sector supports the Status Quo with the need to have an undergoing review of 'legitimate marketing or advertising expenses'. Additional case law is important to assist in providing clarity on the latter.

Option 3.1.3 The sector works diligently to ensure transparency but supports any additional guidance around legal obligations on the use of marketing funds.

2.3 Principle 4

A healthy franchising model fosters mutually beneficial cooperation between the franchisor and the franchisee, with shared risk and reward, free from exploitation and conflicts of interest.

2.3.1 Problem 4.1 *Supplier rebates can lead to conflicts of interest*

The issue of supplier rebates is well understood in the industry with some chains providing supplier rebates while others choose not to.

The group purchasing effectiveness of a franchisor is often pointed to as a source of competitive advantage. If the price is competitive and the franchisee has the opportunity to opt in, the disclosure of the amount of rebate should not be material.

Recommendation 4

Option 4.1.1 In relation to the accommodation sector, the association maintains there should be not changes to the Franchising Code in relation to supplier rebates.

2.3.2 Problem 4.2 & 4.3 *Conflicts of interest in the context of capital expenditure and unilateral variations*

The imposition of capital expenditure requirements on accommodation businesses lies in a franchisee's compliance to brand standards. It has been suggested that even if some franchise agreements 'may' require a franchisee to hold an FF&E reserve fund, it is unlikely that this is verified by the franchisor who does not have access to a franchisees P&L or balance sheet. Ultimately, the obligation to comply to the brand standard and pass an annual brand audit is the way by which franchisors ensure their brand and reputation is protected.

The industry points to the need to be flexible in responding to changes in the business environment and ensuring franchisees are competitive in an industry which is consistently being disrupted. In discussions with industry they point to the fact that the introduction of new brand standards comprises a lead in period to achieve compliance and in certain cases a waiver process (or alternative arrangements) exists depending on the circumstances of individual properties.

Recommendation 5

Option 4.2.1 The association would not support a change to current regulatory settings, which would limit the flexibility to be more competitive and meet changing consumer needs. While education around legal rights and obligations is important, it points to the importance of the franchisor/ franchisee relationship and commitment to the brand.

2.4 Principle 6

Franchisees and Franchisors should be able to exit in a way that is reasonable to both parties

2.4.1 Problem 6.1 *Reasonable exit arrangements may or may not be perceived to be, available or accessible for some franchisees.*

Most franchise agreements specify the ability of an owner being able to terminate “without cause” or upon sale or novate the franchise to an incoming purchaser. Compensation in these circumstances is negotiated in advance as part of the commercial terms prior to the franchise application being lodged.

Industry would not support the breadth of the proposed circumstances where a franchisee may be able to terminate (including circumstances such as hardship), as this would significantly impact the ability of the franchisor to make long term investment decisions. Given most of these franchisors are publicly listed companies that operate globally, the protection of the brand and the customer experience is critical and provisions that encourage easy exit for the franchisee would not be in the interests of the business long term.

The accommodation sector is extremely competitive, and it is not in the interests of the franchisor to have a poor partnership with the franchisee. It is in the interest of franchisors and franchisees to ensure that the termination terms and processes are clarified and agreed in advance of any contract being signed.

Recommendation 6

Option 6.1.1 The association would recommend that franchisee exit rights are determined primarily by the franchise agreement itself (with the exception of the right to ‘cool off’ (Principle 2)) and the general law relating to the termination of contracts.

3.0 Conclusion

The Association and our members appreciate the ongoing consultation with industry. We understand the well-publicised issues that have arisen in franchising and resulted in this inquiry and seek to differentiate the tourism accommodation sector.

As outlined above, franchising in the tourism accommodation sector is dominated by largely global, publicly listed brands that have strong corporate governance. As with other sectors, franchising has proved successful in enabling these brands to grow their footprint.

Yet the statistics demonstrate that in Australia, franchised properties currently represent only 10% of total accommodation stock with potential to grow further. This contrasts with the short-term rental accommodation industry that has been permitted to grow with minimal transparency and regulations

Importantly franchising has been critical in the investment in regulated tourism accommodation product regionally and the employment of staff. However, over-regulation can harm the franchising

model in the accommodation sector, therefore as an industry association we would advocate strongly that for the sake of the minority it should not be necessary to over burden the majority.

As outlined in the submission above, we overall support the current regulatory settings. While further clarification may be needed in some areas such as '*legitimate marketing or advertising expenses*' and education around legal rights and obligations remains important, the industry constantly refines governance. This is a recognition that damage to the brand will impact the whole property portfolio.

We therefore look to work with government to encourage further growth in the regulated tourism accommodation sector in Australia, adding to the visitor and resident facilities available in destinations and increasing employment.