



Consider this: you are a potential franchisee with significant cash resources and excellent business skills. You have narrowed your franchising decision down to two alternatives. As part of your due diligence review, you ask both franchisors for details of their corporate governance frameworks.

Is a lack of governance costing your business?

Andrew Harvey

Managing Director – Optimum Assurance Group Pty Ltd

Franchisor A provides you with a document revealing:

- Its operations are governed by an independent board of directors, comprised of individuals with a balance of skills and experience appropriate to the nature and extent of the franchise operation;
- The roles of the board and senior management are separate and well-defined;
- Among other things, the board reviews compliance with relevant legal requirements and monitors the ongoing solvency of the business;
- The franchisor has a code of conduct governing the behaviour of its senior management team, ensuring standards are maintained in areas such as managing potential conflicts of interest, business ethics, employment practices, community relationships, and privacy;
- The franchisor has a formal process for receiving and dealing with franchisee complaints, which is monitored by the board on a monthly basis;
- The franchisor has a formal risk management policy in place which identifies, assesses, monitors and manages business risk; and
- Remuneration of senior management is overseen and approved at board level.

After much prompting, Franchisor B provides the following information:

- Its operations are governed by the chief executive, who is also the franchise founder and sole shareholder;
- The chief executive is responsible for ensuring compliance with relevant legal standards and for monitoring the ongoing solvency of the business;
- The senior management team report directly to the chief executive;
- There is no formal code of conduct in place outlining the behavioural standards expected of managers;
- The chief executive is responsible for setting the remuneration levels of all staff, including his own;

- Franchisee complaints are dealt with by the manager they are initially directed to. There is no formal process for monitoring the successful resolution of these complaints; and
- Business risks are identified by the chief executive and his management team on an ad-hoc basis.

All other things being equal, it is clear that most potential franchisees would be much more comfortable investing their hard-earned money in an operation run along the lines of Franchisor A.

The unfortunate reality is that some franchise operations are more closely aligned with the Franchisor B model.

A competitive advantage

Some franchisors reject suggestions to improve their governance processes on the basis that it will be expensive and time-consuming to implement an appropriate governance structure.

This is not necessarily the case – there are some excellent free resources available which can help a business design and implement an appropriate model (see sidebar).

Franchisors need to consider the consequences (present and future) of not having appropriate governance structures in place. Are they losing potential business to competitors who provide franchisees with greater confidence and security?

Are they putting themselves and their assets at risk because of legislative non-compliance? Ignorance, time pressures or good intentions are not acceptable excuses for regulators.

Self-made, entrepreneurial franchisors need to ask themselves – are the skills they relied upon to develop their small business into a franchisable operation sufficient to manage and control an infinitely more complex and demanding business?

The Australian franchise market is mature and sophisticated. The days of franchisors making a killing via large up-front franchise fees are long gone. In order to achieve long-term financial success, franchisors will need to develop robust operating models, which will include solid information and management systems, tailored franchisee training programs, and an appropriate governance framework.

Existing and potential franchisees and their advisors, wary of well-publicised failures such as Kleins, will become increasingly interested in the underlying business practices of the franchisor. How will your business stand up to this type of scrutiny?

Governance 101

The dozen or so franchises that are listed companies are guided by the Australian Stock Exchange corporate governance principles. These principles include:

- Lay solid foundations for management and oversight;
- Structure the board to add value;
- Promote ethical and responsible decision-making;
- Safeguard integrity in financial reporting;
- Make timely and balanced disclosure;
- Respect the rights of shareholders;
- Recognise and manage risk; and
- Remunerate fairly and responsibly.

Although there is currently no regulatory requirement for other franchisors to adopt formal governance principles, all business owners should familiarise themselves with these principles, and consider adopting them for their own operations.

Accountants and other business advisers are able to offer specific advice to franchisors wanting to explore their options further.

Into the future

The recent explosive growth of the Australian franchising sector has been a double-edged sword. Opportunities for entrepreneurs abound, and the community as a whole has developed a general understanding and acceptance of the franchising concept; yet this increased visibility brings with

it an increased expectation that the sector will conduct its affairs in accordance with corporate best practice.

The development of the Franchise Code of Conduct has been a key factor in providing a clear and transparent framework for the conduct of the sector's participants. Recent State and Federal government enquiries and cases such as *Ketchell* highlights the continuing focus the sector receives and the need for continued evolution of the sector's regulatory framework.

As part of this ongoing evolution, the sector may wish to consider taking proactive steps to develop a non-prescriptive governance model for franchisors.

Without doubt, the shrewdest operators will be developing their own governance models, regardless of any regulatory pressures.

For more information on how to set up appropriate governance structures within your business, visit www.oagroup.com.au or call 08 7129 4463.

Other Resources

ASX – Corporate Governance Principles and Recommendations

<http://www.asx.com.au/supervision/governance/>

CPA Australia – Information and services relating to Corporate Governance

http://www.cpaaustralia.com.au/cps/rde/xchg/SID-3F57FECA-AF69AA54/cpa/hs.xsl/875_ENA_HTML.htm **TFR**

Correction: Andrew Harvey was incorrectly referred to as Andrew Hill in the May 2008 edition of TFR. We apologise for any confusion this may have caused.



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