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How is franchising driving business growth?

Private Clients
Franchise Sector Indicator
August 2011
Third Edition

Listening to Australia's franchise sector

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In the 1980s husband and wife team Terry and Rhonda White began franchising their Terry White Chemists business. To help grow the business, they sold the franchisor rights to a third party in the 90s. However, as the years went on, ownership changed hands several times and the White's felt the brand was not reaching its potential. In 2005, with the advice of their Private Clients team, they, as part of a group of seven pharmacists, began negotiating the buy back of the franchisor rights. Now thanks to their vision, and our ongoing advice, Terry White Chemists is a household name with hundreds of stores nationally. The future is certainly looking healthy.

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Franchise Sector Indicator
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Highlights

Strong growth has exceeded targets set for 2010

Overall, the sector has performed extremely well compared to the broader economy and has delivered on the double digit growth objectives it set last year. This is a significant achievement in a difficult economic year, and further evidence of the robustness of the franchise business model.

Sector optimistic about short to medium-term prospects

Franchisors continue to forecast double digit revenue and profit increases over the next three years. However, the sector is being more conservative in its growth plans, preferring to place more emphasis strategically on pursuing organic growth than overseas expansion and acquiring other businesses.

Consumer confidence predicted to have an impact

For the first time since the *Franchise Sector Indicator* commenced three years ago, franchisors have highlighted consumer confidence as a key factor that may affect their growth; reflecting concerns surrounding retail performance and the current uncertainty in global markets.

Key challenges remain recruitment and franchisee funding

Finding new talent and obtaining funding remain key challenges for franchises of all shapes and sizes. Franchisors have begun addressing these challenges through a greater focus on initiatives to attract new franchisees; and are looking at innovative ways to assist prospective franchisees access finance.

New tactics adopted to attract a younger set

Despite identifying recruitment of franchisees as a key issue impeding growth, in 2010 over 50 per cent of franchisors had not changed the way they attracted franchisees. However in 2011, 70 per cent had made changes. These changes include specific initiatives aimed at the next generation of franchisees, Gen Y.

Multi-site operators fundamental to sector's growth plans

Multi-site operators represent a tremendous opportunity for franchisors to solve the difficulties of finding suitable franchisees and, potentially, issues associated with new franchisees obtaining funding.

Online retailing and use of social media on the increase

Franchisors are increasing their online presence to assist with brand building and coverage. Use of social media is continuing to increase with franchisors finding it to be a powerful tool to improve and strengthen customer awareness and loyalty.

Greg Hodson
National Lead Partner – Franchising
PwC

I'm pleased to present the 2011 PwC Private Clients *Franchise Sector Indicator*, an annual survey providing insights into Australia's franchise systems, the challenges being faced and their future opportunities.

This year's *Franchise Sector Indicator* continues the trend of the past two years, telling the story of another year of excellent growth. The sector has achieved what some thought were ambitious targets set in 2010, and has performed particularly well when compared to the broader economy.

This is further evidence that franchising's four key ingredients of a proven and replicable business model, business operators (franchisees) who have 'skin in the game', extensive operational and marketing support for those operators and the branding, marketing and buying leverage that comes from strength of numbers, result in better than average financial returns.

Delivering on the double digit growth objectives set last year is a significant achievement in a difficult economic year. What's more, most franchisors are relatively optimistic about their short to medium-term prospects, and are forecasting double digit growth over the next three years.

However, it is interesting that franchisors seem to be a bit more circumspect than they were in the 2010 *Franchise Sector Indicator*. Short to medium-term growth forecasts, whilst remaining optimistic, are lower than they were in 2010. A greater proportion of franchisors are planning to focus more on the organic growth of the business in the next few years, with a reduced percentage planning to go overseas and fewer looking to grow through acquisition.

This increased conservatism amongst a very optimistic sector is no doubt the result of the slower than expected economic recovery from the GFC. This is emphasised by the fact that consumer confidence is now a significant factor listed by franchisors as a potential impediment to growth with 61 per cent of respondents seeing this as an issue.

Unsurprisingly, given the high levels of employment in Australia and the ongoing global financial market turmoil, franchisors continue to list finding suitable new franchisees and access to funding for franchisees as their key challenges.

In relation to finding suitable franchisees, franchisors are trying new approaches, with 70 per cent of respondents indicating that they had made changes to their recruitment processes since 2010.

Introduction

The sector is becoming increasingly active in trying to attract Gen Y as franchisees, with more than half of the franchisors using specific recruiting tools in a bid to attract this group, compared to only 38 per cent in 2010. An example is the Baker's Delight Fast Franchisee program aimed at bringing potential franchisees through the employee ranks – you can read more about this on page 12 within the report.

Another key area for franchisors to look for new franchisees is, in fact, existing successful franchisees from within their network. The results tell us that on average, only 11 per cent of units are owned by multi-unit owners and that most franchisors believe they have another 15 per cent of their network who could become multi-unit owners. Whilst there are many franchisors who continue to question whether multi-unit ownership will just create more problems for them, it seems to us that many of the perceived issues can be overcome if franchisors adopt a specific strategy and approach to multi-unit ownership.

In relation to funding, it is surprising that only 38 per cent of all franchisors (including just 33 per cent of the larger retail franchises) have their systems accredited with banks – a staggering 75 per cent of smaller systems are not accredited. This is perhaps an indication of the difficult and time-consuming accreditation process adopted by the banks, and also the fact that over the past few years, banks have been inconsistent in their approach to lending to the franchise sector. This presents a huge opportunity for a financier to 'get it right'.

The majority of banks seem to be locked into a lending approach for the sector which was developed years ago and needs an overhaul. It does not make sense that the sector continues to outperform the rest of the business community, and has many risk-alleviating attributes and yet banks make it more and more difficult for franchisees to get funding.

There has been much discussion over the past 12 months regarding the effect of online on traditional forms of business. Although 34 per cent of franchisors are utilising online retailing, they are using it to build brand awareness and increase coverage and not as a tool to compete with their franchisees. They are certainly focussed on the importance of the web and other tools to the success of their business with 23 per cent saying they are looking to increase their online retailing activities over the next 12 months.

The results also revealed some interesting points on training of franchisees. Little training in the way of business management and leadership training currently occurs. The majority of training focuses on day-to-day operational issues. We believe that as the sector continues to mature and grow over the next few years, franchisors should be considering changing their current training methodologies. This will help attract better franchisee candidates and assist in franchisees become better business people with more of them being able to run more than one franchise unit. The Franchise Council of Australia is very focused on education programs within the sector and there are many service providers who can assist with "filling the gaps" in leadership and business management education.

With three years' worth of results under our belts, the PwC Private Clients *Franchise Sector Indicator* continues to demonstrate that franchising is a robust business model which can withstand the swings and roundabouts of a turbulent economy. Whilst many within the sector would like to see more assistance from the government (in relation to supporting funding for franchisees and finalising the uncertainty around State and Federal legislation), it is evident to us that the sector also needs a brand overhaul. There needs to be a programme telling the success stories of franchising, and painting the picture of it as a career and a way to create wealth for the next generation. The sector needs to remain relevant to the person looking to run their own business in a relatively safe environment, but it also needs to attract more professional and skilled investors who look at franchising as a serious business investment strategy. If the sector can deliver on this it will ensure its continued growth and its position as a vital part of the Australia economy.

Greg Hodson
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On behalf of the Franchise Council of Australia (FCA), I am delighted to welcome the third edition of the PwC *Franchise Sector Indicator*. This publication gives us valuable insights into the state of the franchise sector in Australia, the challenges many are facing, as well as the opportunities and untapped potential of the franchise model.

Steve Wright
Executive Director
Franchise Council of Australia

The 2011 survey results are very encouraging. While there is a lot of doom and gloom about small business and particularly retail small business, what this research shows, consistent with the 2009 and 2010 reports, is that the franchising sector continues to perform extremely well.

Franchisor projections in 2010 were quite bullish, so to have achieved growth targets in worse conditions than were anticipated at the time of this survey last year is quite an achievement. These results indicate that a 'downward adjustment' to 2010 predictions has not been necessary in 2011, that's not only reassuring; it is a terrific vote of confidence in the franchising model, as well as the management capability in established brands.

A key issue is the survey finding that the majority of systems still do not have bank accreditation. Given that banks expect a demonstrated return on investment, and that accreditation can be the deciding factor in whether franchisees are able to access funding, there is clearly more work required to make sure our systems are giving themselves the very best prospect of getting funding for expansion.

The fact that the survey has also found that a majority of franchisors have been providing training in sales but not in business management is also a matter that warrants focus. The FCA's role in this area is opportune, and we are working to ensure that relevant financial and other business management training can be provided in tandem with system training. Providing this kind of ongoing support to franchisees can be a competitive advantage for well-managed systems, and something we believe more potential franchisees will be looking for in the future.

Online retailing and web presence is also an important area, and our FCA event program this year will have a much greater focus on dealing with competition and tactical marketing online – in fact, this will be a major theme at our national conference in Melbourne in October.

Introduction

It is also very heartening to see that 73 per cent of systems are reporting that franchisees received the full revenue generated from online sales.

While the results of the 2011 *Franchise Sector Indicator* reinforce the contribution of franchising to the economic health of the nation, if governments are expecting to see this continue, they will have to look at ways that they can contribute – a need reflected in the 67 per cent of franchisors who would like to see more funding support from government.

Franchising has always been a strong performer; with increased support, we can ensure that Australia does not miss out on the potential for a faster return to growth in small business. I hope that all stakeholders get behind the sector so that it continues to be as strong as possible.

> *"A key issue is the survey finding that the majority of systems still do not have bank accreditation."*

Methodology and sample

The PwC *Franchise Sector Indicator* is based on a survey conducted by independent market researchers and analysts, ACA Research. During July 2011, ACA surveyed the owners and key executives of 92 franchise systems with 20 or more individual franchise units.

The sample was selected to understand current trends in the market, the challenges confronting established Australian franchise systems, and what they are doing in response.

We estimate that the number of responses represents around 30 per cent of all franchise systems with 20 or more units currently operating in Australia.

The questionnaire comprised set questions across a range of business areas to obtain a sample-wide perspective on each trend and challenge.

56 per cent of respondents were from non-retail franchise systems and the remaining 44 per cent are retailers. 61 per cent had between 20 and 99 franchise and company-owned units, with the remaining 39 per cent having 100 or more.

Figure 1: Distribution of businesses by industry sector

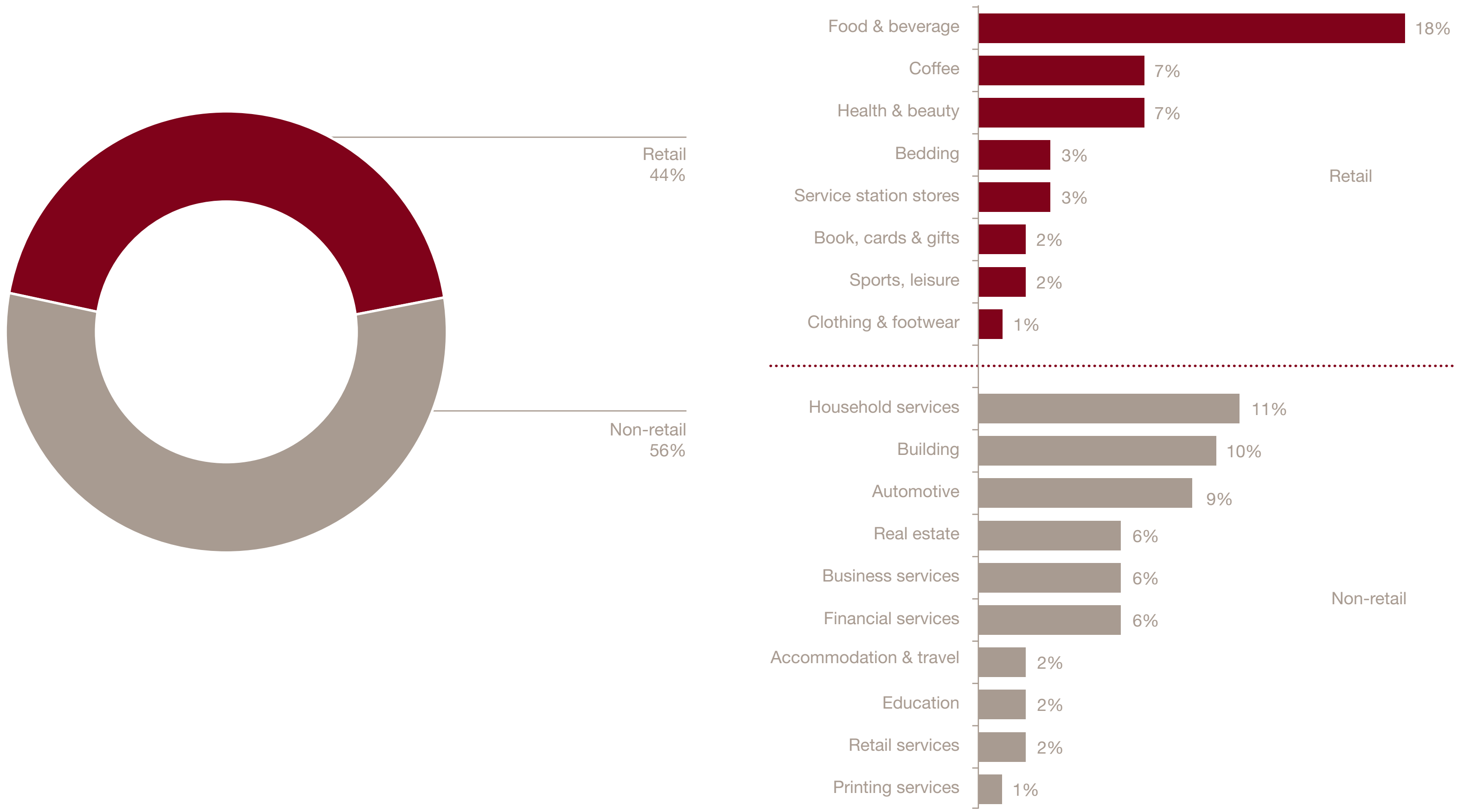


Table 1: Median turnover	
Median	**$'000**
Franchise system	39,000
Franchisor	6,000
Franchisee (average)	555

Table 2: Median turnover by size and sector

Median value	Total number of units (franchise & corporate)		Sector	
	20-99 ($'000)	100+ ($'000)	Retail ($'000)	Non-retail ($'000)
Franchise system	18,000	125,000	45,000	27,500
Franchisor	3,936	31,500	13,750	4,021
Franchisee (average)	725	425	745	329

Retail franchisees had over double the median revenue of non-retail franchisees.

Stores in Australia	**615**
% franchised	**97%**
Multi-site operators	**24%**
Sales globally	**$600m**

Growth plans

New products and expansion in Canada (currently 73 stores)

Recruitment tactics

Fresh Franchisee Program, multi-site operators

Bakers Delight

We're for real.

> "Last year, we had one of our strongest years as a business globally, particularly driven by growth in our Canadian market."

As a mature franchise with 700 sites and $600 million in sales in Australia and Canada, Bakers Delight General Manager Australian Operations Chris Caldwell was delighted with last year's 'solid single digit growth' for the company.

"We had a very profitable performance by our Canadian business, which drove the EBITDA of our consolidated global business quite strongly. In Australia, we managed to achieve top line sales growth, which we were very excited about."

Caldwell attributes the banner year in Australia to the massive rebranding exercise Bakers Delight undertook over a number of months, pushing the 'We're for Real' message.

"The Bakers Delight brand had been around in Australia for 30 years; our positioning hadn't changed for 11-12 years. We were getting fairly clear messages back through research that our brand was a bit tired, and needed to be contemporised.

"The 'We're for Real' platform came out of one of our existing business philosophies, which is real bread, real people, real delight. So it was about getting back to basics, and reminding customers what it is about Bakers Delight that makes us the best quality product in the market."

The campaign included rolling out seven new television commercials, six websites, 2,500 unique pieces of point of sale, new uniforms for staff which are about to be launched into market, and a range of incentive programs for franchisees to ensure "we brought them along on the journey".

The need to keep the brand fresh and contemporary also comes from the ongoing challenge of finding new franchisees.

"I'd love to say that recruitment is not a problem for Bakers Delight, that we've got that all completely covered, but of course we haven't," Caldwell says. "I think it's an issue across all businesses and all industries, it just gets highlighted in franchising because it's not just a staffing issue – we are looking for people to run the business."

Bakers Delight have a range of programs to encourage new franchisees, including their Fresh Franchisee Program which currently has around 100 participants, at least half of whom are likely to end up owning a franchise.

> *"The Fresh Franchisee Program is about fostering young talent within our network, and is one of our key methods of responding to the recruitment challenges faced by the franchising industry."*

"Some of them will come in and they will already have the funds behind them, which we encourage. If they don't have the funding, but they've got a strong history with us and we know the site they are going into is a good match for them, there are a range of ways we can assist them.

"They might lease the business from us for a period of time, and during that period they pay part of the operating profit back to us. They get to keep the balance of the operating profit, which they can use towards a deposit to buy that business. Occasionally we will offer vendor finance to the right people into the right bakery."

Caldwell says that if they find a new site, they are more likely to talk to the surrounding franchisees and encourage a single-site operator to take on another site, or an existing multi-site operator to add another bakery to their portfolio.

"I'm not an advocate for opening a new bakery and putting in a new franchisee, because you are doubling your risk. The new operator may not be up to it, or the site may not turn out to be as strong as you hoped. We just don't need to take those risks, because we'll have existing operators in the area that will probably want to take that on.

"In Canada, it's a different story. Because we're expanding rapidly in Canada at the moment, if we find a great site, we'll take it, and we're now backfilling with franchisees, generally company employees.

"It's exactly the same model we used in Australia, it's just at a different stage of its life cycle. In Canada, it's about 50% franchised and 50% company-owned, whereas Australia is around 97% franchised."

Caldwell is optimistic that the brand can do at least as well in Canada as it has in Australia.

Despite the difficult economic environment, franchisors have once again met or exceeded growth targets set in 2010, indicating franchisors were realistic in their goals and executed their growth plans effectively.

Overall, and especially compared with the private business sector as a whole, the franchise sector has performed strongly – providing further evidence of the robustness of the franchise business model.

Over the last 12 months, on average, franchisor revenue has increased by 17 per cent and franchisor profit has increased by 22 per cent – outperforming last year's forecasts of 13 and 18 per cent respectively.

Franchisee revenue increased by 12 per cent (exceeding last year's forecast of 10 per cent) and profit increased by 13 per cent (meeting last year's forecast).

As a comparison, the ninth edition of the PwC *Private Business Barometer* showed that private businesses estimated their sales grew by an average of six per cent and profit by seven per cent over the previous 12 months.

Figure 2: Estimated versus actual growth over the last 12 months

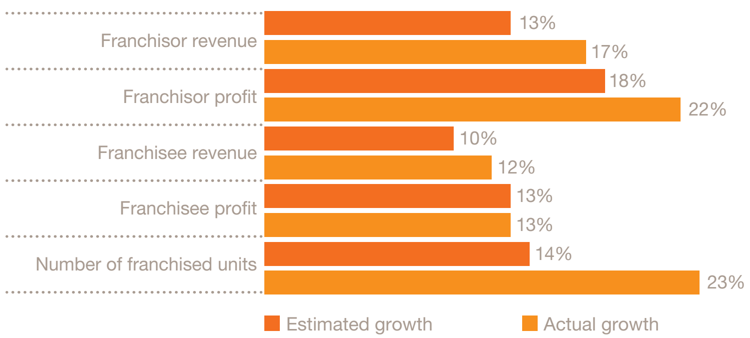


Table 3: Mean growth over past 12 months

	Total number of units (franchise & corporate)		Sector	
	20-99	100+	Retail	Non-retail
Franchisor revenue	23%	9%	22%	12%
Franchisor profit	27%	15%	26%	18%
Average franchisee revenue	13%	11%	11%	13%
Average franchisee profit	13%	11%	13%	12%
Number of franchised units	35%	9%	36%	9%

Growth through innovation

There have been some fantastic stories of successful innovation driving growth within the franchise sector. In the fitness sector, which some may have previously said was saturated, Anytime Fitness has been a leader in promoting a different business model – twenty-four hour fitness. The exponential growth of this business (discussed in more detail on pages 21 and 22) has proven that even operating models that have existed for a long time can be challenged and the results successful.

Another example of innovation in the sector is with the pizza brands, who have challenged the junk food stereotype by making efforts to achieve the Heart Foundation tick, Halal Accreditation and introduced executive chefs to develop their recipes.

We are also seeing franchisors utilising smart phone check-in capabilities to drive traffic to their stores. 7-Eleven and KFC are using digital coupons to attract customers to their retail stores by offering special deals. Although not a franchise, the Commonwealth Bank are offering vouchers to people who check-in when opening a new bank account at a branch – proving that even non-retailers can take advantage of these mobile capabilities.

Growth

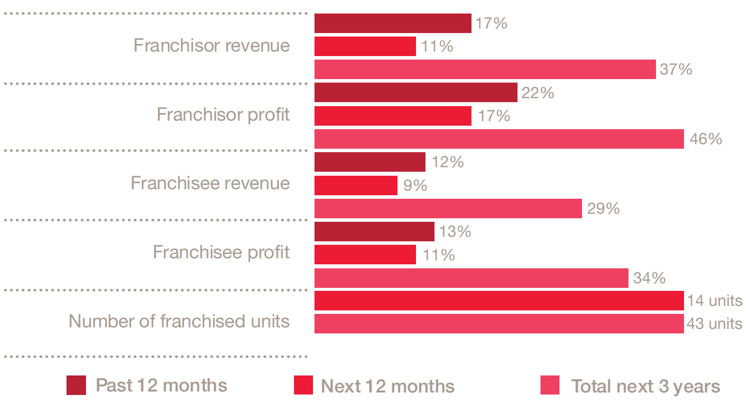
Franchisors remain optimistic about their short to medium-term prospects, continuing to forecast double digit growth.

Franchisors are forecasting revenue growth of 11 per cent for 2012 and 37 per cent over the next three years. Profits are expected to grow by 17 per cent in the next year and 46 per cent over the three year period.

Franchisors believe that franchisees will also perform well over the next three years, with franchisee revenue expected to grow by nine per cent in the next year and 29 per cent over the three year period. Profits are also expected to increase, with an 11 per cent increase in the next year and 34 per cent over the next three years.

Franchisors expect to add an additional 14 franchise units in the coming 12 months and 43 over the three year period. Coupled with the requirement to replace outgoing current franchisees, these growth expectations will again put pressure on franchisee recruitment.

Figure 3: Growth levels – mean percentage growth



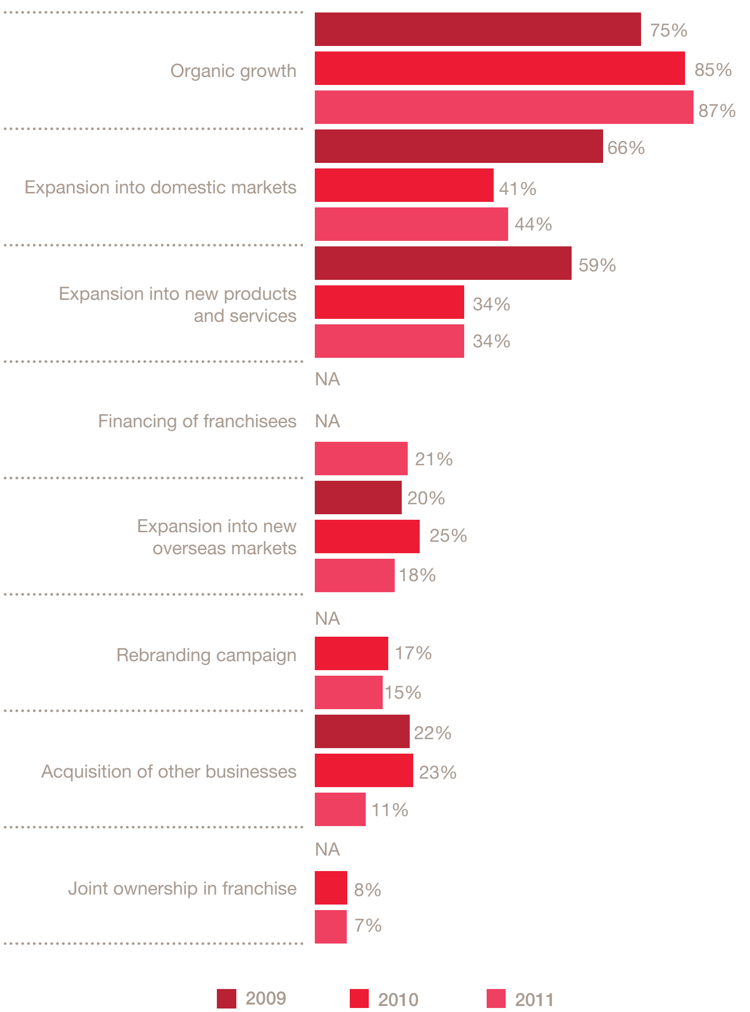
What are the key strategies for the short and medium terms?

Organic growth continues to be the primary growth strategy for the future, again followed by expansion into new markets and diversification into new products and services.

Perhaps reflecting a more conservative approach, only 35 per cent of respondents are looking to go overseas in the next three years, compared with 44 and 47 per cent in the previous two PwC *Franchise Sector Indicators*. Another reflection of a more conservative outlook is a continued reduction in the appetite for acquisition of other businesses, especially in the short term.

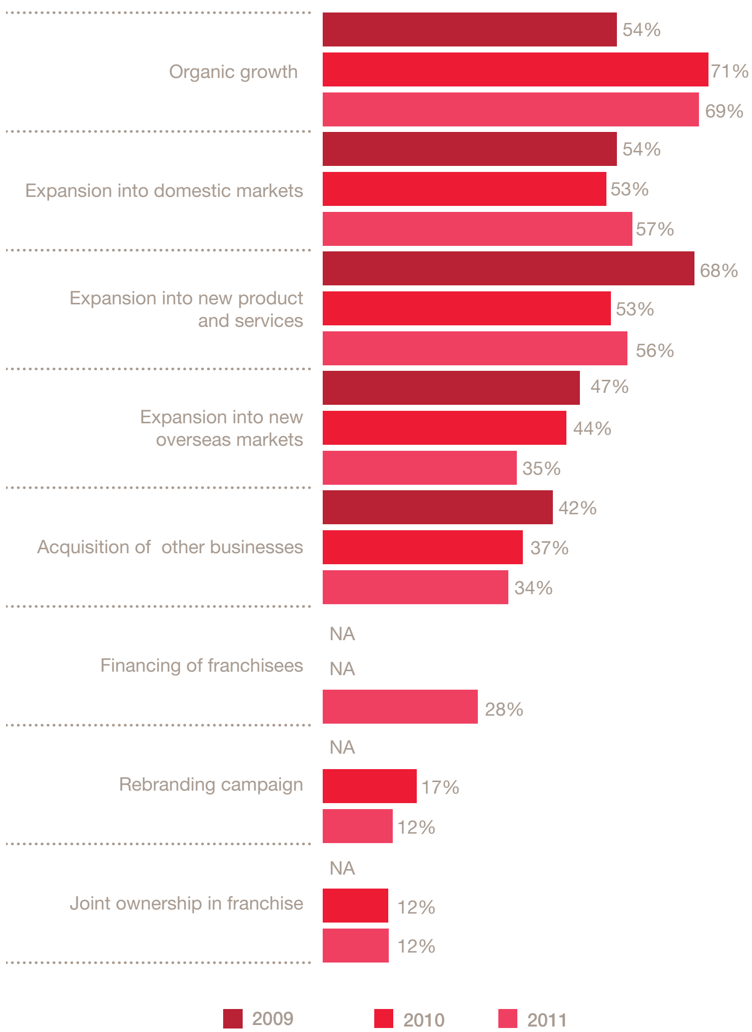
Although slightly more conservative, the sector's projected double digit growth forecasts are signs of a very healthy, confident sector. Franchising would be greatly benefitted by shifting the sometimes pervasive conversation about risk, power and control to highlighting the success and growth of the sector as a significant contributor to the economy.

Figure 4A: Short-term (12 months) growth strategies



Note: percentages sum to more than 100% due to multiple responses
N/A indicates data is not available for this year

Figure 4B: Medium-term (3 years) growth strategies



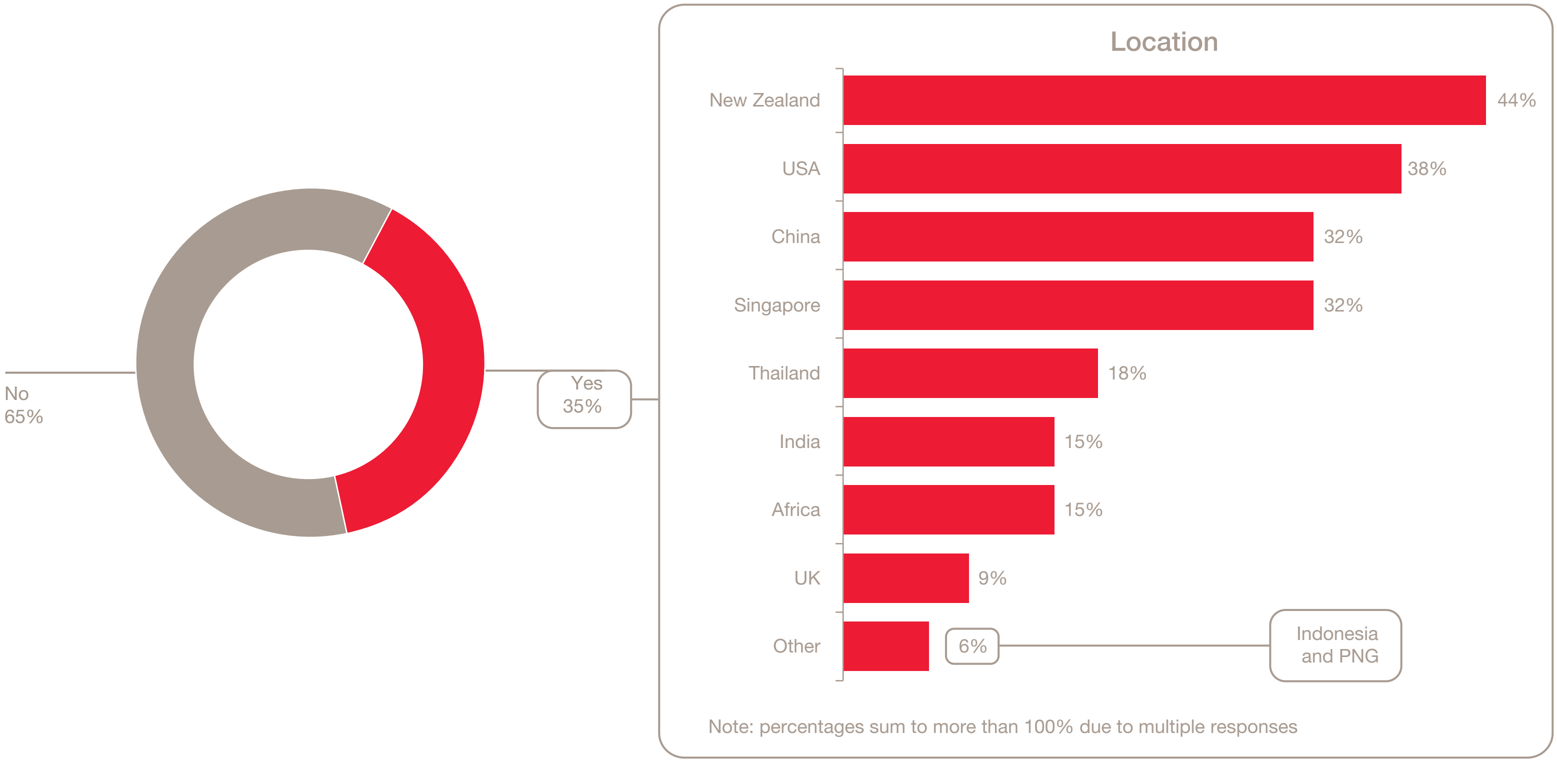
Note: percentages sum to more than 100% due to multiple responses
N/A indicates data is not available for this year

Growth

Whilst New Zealand, the USA and Singapore remain the most popular destinations for expansion, it is interesting to note that a number of the Asian countries are back on the list, notably China, Thailand and India. Franchisors report that they select out-going host countries based on socio-cultural alignment (culture, language, demographics, demand similarities) and the current state of the host economy, reflecting perhaps a desire to minimise risk, time and investment. Therefore, it is not surprising to see New Zealand, the USA and Singapore prominent on the list.

Perhaps greater consideration should be given to broader factors such as future demand, the future state of the economy, and the size of the addressable market in what would be a long-term expansion plan rather than a short-term one. Such an approach generally points to the BRIC economies (Brazil, Russia, India and China) which collectively comprise over 40 per cent of the world's population and are predicted to be among the dominant economies of the future. Entry into these countries involves detailed and diligent planning and targeting, establishment of professional networks of partners and advisors, significant investment and a long-term horizon, thereby may be more suited to large, mature Australian franchise organisations.

Figure 5: Overseas expansion plans (next 3 years)



Sites in Australia	**88**
% franchised	**100%**
Multi-site operators	**50%**
Sales in Australia	**$45m**

Growth plans

Rapid expansion in the short term
– 12 month target of 155 sites

Recruitment tactics

Member and manager referrals,
Google pay-per-click

Jacinta McDonell Jimenez, who, along with her brother, Justin McDonell, launched the US franchise Anytime Fitness into Australia in 2008, says that the low maintenance profile of Anytime means that a high number of franchisees are multi-site owners or are likely to become one.

“Anytime Fitness clubs can run full time with one person, that’s it. It’s a very, very different business model.”

“That was what attracted us to the Anytime model,” McDonell Jimenez says. “My brother and I had a lot of experience running gyms – the traditional full-service, high-maintenance model – and the staffing costs were astronomical.”

The requirement for 24/7 access comes from a unique feature of Anytime Fitness – as the name suggest, clients can access the club any time of day or night. But if they do feel like a midnight or early morning (read 4am) trip to the gym, they shouldn’t expect to find a manager or trainer on site. For much of the day, the business is monitored remotely.

“We have just on 50% multi-site ownership,” McDonell Jimenez says. “Our expectation is that our franchisees will own more than one. That’s just the way we’ve always been, because you don’t have to work the 80 hours a week. It’s very easy to own a second, or third club.”

McDonell Jimenez is surprised at how difficult other franchisors are finding recruitment – at the moment, she can’t keep up with demand. Far from a shortage of leads, their biggest issue is finding enough sites to accommodate them all.

“We have 88 studios opened, but 197 sold. So we’ve got about 110 more due to open in the coming months, and beyond.”

“We don’t have a shortage of franchisees – we have a real estate problem! Our requirements are very different. We need car parking, and 24/7 access, so we can’t be in a shopping centre.”

While franchisors may not have to physically be on-site to run their business 24/7, there is an expectation that the gym owner will be heavily involved in local-area marketing.

“We don’t want them to go and spend $10,000 on a newspaper ad, it’s not what our business is about,” McDonell Jimenez says. “They need to get involved with their local businesses, and people in the community.”

Challenges and opportunities

"Most of them are pretty good, some are better than others – but they all understand from the beginning that local area marketing is what's going to make their business successful."

Social media – in particular the use of Facebook and Twitter by every club in the network – has also been working well as a way of engaging customers, and generating leads for both franchisees and new clients.

"Social media is about creating a community around the club and keeping people connected. I think people are becoming a lot more savvy about Facebook and Twitter even than five years ago, and it's a very low-cost marketing tool. It's also not hard – but you do need to be doing it consistently. Someone has to drive it."

Perhaps partly because she has invested in a US franchise which is tried and tested, so far McDonell Jimenez says she hasn't had any issues with funding. Nor, according to her, have her franchisees. Nonetheless, she is taking the precaution of gaining bank accreditation, a process which, she says, has been "exhausting".

As to why her franchisees aren't having too many issues accessing funding in spite of it being a sector-wide problem, McDonell Jimenez puts it down to the profile of the typical Anytime Fitness franchisee.

> *"[Bank accreditation] is definitely overly complicated. We've been 'nearly there' for three months. I can understand why a lot of franchise systems aren't doing it."*

"I think franchisees now are a lot more savvy in what they are looking for, and more people are thinking, I want to buy a business, not a job. I think that's where we sit in the fact that an Anytime Fitness franchise is a low-staff model, and a very strong business model."

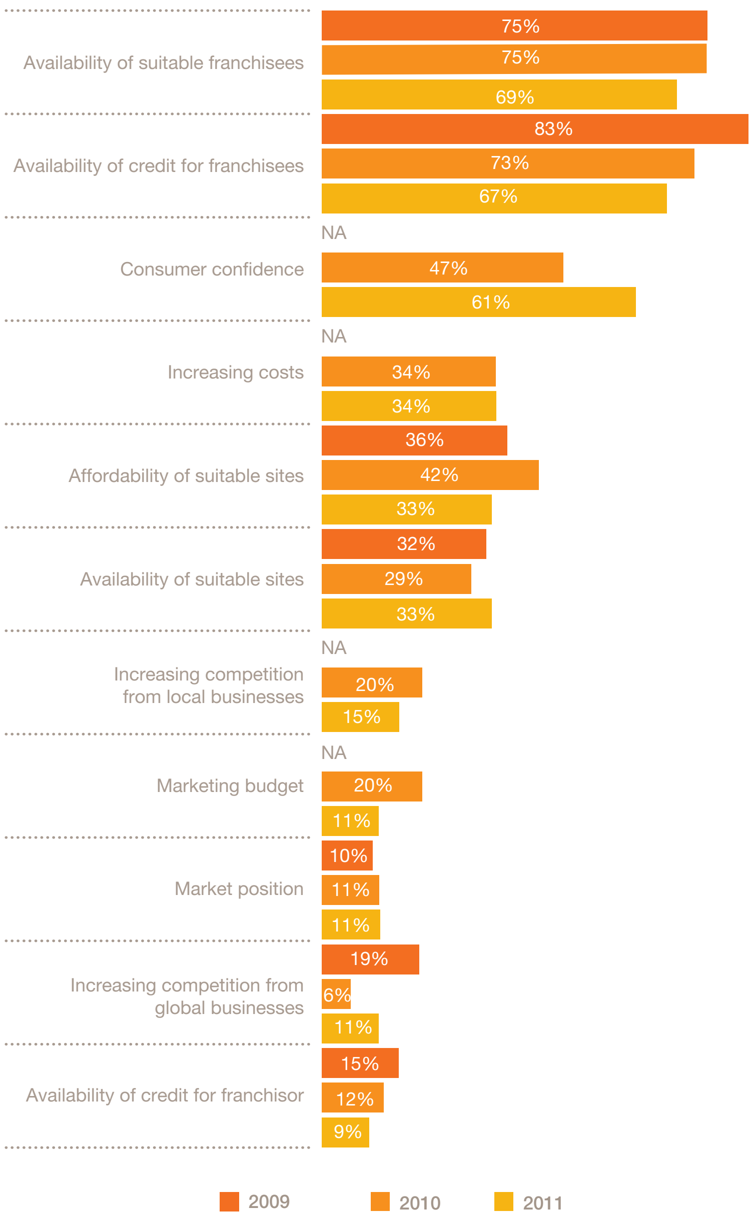
"A lot of our franchisees keep their career as well as have one of our franchises. For others, it's a lifestyle thing – they can travel, spend more time with their kids – they're not bound to the business."

Something must be behind the 70% growth Anytime Fitness Australia experienced last year, and the similar target they've set themselves for 2011.

"We're looking at growing by another 65% in the next 12 months," says McDonell Jimenez. "The first step is to open the clubs that are already sold. Then, in the medium-term, we want to achieve 300 to 350 clubs open. And then we'll see from there."

Finding suitable candidates and obtaining credit for franchisees are still issues many franchisors expect to face when it comes to realising their growth plans. And, increasingly, consumer confidence is becoming a significant concern when planning for the future.

Figure 6: Key challenges to meeting short-term growth targets



Note: percentages sum to more than 100% due to multiple responses

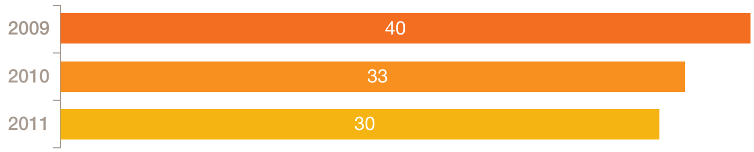
Challenges and opportunities

Franchisee recruitment still a challenge

Despite the consistent levels of growth we have seen in the sector over the past three years, finding suitable franchisees continues to be difficult.

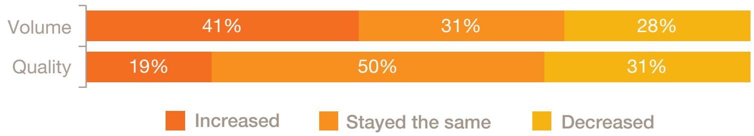
Once again, the volume of enquiries from potential franchisees continues to decrease, with average monthly franchisee enquiries dropping from 40 in 2009 to 30 in 2011.

Figure 7: Average monthly franchisee enquiry



Frustratingly for franchisors, not only are they experiencing a decline in the volume of franchisee enquiries but, 31 per cent also report a decline in the quality of franchisee enquiries. The lack of volume and diminishing quality are no doubt due to high employment levels and also the difficulties faced by franchisees when borrowing, meaning franchisees are unable to meet franchisor's minimum criteria.

Figure 8: Changes in the volume and quality of franchisee enquiries over the past 12 months



Non-retail sector feeling the pinch

The non-retail sector is having particular difficulty generating volume of enquiry (with an average of 22 per month compared to an average of 40 received by the retail sector). This possibly reflects higher levels of employment, as non-retail franchises typically have lower investment requirements and financial returns and are therefore more likely to be compared to what an individual could earn through salaried employment.

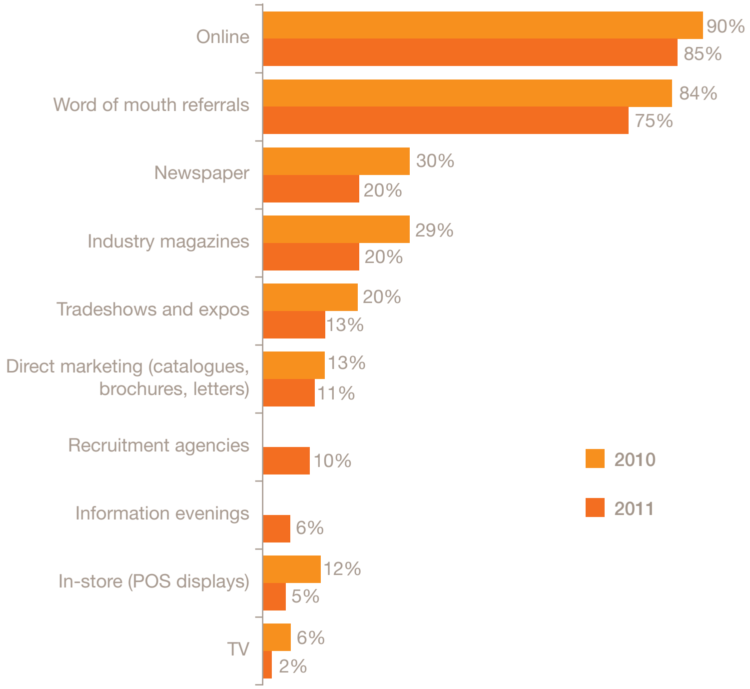
Table 4: Franchisee enquiries per month

	Total number of units (franchise & corporate)		Sector	
	20-99	100+	Retail	Non-retail
Mean	19	48	40	22
Median	6	28	20	6

New strategies adopted to attract franchisees

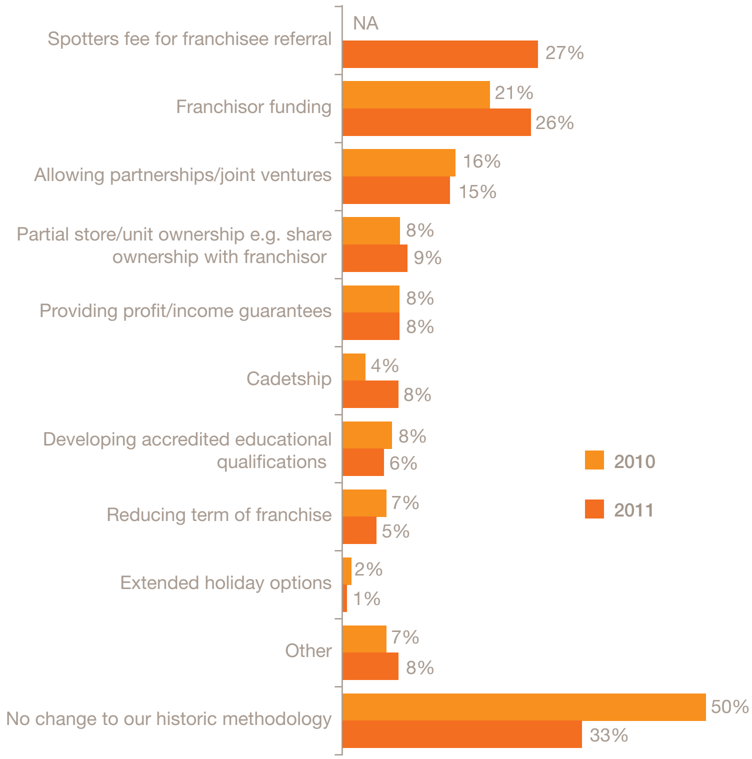
The sector has reported diminishing effectiveness across the board of marketing and promotional initiatives used to attract franchisees. This may be due to a range of factors impacting underlying demand – the clutter associated with some online channels and the proliferation and diversity of marketing mediums, or it is perhaps an indication of broader concern by prospective franchisees about the economy and investing in a business.

Figure 9: Most effective marketing mediums for franchisee enquiries



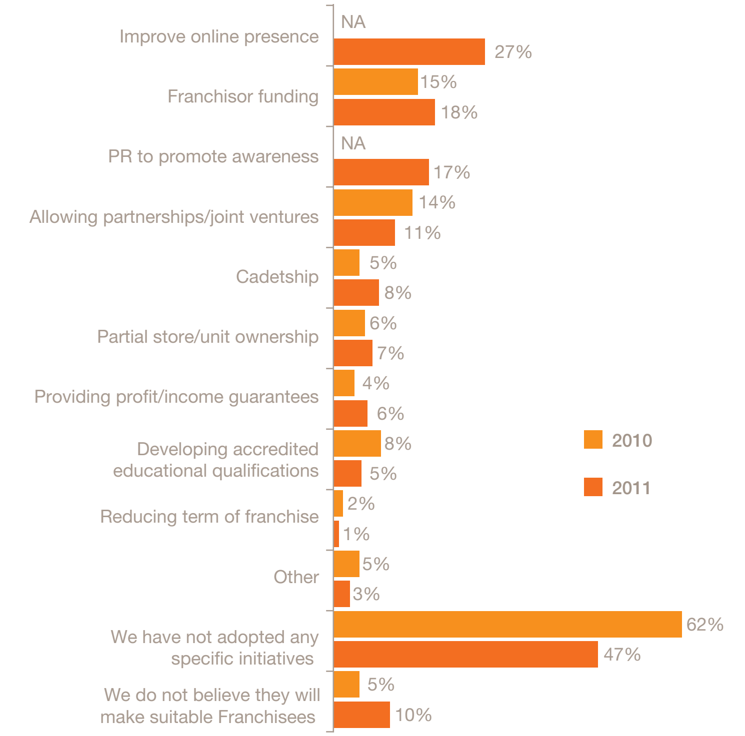
Note: percentages sum to more than 100% due to multiple responses

Figure 10: Initiatives adopted to attract franchisees



Note: percentages sum to more than 100% due to multiple responses

Figure 11: Initiatives recently adopted to attract Generation Y franchisees



Note: percentages sum to more than 100% due to multiple responses

Many franchisors have turned to using spotter fees and offering franchisor funding to attract franchisee candidates.

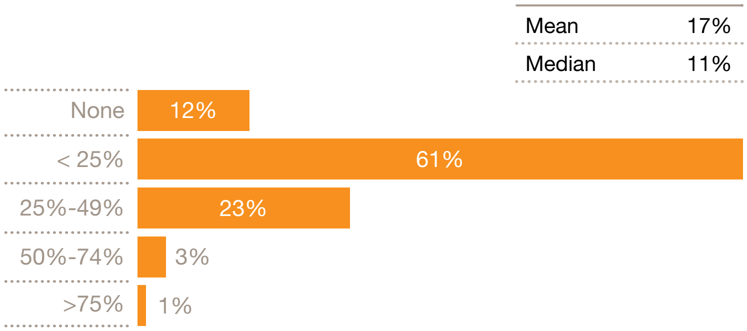
Encouragingly, there is a greater focus on Gen Y, with more than 50 per cent of franchisors now using specific, targeted initiatives to attract franchisees from this age group. Improving online presence, franchisor funding and PR activities are the most common strategies employed to target this group.

Challenges and opportunities

Multi-site franchising has untapped potential

There continues to be an opportunity for franchisors to address their recruitment issues by looking internally at current franchisees to take on additional franchises. Currently only 11 per cent of all franchise units are owned and operated by multi-site franchisees. In contrast, over 50 per cent of all franchise units in the United States are owned by multi-unit franchisees.

Figure 12: Multi-unit franchisees (as a percentage of the total network)

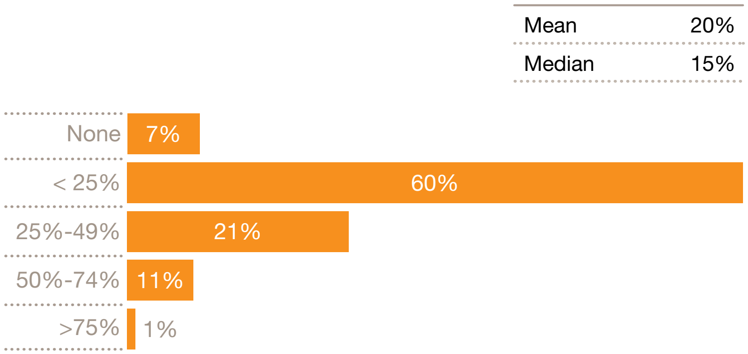


Franchisors have indicated that they believe a further 15 per cent of their franchisees have the potential to become multi-unit franchisees. Given the prevalence of multi-unit franchising in the United States, we would have expected the “potential multi-unit franchisees” to be higher. Perhaps this reflects the type of candidates that have previously been recruited as franchisees who do not necessarily have the capacity to build businesses.

Whilst there are many franchisors who continue to question whether multi-unit ownership will just create more problems for them, it seems to us that many of the perceived issues can be overcome if franchisors adopt a specific strategy and approach to multi-unit owner which would include greater focus during the recruitment process on the potential of the franchisee to become a multi unit owner.

To take advantage of this opportunity, diligent planning is required. Franchisors will also need to increase systematisation, leverage technology, train and develop franchisees beyond the operational level; and provide a more in-depth and qualified level of support.

Figure 13: Single-unit franchisees with potential to become multi-unit franchisees (as a percentage of single-unit franchisees)



In our experience, the majority of Australian franchisees fall into the ‘buy yourself a job’ category, and have expectations of returns above salaried employment, proportionate with the financial risk of their investment and is a key reason for the low penetration of multi-site operators in Australia compared to the United States. In line with addressing the key challenges of talent and capital, an opportunity may exist for targeting and positioning franchise opportunities to more professional and skilled franchisees, who perceive franchising as a means of diversifying a business or investment portfolio.

The United States examples of multi-unit franchisees who are listed on the stock exchange, are an illustration of a professional brand of business builders within franchise networks. Australian franchisor concerns about power and control need to shift to the potential benefits of growth and returns where the strategy is justified.

Funding

Franchisee funding remains a major issue, with banks tightening lending criteria and sending an inconsistent message on their willingness to lend to franchisees.

Bank's reduced risk tolerance continues to be cited as a factor leading to difficulties for franchisees obtaining funding.

Figure 14: Are franchisees having difficulty obtaining funding?

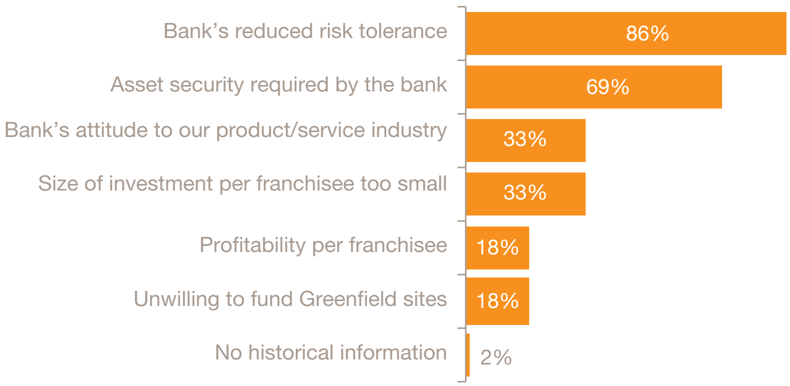
Low rate of bank accreditation – symptom or cause?

Given that franchisors can improve franchisee's financing prospects by having their system accredited by one or more banks, it is surprising that only 38 per cent of franchisors have gone through this process. Smaller systems are particularly unlikely to be accredited (75 per cent are not), perhaps reflecting the difficulties faced by these systems in becoming accredited.

It is particularly surprising that 33 per cent of the large retail businesses are not accredited, as they typically meet the banks' key criteria of scale, proof of concept and capital investment by franchisees.

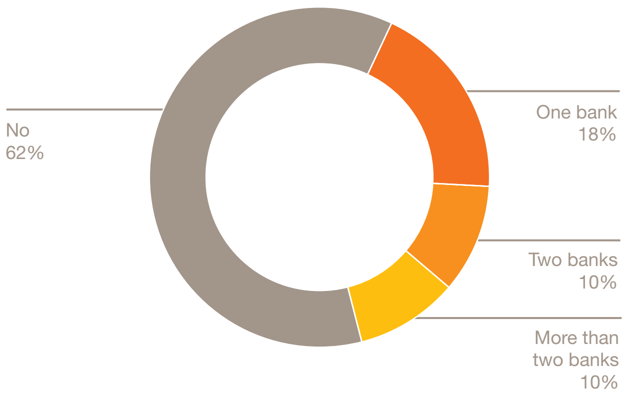
This is perhaps an indication of the difficult and time-consuming accreditation process adopted by the banks, and also the fact that over the past few years, banks have been inconsistent in their approach to lending to the franchise sector. This presents a huge opportunity for a financier to 'get it right'. The majority of banks seem to be locked into a lending approach for the sector which was developed years ago and needs an overhaul. It does not make sense that the sector continues to outperform the rest of the business community, and has many risk-alleviating attributes and yet banks make it more and more difficult for franchisees to get funding.

Figure 15: Reasons why franchisees are having difficulty obtaining funding



Note: percentages sum to more than 100% due to multiple responses

Figure 16: Franchise systems accredited by a bank



Challenges and opportunities

Table 5: Bank accreditation broken down by retail vs non-retail

Retail systems accredited by a bank

Retail sector	Total number of units (franchise & corporate)	
	20-99	100+
Yes	37%	67%
No	63%	33%

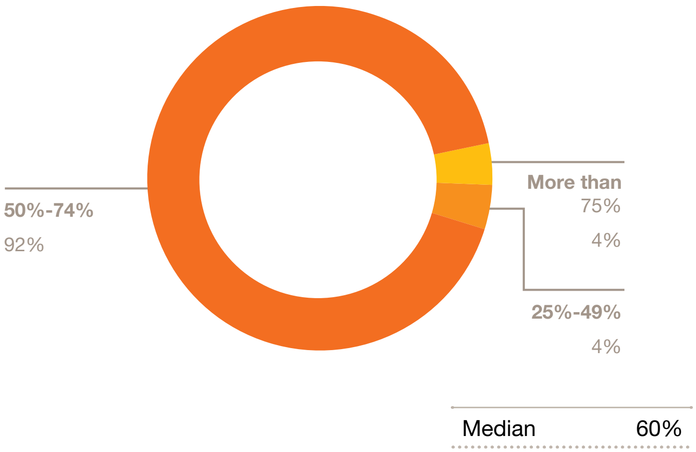
Non-retail systems accredited by a bank

Non-retail sector	Total number of units (franchise & corporate)	
	20-99	100+
Yes	14%	53%
No	86%	47%

Banks limiting exposure to franchise systems

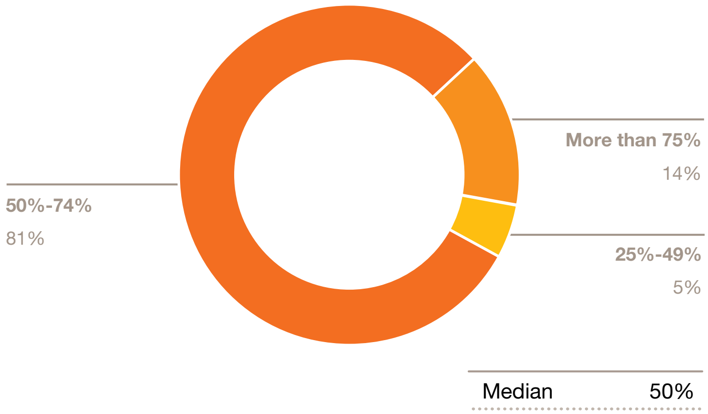
Generally, banks are only willing to lend up to 60 per cent of a franchisee's capital investment in the business.

Figure 17: Percentage of franchisee's set up costs that banks lend



Banks also limit their exposure to franchise networks by agreeing during the accreditation process to lend to an average of 50 per cent of the network. Franchisors can assist franchisees with the funding difficulties by gaining accreditation with two or more banks (currently only 20 per cent of systems have completed this process).

Figure 18: Proportion of a network that banks are willing to lend to



Sales and marketing

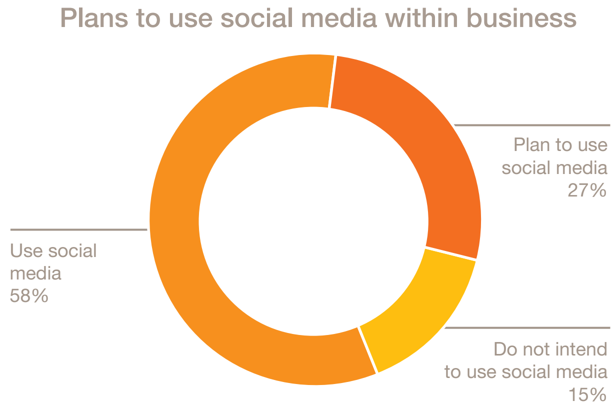
As predicted in 2010, 85 per cent of franchise groups are now using or planning to use social media for marketing, customer engagement and customer feedback. Facebook is the most popular social media channel, but Twitter, YouTube and corporate blogs are also widely used.

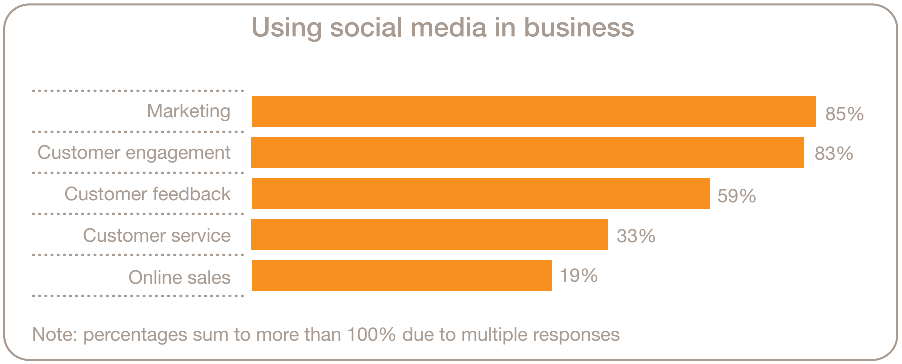
Rise of social media use by franchises mirrors general popularity

The popularity of social media and online should come as no surprise: the 2011-2015 PwC *Entertainment and Media Outlook* report reveals that the Australian entertainment and media industry will grow 28 per cent over the next five years. This growth is being fuelled by social media, one consequence of the soaring number of tablet devices in use in Australia (expected to increase from 750,000 today to 5.5 million in 2015). Online services and social media are proving to be natural complements to more traditional advertising media.

Many franchisors are finding that social media is a powerful tool to improve and strengthen customer awareness and loyalty. They are also using it as a mechanism to engage with their customers.

Figure 19: Plans to use social media



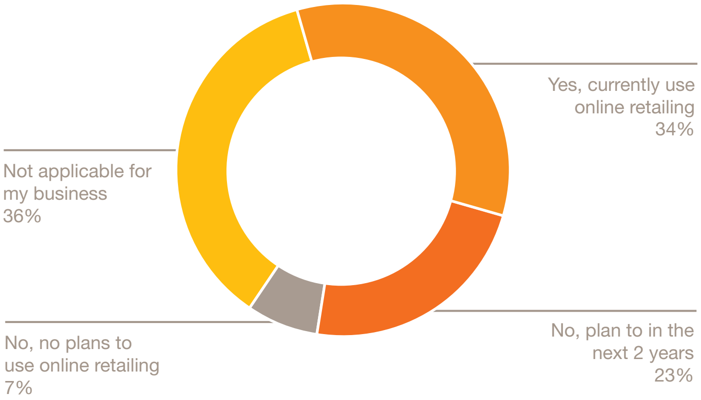


Challenges and opportunities

Online retailing increasing

One third of franchise systems now claim to have an online store. This is predicted to grow to 57 per cent over the next two years.

Figure 20: Online retail presence



Of the franchisors that are currently retailing online, 23 per cent reported that over 20 per cent of their revenue is generated through online sales. In comparison, the PwC *Entertainment and Media Outlook* reported that only 5.5 per cent of Australian retail sales are currently online. The *Entertainment and Media Outlook* predicts that over the next few years, Australia will move towards the current levels of online sales in the United States (7.5%) and the United Kingdom (9%), still well below the levels being achieved by some franchisors.

Franchisors have reported that using online retailing has had a positive impact on brand and market coverage. They reported minimal negative consequences associated with using online retailing as a strategy. It appears that franchisors are using online channels as an opportunity to raise brand awareness of their businesses and broaden accessibility; rather than being forced to go down this channel due to the threat of online competition.

Figure 21: Percentage of network's sales made online

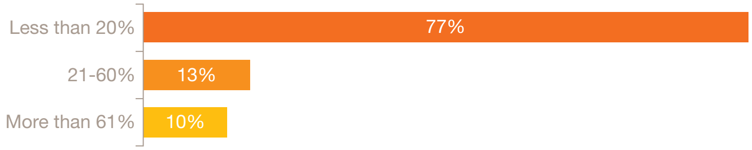
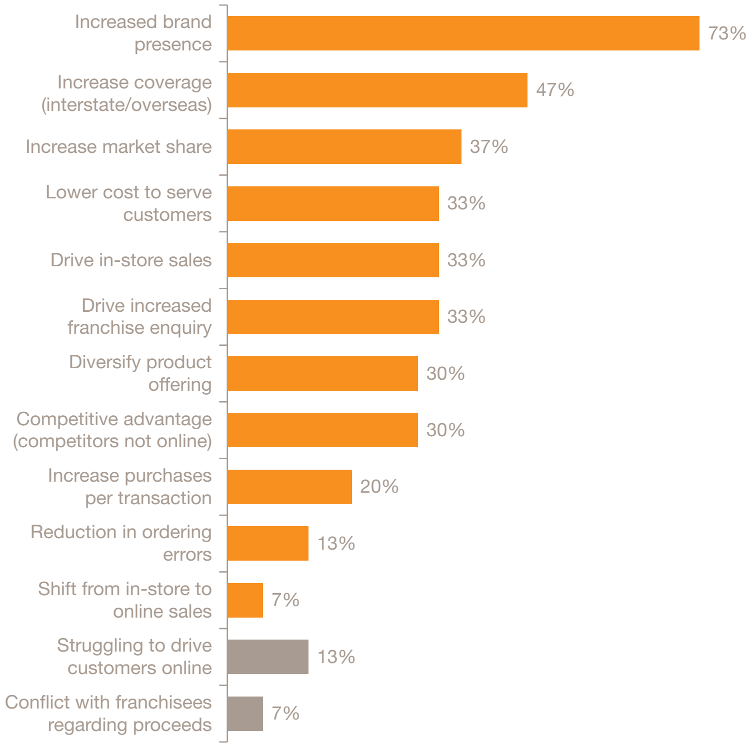


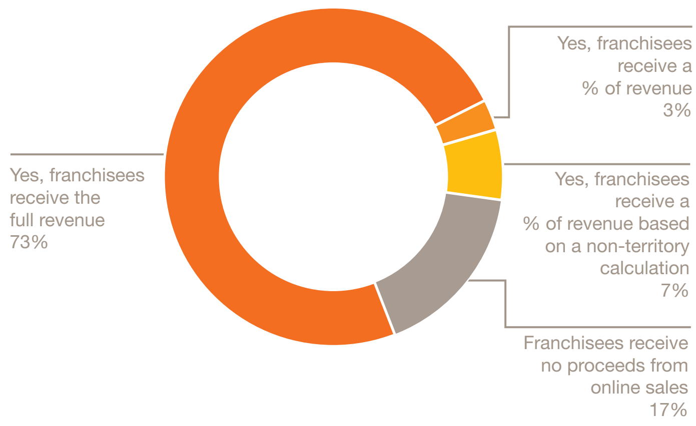
Figure 22: Impact of retailing online



Note: percentages sum to more than 100% due to multiple responses

In spite of previous concerns that online retail may cannibalise franchisee sales and create channel conflict, 83 per cent of franchise systems report that franchisees receive the full or partial revenue generated from online sales. This is a positive trend indicating that franchisors are using online retailing as a group-wide collaboration to boost franchisees' bottom lines rather than keeping the income for themselves.

Figure 23: Distribution of proceeds to franchisees from online sales



Multi-channel approach solidifies businesses

Once again, the sector has shown limited use of company-owned units as part of their respective networks (the average number of company-owned units is 1). It would appear that many franchisors are making a single-channel franchised distribution decision, and venturing slightly into using electronic (web, mobile) channels. In the face of the consistent, fundamental and long-term challenges of talent and capital, franchise businesses need to think of themselves as being in business rather than in franchising.

This requires consideration of an integrated multi-channel distribution approach, involving franchise and company-owned units, electronic channels and upstream diversification into the supply chain. Anecdotally, it would appear profit maximisation occurs this way rather than taking a single-channel approach. Prominent franchisors that take a means end approach to franchising include McDonald's, Aussie Farmers Direct, AGL, Telstra, ANZ and Aussie Home Loans, all of whom utilise franchising as part of an integrated multi-channel strategy.

Operations

> “My idea was, let’s get a group of people together and work towards one common goal, which is to improve the business, improve the brand name, and basically get the product out in the market place that the customers want.”

Len Poulter, founder of Lenard’s and a veteran of the sector, has built the Lenard’s franchise to 200 stores nationwide with a company turnover of $150m. He calls himself a ‘frustrated butcher’, who was driven to start Lenard’s after witnessing the tendency of butchers to compete on price, rather than quality.

Len chose chicken because it “is very consistent, always delivers the same product all the time, it’s never tough, it’s easy to add flavours to, easy to put sauces to, and easy to work with”.

The model proved successful, and at first, finding franchisees was not difficult.

“In the early days, it was all driven by word of mouth,” Poulter says. “We were a brand new concept in the marketplace, and everybody liked the idea. It’s a lot more difficult now because there are so many franchisors out there. You’ve really got to generate a lot of interest and a lot of excitement, which is really no different to selling a piece of chicken at the counter.”

Poulter says it’s important for a franchisee to know what they’re signing up for. “When we get a franchisee, we get them to work in the job for three days, over a weekend, so they understand that this is the thing that they’ve got to do for the next few years of their life.”

Running a Lenard’s is quite labour-intensive, and as a result there are very few multi-site operators within the network.

“We’ve been encouraging it, but we don’t seem to be able to get the multi-sites across the line with the franchisees” Poulter says. “We had a big drive about five years ago, but our model is difficult to execute, so we realised that we needed to go back and do some more work on it.”

Stores in Australia **200**

% franchised **99%**

Multi-site operators **17%**

Sales in Australia **$150m**

Growth plans

Encouraging multi-site operators and increased product sales; overseas expansion.

Recruitment tactics

Streamlining franchisee operations to make the model more profitable.

Lenard's®

Operations

> ***"At the moment we are looking at getting one of our major suppliers to do more portion cutting and value adding at the factory end, so that shops can be managed as a multiple."***

"What we are looking for are smarter, bigger, business people, who can make money, who can own five, 10 stores, or a region, and manage that under their own umbrella, because there is a very good return on these stores."

Len says there's a 'major financing problem' in the sector, but that Lenard's is reluctant to get involved in franchisee financing.

"We've always been very careful of being involved in people's finances, outside of the operations and their profit reporting, because there're so many variables.

"We've analysed the business so well for them that they can plan to make money, it shouldn't be a problem – it's how they execute it. They've got to be able to get proper advice externally, so we encourage them to get very good financial advice from an accountant, and professional legal advice."

The company has partnered with wholesale distributors Metcash to build up a network of Lenard's stores within IGA supermarkets, a strategy which has huge potential for the business outside of the franchising model; and recently they entered into a joint venture to trial a similar model in Singapore. And the company is considering trialling a web-based retail platform for customers to place an order online and pick up on their way home.

But for franchisees currently, growth is focused on increasing sales and continuing to reduce costs where possible to improve profit margins.

"In Australia, we are trying to go backwards down the supply chain now, to make it easier and more efficient for our franchisees, and to make the model even more financially successful. Because of the size of our stores, we are trying to make it more streamlined, and stay in the areas we want to stay in."

"We're also focusing on customer service, getting people into the store, and increasing the amount of each sale."

Poulter considers there is still a lot of potential in the market for Lenard's value-added chicken products.

"Twenty-four years ago, I looked at chicken as being the best product, and a growth product in Australia, and it's still growing. There's probably another 10-15% growth in the meat market alone, for chicken, in the next five years. We are in the right place to be able to take advantage of that."

Ongoing support and training, along with further efficiencies in distribution management are the key to strengthening operations and adding to the bottom line.

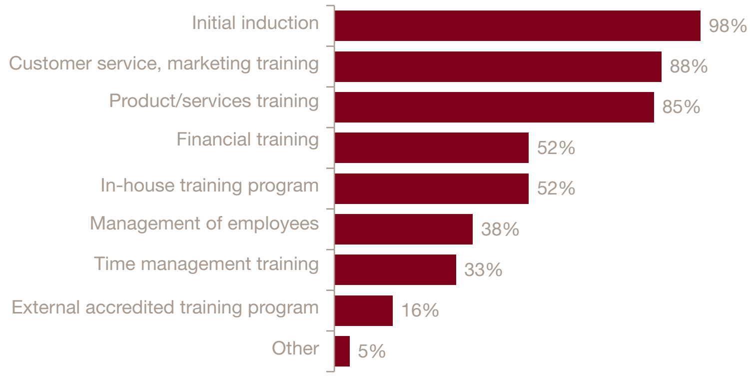
Franchisee training

Franchisee training tends to focus on service and selling rather than financial and business management. While customer service, marketing and product training are very common, only half of the franchisees undergo training in financial management and only a third in employee management and time management.

This indicates a significant opportunity for franchisors to improve the performance of franchisees with further training and support in these key areas. If franchisors are able to integrate a comprehensive training program into their franchisee offering this will assist in further developing their franchisees, enabling franchisees to have development goals and improve their leadership and management skills over their tenure.

The Franchise Council of Australia is very focused on education programs within the sector and there are many service providers who can assist with “filling the gaps” in leadership and business management education.

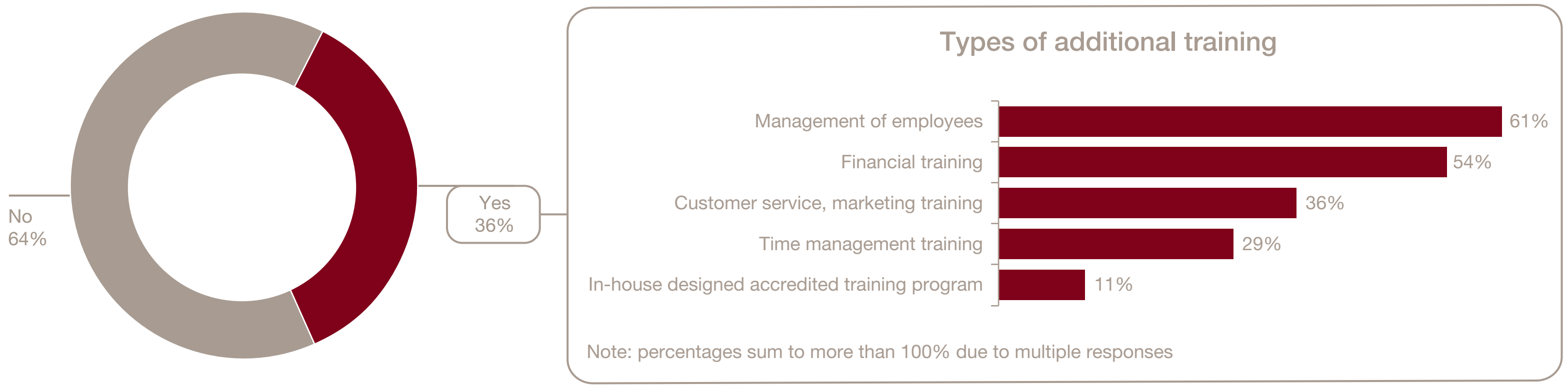
Figure 24: Training offered to franchisees



Note: percentages sum to more than 100% due to multiple responses

Only 36 per cent of franchise systems offer additional training to multi-unit franchisees. We believe more focus should be given to training and developing franchisees as they transition from having one franchise to two or more. In order to take on these roles with the associated increased responsibilities, franchisees will likely require additional time, communication, people and financial management skills.

Figure 25: Additional training undertaken by multi-unit franchisees



Note: percentages sum to more than 100% due to multiple responses

Operations

Franchisors continue to work the supply chain

Franchise systems continue to look for ways to increase efficiencies and generate income from the supply chain, with the number of franchises receiving rebates from suppliers increasing considerably (from 37 per cent in 2009 to 49 per cent in 2011).

Many franchisors are sharing the rebates by distributing them to franchisees and also allocating proceeds towards the marketing fund.

Figure 26: Percentage of franchisors receiving a rebate or other financial benefit associated with supply by third party suppliers to franchisees

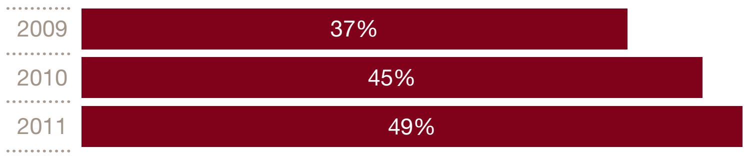
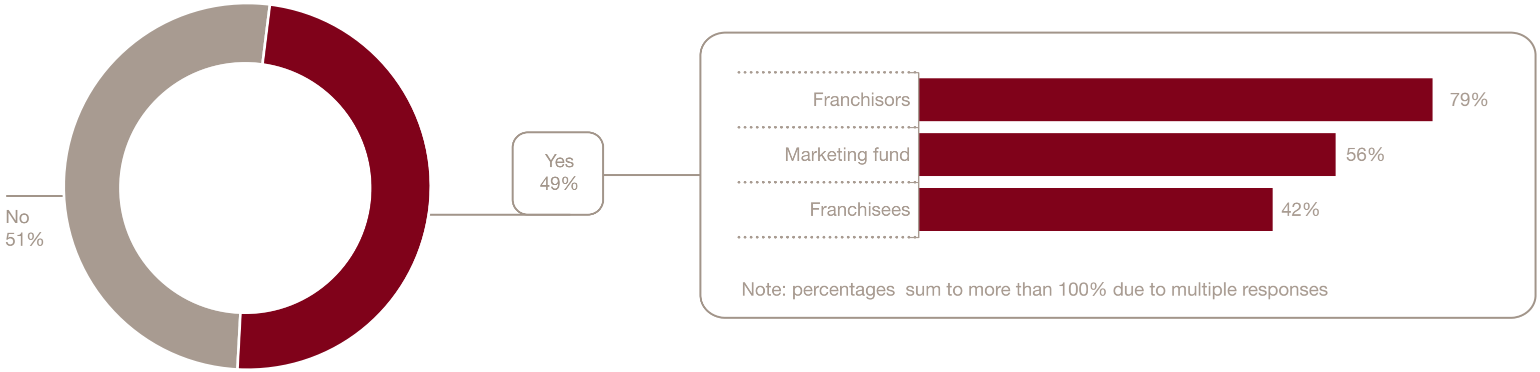


Figure 27: Distribution of rebates within system



Blue Sky Private Equity

Franchise sector brand

"Back in 2008, the world economy was pretty bleak, and at Blue Sky we wanted to invest in a consumer staple when everything was unstable – hence Lenard's."

For Tim Wilson, Managing Director of Blue Sky Private Equity, investing in Lenard's as a company selling a value-added consumer staple was too good an opportunity to pass up, especially given the economic outlook at the time.

"At a time when we were expanding as a private equity house and doing deals at the smaller end of the market, the Lenard's franchise model gave us the opportunity to invest in a company with a strong national brand, 200 shops and $150m in turnover, something which is usually the province of mid-tier private equity firms."

Wilson says Blue Sky works a bit differently to other firms, preferring to enter into a partnership with the existing owners rather than "buying the business and then working out what to do with it".

"We take a large minority stake, around 40%, in a company where we like the business model, the founder and the management team, then back their vision. We certainly spend a disproportionate amount of time during the due diligence process to make sure they are people we can work with; and of course it works both ways."

In the early days, when Lenard's was growing rapidly, the company sold regions around the country to master franchisors with responsibility to drive growth in those regions.

"In a high-growth phase that make sense," Wilson says. "But the money that we invested in the company was used to buy back all the master franchisor regions around the country. Having a direct relationship with all of them allowed us to reinvigorate the franchisee/franchisor relationship."

Franchise sector brand

Wilson says firms like Blue Sky are an essential part of the funding mix for the franchise sector.

"Even when the banks are going bananas and throwing money at anything, they will still only lend against historical performance, not future growth. So you're hampered by what's happened in the past six months. And now, when banks aren't lending money to anyone, we're even more important."

Blue Sky would certainly consider investing in another franchise, and in fact have a few opportunities in the pipeline, according to Wilson.

"We've got a good grounding now, and a thorough understanding of how the whole sector works – we may even consider expanding an existing business through franchising."

Given the contribution of the franchise sector to the Australian economy, there continues to be a requirement for increased awareness of the strength of the franchise model across government and the business community, as well as prospective franchisees.

As discussed in last year's *Franchise Sector Indicator*, the fact that the sector continues to outperform the general economy and yet has difficulties attracting potential franchisees and gaining funding from the banks indicates that the franchise sector requires a brand overhaul. This would require a joint effort by the Franchise Council of Australia, franchisors, the banks, suppliers to the sector (such as PwC) and the government, to raise the profile and awareness of the sector.

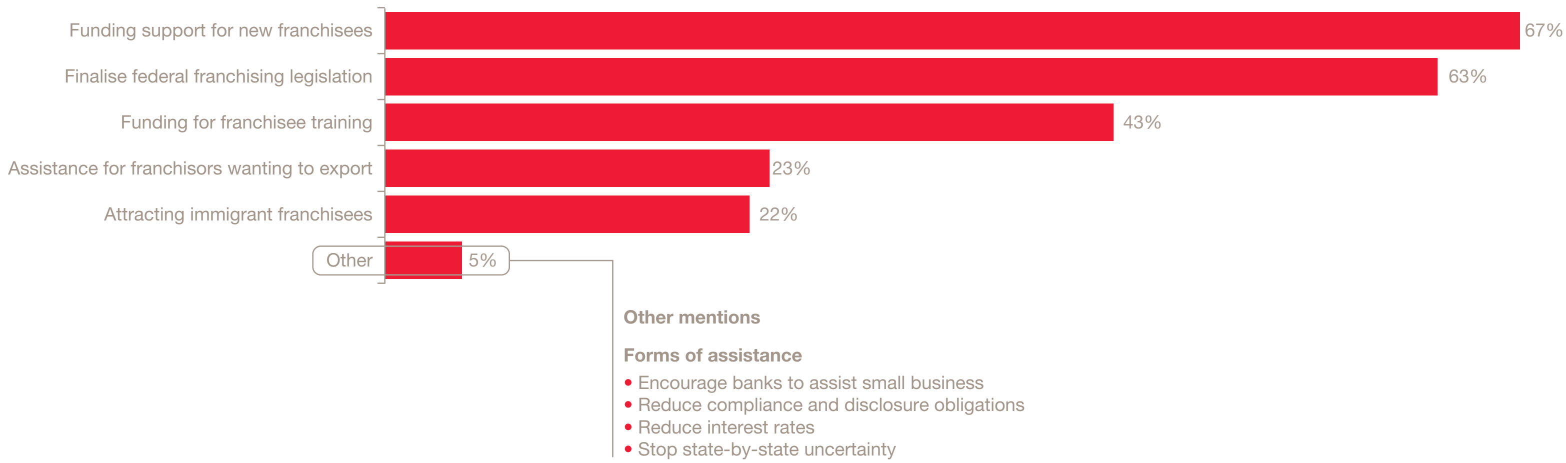
Franchisors have indicated that they would like to see increased government support in financing new franchisees, funding for franchisee training and finalisation of the questions surrounding State versus Federal franchise legislation.

In relation to funding, The United States has several initiatives for funding incoming franchisees including acting as guarantor to bank loans where incoming small business owners are having difficulty gaining financing. It seems that franchisors in Australia want a similar programme.

There is also a huge opportunity for an Australian bank to increase its franchise sector lending through more flexible lending practices, acknowledging the strength of the franchise model. It does not make sense that the sector continues to outperform the rest of the business community, and has many risk-alleviating attributes and yet banks make it more and more difficult for franchisees to get funding.

In a show of confidence in the sector and the franchise model, PwC has seen increasing interest by investors, to add franchised networks to their portfolio.

Figure 28: Desired government assistance within the sector



PwC contacts

PwC Private Clients – Franchising

Private Clients – Franchising

Business is full of challenges. Capital. Distribution. Retaining talent. Scale. Franchising is often an effective strategy for overcoming these hurdles and realising the full potential of your business.

PwC Private Clients can help you decide if franchising will work for you. Our team provides strategic advice and consulting to help many of Australia's most successful domestic and international franchises. And because some of our team have been franchisors or franchisees themselves, they bring a unique perspective.

A franchise can help you fast-track market penetration, reduce financial risk and improve your operations. We stand ready to help you grow, manage, administer and improve your business. A committed partner for the life of your business, we take an holistic approach to your success. We'll grow your business as if it was our own.

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Acknowledgements

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Steve Wright is the Executive Director of the Franchise Council of Australia (FCA). The FCA is the industry body representing and working for the benefit of the Australian franchise sector. The FCA is a nationally incorporated not-for-profit association, providing localised member services via five state chapters throughout Australia. Membership of the FCA is voluntary, and is open to any organisation or individual involved in the franchise sector, including franchisees, franchisors, lawyers, accountants, banks, consultants, academics and publishers.

www.franchise.org.au

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Respondents

PwC Private Clients would like to thank the 92 respondents from the franchise community in giving their time to take part in this important part of research in to the sector. Respondents were asked 52 questions, the highlights of which have been provided in this report.

The Copy Collective

Passionate about providing good copy and words that will have an impact and persuade, The Copy Collective is a global group of writers, journalists and editors. The aim of The Copy Collective is to provide a one-stop-shop of the most experienced and highly-qualified writers for clients.

The Copy Collective specialises in working with corporate, agency and charity clients and was founded in 2003 by experienced business journalist and direct mail copywriter Dominique Antarakis. The Copy Collective was delighted to work with PwC Private Clients to craft the 2011 *Franchise Sector Indicator*.

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Jacinta McDonell Jimenez of Anytime Fitness, Chris Caldwell of Bakers Delight, Lenard Poulter of Lenard's and Tim Wilson of Blue Sky Private Equity

PwC Private Clients would like to thank Jacinta, Chris, Lenard and Tim for freely giving their time and providing their valuable insights for this issue of the *Franchise Sector Indicator*. It has been a pleasure being able to share the experiences of these very successful businesses and we wish them the very best.

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