PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES INQUIRY INTO THE OPERATION AND EFFECTIVENESS OF THE FRANCHISING CODE OF CONDUCT

ANZ APPEARANCE 14 SEPTEMBER 2018

RESPONSES TO QUESTIONS ON NOTICE

1. **Ms Tinsley: The only thing I'd add is that this process continues. Previously, historically, we may not have asked all those questions, but as we've had examples where we continue to evolve this process we assess the franchisors. So the other element of this is that this is subject to annual reviews. We assess this annually.**
ACTING CHAIR: How long has that been the practice of ANZ?
Ms Tinsley: Do you mean the annual review?
ACTING CHAIR: Yes.
Ms Tinsley: I'd have to take that on notice, but over three or four years.

   ANZ has conducted annual reviews of accredited franchise systems for over 10 years.

2. Senator KETTER: But the franchisor would have the information.
Ms Tinsley: Yes, I believe some systems have point-of-sale information. The information that they provide to the bank is up to the franchisor.
Senator KETTER: But with an accredited system, surely that's part of your arrangement, that you would have access to that through the franchisor?
Ms Tinsley: They do provide us the information. I couldn't speak to whether all the accredited brands provide us point of sale today, but I could take that on notice and provide that.

Accredited franchise systems do not provide point of sale information to ANZ for the purposes of franchise accreditation.

3. **Ms KEARNEY: Just on that, to what extent do you examine the exit fees or arrangements for franchisees?**
Ms Tinsley: I would need to take that on notice in terms of the details, but that is not something that I have deep knowledge of at this time

ANZ gathers information from franchisee applicants for loans in order to assess the applicant's capacity to repay a loan. We do not specifically examine exit fees under franchise agreements.

4. **Senator KETTER: I'm interested in RFG, one of your accredited franchise systems, and whether you've changed the lending parameters in recent times. We've heard about the fact that the franchisees and some of the brands can't buy cheaper coffee of exactly the same quality at a supermarket; they have to go through the franchisor to purchase that. I think milk is the same. There are probably other examples of where the franchisor has the power to change basically the business model for the franchisee. Your customer is the franchisee. You should have an interest in that. How has this been reflected in the lending practices?**
Mr Lang: Certainly. Obviously there are customer confidentiality issues. I'm absolutely prepared to do that on notice. I can speak in the general, though, if that's okay?

In relation to accredited franchise systems, ANZ has not changed its lending policies as a result of franchisor-franchisee supply arrangements or franchise system rights to change aspects of their business in a way that affects franchisees.

5. **ACTING CHAIR: Could you identify, in line with the failed loans, where they were associated with any particular lenders?**
Mr Lang: Certainly. We're more than happy to provide that information.

We have reviewed ANZ Small Business Bank disciplinary matters over the last two years and have not identified any matters involving lending to a franchisee.

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RESPONSES TO QUESTIONS IN OCTOBER 2 LETTER TO ANZ

1. **Please provide a list of which franchise systems for which accreditation has ceased over the last five years, including the date when accreditation ceased and the reason.**

   ANZ has not removed accreditation from a franchise system in the last five years. As noted in our 12 October responses to questions on notice, where we have concerns about a franchise system, our practice has been to change our lending policy in relation to that system. This allows us to continue to obtain information about the overall performance of the franchise system which our existing customers may be part of.

2. **Would you be willing to make the accreditation list publically available as a matter of general practice?**

   ANZ provides public materials where appropriate to prospective franchisees in accredited franchise systems. This information takes into account the circumstances of particular franchise system and aims to provide useful information to potential customers. For example, the Poolwerx flyer, provided at the 14 September inquiry hearing, outlines ANZ's approach to lending to prospective Poolwerx franchisees.

   ANZ does not believe it appropriate to publish a list of all accredited franchise systems in all circumstances. We may have determined that we do not wish to make additional lending to new franchisees in a particular system (for example, because we have reached a level of concentration consistent with our risk appetite). In this case it would be confusing to publish a list including that system as it would likely be incorrectly interpreted as indicating a willingness to lend to new franchisees.

3. **Please provide information on how the franchise accreditation process works.**

   As noted, in Mr Lang's 14 September testimony, ANZ maintains a panel of about 70 franchise systems that are designated as either "accredited", or "preferred".

   Maintaining a panel gives us more understanding of a franchise system to inform our bankers and credit assessors when we make a loan to a franchisee. Franchisees and franchisors can benefit because we have more information and application processes can be more efficient.

   We seek to understand factors such as the accredited franchise system strategy and financial performance; competition; franchisee disclosure; franchisee costs; recruitment, training and field support; site selection; leases; sale arrangements; and management of distress.

   A panel relationship does not involve ANZ banking the franchisor. No assurance is given that we will make loans to franchisees of that system. Franchisees remain free to choose who they bank with.

   Where we believe the franchise system is performing well - and subject to our assessment of the individual franchisee application - marginally higher maximum lending limits may be offered (please refer to ANZ documents provided at the 14 September hearing).

4. The committee has heard that all the fees for the use of accreditation are paid by the franchisee when they are applying for loans via individual loan application fees for their loans. To what extent does your bank charge franchisees for the accreditation of the franchise company?

ANZ does not charge fees to a franchisees related to the accreditation of a franchise brand or system. The fees charged by ANZ are the standard fees that apply generally to small business loans.

5. Does the accreditation of a franchise incur an adjustment of the risk grade that the bank applies, and are there any changes to the capital holding requirements for the bank?

No. The risk grade of the loan is dependent on the strength of the individual franchisee. The capital holding requirements are the standard requirements that apply to business lending and are not affected by accreditation of a franchise system.

6. On average, what percentage of franchisors fails to meet accreditation criteria when applying with your bank?

As noted, ANZ has not accredited a new franchise system in the last five years. Franchise systems have entered the ANZ Panel under the "Preferred" model. Under the preferred model, there is no specific credit policy that applies to the franchise system (ie maximum lending limit). The ANZ Franchise team conduct preliminary discussions with potential Panel franchise systems. It is estimated that around a quarter of franchise systems with which there are early stage discussions may not meet ANZ Panel requirements.

7. Does the total purchase price that a franchisee pays for a franchise regularly exceed the value of the franchise and what ratios might be used to assess this valuation?

ANZ is not aware of information that suggests that purchase price paid by franchisee customers regularly exceeds the value of the franchise. To assist the committee, our approach to considering the value of a franchise business is outlined below.

Purchase of a greenfield business: the purchase price would generally be the sum of all costs incurred to start the business. ANZ uses this sum as the initial valuation where costs are up to $1m, noting that the ANZ credit approvers may require an external valuation depending on the circumstances.

Purchase of an existing business: the purchase price would be the price on the contract of sale to be executed between the vendor and the prospective client. ANZ utilises the actual contract of sale price as the indicative valuation up to $1m, again noting that credit approvers may require an external valuation.

8. **Does your bank consider that a portion of the loan will be paid from the sale of the franchise at the conclusion of the contract or are repayment calculations generally restricted to the proposed turnover during the term of the contract?**

Term loans for the purchase of a franchise are the principal form of lending to franchisees. Loans are fully amortised prior to expiry of tenure of franchise agreement, business or lease; that is, there should be no residual amount owed to the bank. Loan terms are set at the lesser of the franchise agreements tenure, or lease tenure (including options) up to a maximum of 10 years. These loans may be unsecured or partially secured.

Applicants for franchise loans are expected to contribute at least 50 per cent of the value of the business as equity. Applicants may raise some of this contribution by borrowing against other assets, such as investment or residential property. Where ANZ provides this lending it will likely be in the form of a business mortgage loan. The life of a business mortgage loan may extend beyond the franchise agreement or lease tenure.

9. **To what extent do banks assess a franchisee's business plan in order to determine the franchisee's ability to repay the bank loan and other creditors, pay a legal wage and any other overheads, and meet minimum living expenses within the term of the franchise agreement and the provisions of the exit arrangements?**

ANZ gathers information which demonstrates appropriate due diligence and takes into account the factors required to run the business successfully. ANZ requests a range of documents such as a business plan or a cash flow forecast which demonstrates the ability to repay the bank loan taking into account other business and personal expenses where relevant.

For accredited franchise system loan applicants, we generally take into account average financial performance indicators provided by the system in assessing the loan (eg gross sales, variable and fixed business expenses). As noted at the hearing, where we have become aware of issues (such as wage payment rates) we will seek to raise those issues with the accredited franchise system.

Where an existing franchise is being bought, financial information will be available on the payroll costs and sometimes the franchise employee roster. For a new franchise, generally a specialised credit assessor experienced in franchises will assess an application.

Where a loan application for non-accredited franchise is being assessed, other available benchmarks may be considered where appropriate in the circumstances; for example, industry benchmarks based on ATO data.

Please also refer to the answers to question 8 and 15.

10. If the franchisor is not accredited, is the bank's assessment of a franchisee's loan restricted to an assessment of the franchisee's business plan and any financials provided to the franchisee by the franchisor in the disclosure documents?

Please refer to the answer above. Each applicant is required to provide a business loan application for the specific franchise and loan. ANZ’s credit assessment is required to be based on specific applicant, franchise and loan.

11. Does your bank require prospective franchisees to include an exit strategy in their proposed business plan and does your bank assess whether the exit strategy aligns with requirements outlined in the franchise agreement?

ANZ does not require prospective franchisees to include an exit strategy in loan applications.

12. Does your bank account for depreciation of a franchisee's assets, including for equipment, leases and the contract when making an assessment? Does your bank check that prospective franchisees are informed about the depreciation of assets and the impact this may have on the future resale value throughout, and at the conclusion of, the franchise agreement?

ANZ reviews the costs associated with running the franchise including asset replacement, fit-outs, or refurbishment. These will generally be detailed in the franchise agreement. Where an existing franchise is being purchased, the contract of sale will detail the goodwill purchased, assets and other set-up costs such as fit-outs.

It would not be appropriate for ANZ to advise the applicant on asset depreciation, resale value or other similar matters.

13. Does your bank consider that there needs to be a clearer distinction between the items a franchisor owns and the items a franchisee owns in the franchise agreement to assist banks to conduct a more informed assessment?

This is not a matter that we have considered nor has it arisen as a significant issue. We would expect that clarity of ownership of assets is important for both franchisee and franchisor.

15. When your bank accounts for a franchisee's operating costs, does it also apply a minimum standard to ensure the franchisee's wages will cover personal living expenses when assessing the profitability of the business?

a. What standard is generally used?

Please refer to the answer to questions 8 and 9 for an outline of the general approach to assessment of lending.

As part of the assessment process, the franchisee’s wages or salaries are checked to see that they are reasonable.

Applicants are required to provide a personal statement of position to allow ANZ to assess overall capacity to service and whether the applicant can meet their personal and other business expenses and liabilities, as well as franchise related expenses and liabilities. Assessment of this personal statement of position includes relevant payments or wages to be paid to the franchisee.

b. Noting that responsible lending laws currently do not apply to small business lending, to what extent does your bank apply the principles of responsible lending laws to its small business lending?

ANZ applies the standards required under the Code of Banking Practice of a prudent and diligent banker. The general principle common to both small business and consumer lending is that the applicant must provide sufficient information to the bank to demonstrate that they have the capacity to repay the loan.

16. How cost-effective is it for the bank to undertake an assessment of a franchisee's business plan, as opposed to assessing the security (such as a family home) that a prospective franchisee can provide?

As noted above, the bank assesses the capacity of the applicant to repay the loan. This is a mandatory requirement and assessment of security is not a substitute for it.

17. Is there a minimum loan amount below which the assessment of a business plan would significantly increase the cost of a franchisee acquiring a bank loan?

The minimum ANZ business loan amount is $10,000. Standard fees apply and this may mean that applying for a small loan is financially unattractive to an applicant.

18. To what extent does your bank account for the differences in business ownership and entitlements between independent small businesses and franchised businesses with particular regard to:

a. The possibility of non-renewal of a franchise agreement.

The ANZ credit policy applies similar rules to both independent small businesses and franchised businesses. As noted in the response to question 8, business term loans are set at the lesser of franchise agreement tenure (or equivalent for an independent business), and lease tenure (including options) up to a maximum of 10 years. The term of business mortgage loans may extend beyond this.

b. The obligation for a franchisee to continue operating the business as per the franchise agreement even if the business is making a loss.

ANZ is not a party to the franchise agreement and is not able to comment on such an obligation. Where a small business customer is in difficulty, we make hardship arrangements available and will endeavour to work with the customer while they restore the business to a sustainable position.

c. The franchisee not being entitled to own the goodwill that was included in the purchase price and which may affect the resale value.

As noted above ANZ credit policy applies similar rules to both independent small businesses and franchised businesses. Goodwill, as part of the purchase price, is required to be amortised over the term of the loan. A goodwill component of potential resale is not taken into account in assessing security or the capacity to repay a loan.

d. The limited term of the franchise agreement (often 5 or 10 year terms) in which the bank may recoup the loan amount including interest.

Please refer to the answer to question 8 and 18a.

19. How does your bank manage conflicts of interest to ensure bank officials are not pressured to approve prospective franchisees for accredited franchises?

Credit assessment for franchise lending is supervised by the ANZ Risk function and operates separately from the Australia Division bankers who have the relationship with the franchisee. The key performance indicators for credit assessors are based on the quality of assessment and adherence to processes and policies. They do not relate to approval of transactions. Credit assessors are subject to a range of performance monitoring, assurance and audits.

20. Where do banks generally sit in the franchisee creditor list, and is that different in accredited franchise systems? Is it becoming more common that banks are below the franchisor on the franchisee creditor list?

The ranking of the bank as a creditor to a failed franchisee will vary considerably and we are not able to provide a general answer. Circumstances will vary for example, depending on the rights of the franchisor, business assets of the franchisee and the security held by the bank for lending.

21. How common is it for franchisees to obtain finance from franchisors? When that occurs, are banks providing the funds to franchisors?

Most franchisees would obtain funding directly from lenders. We are aware in some cases franchisees may obtain funding from franchisors but are not in a position to comment on whether this is a common practice.

22. Is there a notable shift towards joint franchisor/franchisee part ownership to lower start-up costs?

ANZ is aware that some franchise systems have joint franchisor/franchisee part ownership arrangements. We understand that these are intended to assist capable store managers with limited equity to purchase their own store. We are not able to comment on the incidence or trends in these arrangements.

23. Could silent investors or crowd funding arrangements be used by franchisees to offset risk?

ANZ is not able to answer to this question as it does not relate to bank funding of franchises and we do not have knowledge of the arrangements that might be used by franchisees.

24. Are there any ways in which a franchisee can offset the risks associated with purchasing a franchise?

A prospective franchisee should ensure that they have good business and financial management capabilities, or have access to this capability, to minimise risk.

Franchises, like other small businesses, operate in competitive markets and face many different and changing requirements. A franchisee needs to effectively manage day to day operations, as well as their business cashflow and finances, staff and leases. They need to ensure that they meet their legal and regulatory obligations. They require sufficient capital to manage through seasonal changes and any business cycle.

In purchasing a franchise, a prospective franchisee will need to assess factors such as the competition in the particular area, the maturity and scale of the franchise system and its market position; the systems, process and support provided by the franchise system to the franchisee; and financial and other obligations of the franchisee to the franchisor.

27. What was the average price of a franchise unit in FY2007–08 and in FY2017–18?

The price of a franchise is used in assessment of individual loan applications where an existing franchise is being purchased. However, we do not track franchise prices or pricing trends and are not able to answer this question.

28. What definition of small business does your bank prefer to use?

For the purposes of ANZ customer management, a business customer with total business lending to ANZ of less than $1 million is generally classified as a small business in ANZ and managed in the Small Business Bank division. Various regulatory definitions of 'small business' apply for different purposes (for example, under the Unfair Contracts Terms law and the Code of Banking Practice 2013 and its successor Banking Code of Practice 2019).

Note

Questions 14, 25 and 26 seek ANZ business data and we have answered these on a commercial in confidence basis.

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RESPONSES TO QUESTION ON NOTICE IN RELATION TO TRENDS IN FINANCIAL DISTRESS

Response to question on notice at hearing

Senator WILLIAMS: Over a five-year period, with your franchisee banking, have you seen a percentage increase in the number of franchisees getting into financial trouble? Even though you say it's pretty low, has there been an increase in indications to your bank portfolio on franchisees of increased in appearance of more troubles in the franchise industry than what it was five years ago?

The table below shows broad trends in the maximum and minimum portfolio delinquency rates (90 days plus overdue, loan value) for different small business bank lending portfolios for three periods, 2013-15, 2016-17 and 2018 to August.

The table is expressed as an index relative to the ANZ Small Business Bank (SBB), '2018 to Aug' delinquency rate.

As delinquency rates vary over time, ranges provide a guide to relative rates and broad changes over time.

As shown in the table, the delinquency rate for franchises has generally been lower than that for the ANZ Small Business Bank (SBB), retail trade, or the accommodation/café/restaurant segment.

Delinquency rates for the different portfolios have increased over the period. Most recently, the franchisee delinquency rate has increased though it remains below that for the accommodation/café/restaurant segment.

	SBB 90+	**Franchisee 90+**	**Retail Trade**	**Accom/Café/Rest**
2013 – 2015	0.6 to 0.8	0.5 to 0.8	0.6 to 0.8	0.6 to 0.9
2016 – 2017	0.7 to 1.0	0.6 to 1.0	0.7 to 1.1	0.8 to 1.5
2018 to Aug	1 (index)	1.0 to 1.2	1.0 to 1.1	1.5 to 1.7

Note: Ranges shown are rounded and indexed to the value for the Small Business Bank minimum to maximum rate for 2018 to August (which equals 1 for both minimum and maximum when rounded)