



To – various addressees

Re: FINANCIAL SYSTEMS INQUIRY “REPORT” – Submission & comments

I’m Gordon Batt, 62yrs with businesses in the retail fuel industry – both as a franchisee & independent service station owner. I’ve been in the oil industry 40yrs, 50% of the time as a multi-national employee/manager & 50% as an “independent” operator, or SME.

Submission - general

My comments below focus on the ‘Financial Systems Inquiry’ but also include postscript comments on ‘Franchising’ & ‘Taxation’.

Whilst I have not examined the entire Murray report I believe I have a reasonable grasp on the matters that are addressed & concern me.

From the outset I advise I have the highest respect for the inquiry’s panellists, but am concerned that it comprises persons representing only three aspects of the Australian financial system. ie

- (i) Banks
- (ii) Big business
- (iii) Academia

Consequently some preliminary conclusions made appear to lack a full recognition of the financial system impact on SME’s, whom the report acknowledges;

- (i) Comprise 2 million businesses
- (ii) Employ 70% of the workforce
- (iii) Contribute 50 % of private sector output

Given this group’s vast contribution to Australia’s financial system as a 50%+ player, it seems an obvious omission for SMEs to not be represented on the panel.

Submission - specific

My concern is with the credit/debit cards ‘merchant surcharge’ issue, where retailer (SME) capping is suggested in the absence of any apparent evaluation of the charges most industry players bear. Accordingly I submit that there are at least two fundamental questions requiring evaluation & response prior to contemplating merchant fee caps as a means to alleviating perceived cashless society impediments. They are;

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- a) Are the prevailing bank/franchisor credit & debit cards fees justifiable & if so, what methodology was employed to determine this?
- b) Why is the cost burden of cashless society apparently being directed solely at merchants (typically SME's) & not card providers or the consumers?

All players - banks, SMEs & consumers - benefit from a cashless society yet this reality is avoided by the report. Furthermore, card providers are fully compensated via their merchant service fees (MSF) & are currently the greatest beneficiary of our cashless society, along with consumers who pay little or nothing. SMEs are therefore the 'meat in the sandwich, with little option but to accept consumer cards & MSFs to stay in business.

Certainly a few industries (taxis, airlines, etc) have rorted the system with excessive card surcharging, but this is not typical so why tarnish all merchants with the same brush? Surely it's better to deal with a few recalcitrant excesses than to universally penalise & smear all merchants with an artificial below-cost cap?

Card costs are **set** by providers (mostly banks) for non-altruistic reasons, where rates vary solely according to their dictum. The report seems to ignore this fact & their inherent market power, implying an entrenched bias &/or political constraint by the panel.

Also, reality is that banks & big business typically prescribe for SMEs to pay them via direct funds transfer (sometimes with direct debit account access) as they are in a position to specify their payment terms. They often also require a prepayment/deposit &/or security for services, thus bearing a reduced financial risk. SMEs mostly can't do this & thus bear the brunt of our financial system's vagaries, copping it every which way.

The report also acknowledges that SMEs pay more for bank loans, despite the greater security provided (frequently residential guarantees), and yet the banks say we are a greater risk as they *know less about them*. This assertion is highly misleading given their level of control is far higher & where banks can & do employ heavier-handed tactics over SME's. Loan interest rate doubling or realising on bricks & mortar security for recoverable indiscretions are enacted far quicker than for a public company. Banks do this because it's easier & they can, using their powerful position, bank account control & intricate legal agreements to dominate SME's without the wherewithal to challenge. From my direct experience this strategy is *inculcated* into their credit department dna & remuneration & they are effectively a law unto themselves.

SME economics

At my two small/medium sized regional service station franchises the oil coy pays me 3.1 cents per litre (cpl) fuel commission = a 2% gross profit margin. When customers pay by Visa or Master card we lose 0.75% or 1/3rd of this. Amex/Diners charge about 2% & banks now charge about 0.5% on debit cards. Just how they calculate & justify these charges when they own the clearing houses is pure mystery & completely over looked in the report.

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Furthermore, about 30% of our fuel sales are made on oil coy (proprietary) card where we are charged 1.25% & are specifically prevented from on-charge customers. The newest franchise agreements now *specify* that we must not charge for *any* credit or debit cards whatsoever, requiring me to bear annual MSF costs of \$80,000pa! How can this dictum be fair & reasonable?

Conclusion

Surely any financial systems inquiry needs to fully assess the role & responsibility of **all** the market players (not just the middle-man merchants) & I can't but help wonder why it is left to an SME like me to point this out?

Banks & other card providers, big business, some government departments & consumers are clearly the prime beneficiaries of the prevailing cashless society, so they too must be dealt with by this inquiry.

Continually squeezing the biggest but easiest target (SMEs) would be both totally unfair & un-Australian.

Yours truly,

Gordon Batt

(Refer accompanying email for contact details)

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Postscript:

Not directly related to the financial market but nonetheless consistent with an Australian market place “review” are the issues of franchising & tax.

Franchising

Much of the original intent of franchising has become lost in Australia with the excessive control the system now allows franchisors. Franchise fees & rents have escalated beyond reason, largely based on immigrants employing & under paying extended families. Inflammatory? Perhaps, but my franchisor knows this to be the case, quietly reaping the benefits. It is why so many long term Aussie franchisees have left the industry & why every new franchisee is a new Australian. This is reality, not racial bias or sour grapes, with the playing field no longer even.

In my time as an oil coy ‘national franchise manager’ we developed (late ‘80s) the first true oil industry franchise system & all other oil companies subsequently followed. Our system (*Team Pak*) was based on the principles espoused in the (McDonald’s based book) ‘*The Golden Arches*’ where the underlying premise was “*we make money if our franchisees make money*”.

Regretfully this franchising principal is often lost today, too often replaced with “if you totally comply we may help you to *survive*”. This is the new reality & franchising has morphed into a control mechanism for big business. Franchisees are now effectively “off the books” employees, an arrangement highly beneficial to franchisors who essentially finance the FCA* & gain SME business control & direct bank account access, without the burden of normal employer obligations.

Franchising was meant to be about the application of a proven business formula through independent business people, but agreements have become so prescriptive, water tight & margin thin that independent business people have almost zero “wriggle room” any more. There was a time too when franchisors were also accountable for marketing budgets, supplier kickbacks, rent & royalty charges, etc... But no information is provided these days.

Bottom line – Australia’s franchising system needs reassessment, given its massive industry footprint & relative lack of franchisee voice. (*FCA = Franchise Council of Australia).

Taxation

Franchising is a substantial component of the Australian SME market & one where franchisors extract large franchise fees, typically \$250 to \$500k++ for each. Yet the ATO determines these fees are a *non-deductible* expense to the SME but are *assessable* as income to the franchisor, despite the fact the SME has most likely mortgaged home to raise funds, an absurd predicament.

In my case the franchise fees are in addition to a myriad of other fees & costs including; rent, royalties, training, legals, break fees, inventory guarantee, systems fees, maintenance, card costs, upgrade closures, meetings, conferences, etc... etc...

Bottom line – the current ATO treatment of Franchise Fees as a non-deductable tax expense is an unjustifiable penalty hampering SMEs. It should be amortisable over the franchise term (typically 10yrs) after which it has zero value. It’s really just another form of rent, but paid in advance.