

Our ref: RT:2201450

30 January 2024



Bakers Delight - AA1000650 – Response to Draft Determination

We refer to the Draft Determination dated 14 December 2023 (**Draft Determination**) regarding the authorisation application (**Application**) sought by Bakers Delight Holdings Ltd (**Bakers Delight**) with the Australian Competition and Consumer Commission (the **ACCC**).

Unless otherwise stated, all capitalised words have the same meaning and definitions as in the Application. Specific references are made to the paragraphs in the Draft Determination.

1. Paragraphs 1.9, 3.28, 3.33, 3.37 – costs associated with the new POS System
 - (a) It is not correct that the cost of implementing the new POS System will be spread amongst all Bakers Delight Bakeries.
 - (b) There are two main costs associated with the new POS system, namely:
 - (i) Costs which are associated with implementing and developing the new POS System (**Implementation Costs**); and
 - (ii) Costs which relate to the ongoing operation and maintenance of the new POS system (**Ongoing Costs**). These costs are on-charged to Franchised Bakeries as part of the Information Technology Services Fee that is payable by Franchised Bakeries on a monthly basis to Bakers Delight.
 - (c) Another cost associated with the new POS System is the requirement for Franchised Bakeries to purchase and install a new EFTPOS pinpad machine. The cost of one pinpad is nominal and is a once-off fee, along with a monthly warranty fee per pinpad device. Franchisees are not required to purchase any other hardware or software as part of the transition to the new POS system.
 - (d) Bakers Delight will bear the Implementation Costs because it relates to the transitioning between the old POS system and the new POS System. To date, Bakers Delight has already incurred a sum in excess of \$**[CONFIDENTIAL]** in Implementation Costs to implement the new POS System and estimates it will incur an additional \$**[CONFIDENTIAL]** in Implementation Costs if the Proposed Conduct is not authorised.
 - (i) Bakers Delight has not sought recovery of these costs from Franchised Bakeries.
 - (e) The Ongoing Costs will include:
 - (i) time incurred by BDH's Information Technology Services Team in developing and testing and supporting the new POS System to enable the Bakers Delight Bakeries to operate their retail services; and

- (ii) software licence fees for software employed in the delivery of these solutions.
- (f) The Ongoing Costs are borne by and spread across the Franchised Bakeries.
- (g) IT Service provision costs continue to rise in line with inflation as input costs increase.
- (h) The transition to the new POS System will not result in a significant increase in technology fees to Franchised Bakeries, except for those Franchised Bakeries with two or more points of sale devices per bakery who will now pay additional licensing costs for these devices.
- (i) If the Proposed Conduct is not authorised, then Bakers Delight will consider the two following options:

Option 1: fully automated solution

- (i) Promotion Discounts can vary significantly in their complexity. Promotion Discounts are a rule or set of rules that are evaluated against the customer's shopping basket to determine if they qualify for a promotion.
- (ii) As the rules are quite flexible and may involve multiple products and conditions, it is not a structure that lends itself easily to being automatically programmed and created in the POS System. Bakers Delight therefore anticipates that this will be a highly complex implementation process and the Implementation Costs for the design, development, testing and deployment fees are estimated to be approximately \$[CONFIDENTIAL]. The actual costs may be higher depending on any issues that arise during the testing and implementation stages.
- (iii) Bakers Delight will continuously change and modify the types of Promotion Discounts that are offered to remain competitive in the manufacture and retail sale of freshly baked bread. This will require Bakers Delight to incur additional and ongoing costs for implementing new Promotion Discounts and other required changes.
- (iv) Bakers Delight operates in a cloud environment and will need to upgrade the POS System platform numerous times per year. The costs of upgrading the platform and reviewing and testing the Promotion Discount Records each time there is an upgrade ("Solution support and evolution") will amount to approximately \$[CONFIDENTIAL] per annum.

Option 2: less automated solution

- (v) This is the option proposed in Bakers Delight's submission dated 20 October 2023. This option would allow every Franchisee Bakery to nominate their own price tier if none of the five price tiers were suitable. The nominated price tier would be manually created within the system by Bakers Delight's Information Technology Services Team and made available as a price tier for all Franchised Bakeries to select. The coding for the new Promotion Discount Records, system changes and development costs to facilitate this process is anticipated to cost approximately \$[CONFIDENTIAL] per annum.
- (vi) Bakers Delight anticipates the Solution support and evolution costs of \$[CONFIDENTIAL] per annum to test this functionality and for upgrades to the cloud server.

- (vii) This option would require Bakers Delight's Information Technology Services Team to manually create and test the new Promotion Discount Records for each new price tier requested by the Franchised Bakeries ("Promotion creation and test costs").

This anticipated fees associated with the additional effort to create and test these extra Promotion Discount Records are as follows:

Additional price tiers requested per Promotion Discount	Additional Promotion creation and test costs per annum
0 – 4 price tiers	[\$CONFIDENTIAL]
5 – 10 price tiers	[\$CONFIDENTIAL]
11 – 20 price tiers	[\$CONFIDENTIAL]

- (j) Both options would require additional resources to support the additional load associated with having many extra promotions to load into the system and then evaluate for each transaction ("Platform Resourcing upgrade").
- (i) The current costs of the Bakers Delight system server are approximately [\$CONFIDENTIAL] per month.
- (ii) If the Proposed Conduct is not authorised and Bakers Delight intends to maintain the performance quality of the POS System, then a larger server must be obtained which will be approximately double at [\$CONFIDENTIAL] per month, or at least an additional [\$CONFIDENTIAL] per annum. This is an estimate only, and there is no guarantee that a server of this price would provide sufficient capacity.

[CONFIDENTIAL]

Table 1

- (k) As per Table 1, the Ongoing Costs are substantial for both options. Franchised Bakeries are anticipated to pay an additional \$25 per month in technology fees that are above and beyond the costs of transitioning to the new POS System.
- (l) The higher costs will be payable by all Franchised Bakeries, even those Franchised Bakeries who do not deviate prices and therefore will not receive any reciprocal benefit from the increase in technology costs.
- (m) Franchised Bakeries are likely to increase the price of Promotion Discounts in order to retain current profit margins, which will be passed on to consumers.
2. Paragraph 1.10, 3.56 – Franchised Bakeries' ability to select pricing strategies

For the avoidance of doubt:

- (a) under the current POS system, Franchised Bakeries can set their own prices on Promotion Discounts and Individual Products;

- (b) under the new POS System and Proposed Conduct, Franchised Bakeries can set their own prices on Individual Products and select the price of Promotion Discounts from five price tiers that are available for each Promotion Discount.
 - (c) The price tiers cover 80% of existing pricing strategies and are suitable for Franchised Bakeries to respond to local market conditions and financial pressures. Bakers Delight reiterates that the highest price tier will eliminate any discount associated with the bundling of the Individual Products.
- 3. Paragraph 1.25, dot point 4 – Franchised Bakeries' ability to range products
 - (a) To clarify, the new POS System does not limit the ability for Franchised Bakeries to select or modify what products to which a Promotion Discount applies.
 - (b) Instead, Bakers Delight as the Franchisor determines what Promotion Discounts are ranged and offered. Bakers Delight, as franchisor, possesses the knowledge and data necessary for discerning successful and unsuccessful product offerings. Furthermore, Bakers Delight dedicates resources to research and development, creating new products to maintain the network's relevance and stay attuned to customer trends. This is commonplace in franchise networks.
 - (c) Bakers Delight is not proposing to restrict prices – rather, it proposes to limit the prices to five price tiers with one tier equal to the RRP, one below the RRP and three above the RRP. The Proposed Conduct does not propose to force Franchised Bakeries to offer discounts on any Promotion Discounts.
- 4. Paragraph 2.2 – RRP not appropriate for Franchised Bakeries
 - (a) Bakers Delight disagrees with this interested party submission.
 - (b) It is incorrect that over 50% of Bakers Delight Bakeries deviate above the RRP.
 - (i) Based on data extrapolated from the current POS system, there are on average 36 deviations from the RRP per Promotion Discount, whether above or below the RRP. This equates to approximately 7% of all Bakers Delight Bakeries.
 - (ii) The information in paragraph 4(b)(i) is contained in the Application and is not confidential information.
 - (c) Furthermore, Bakers Delight reviews the RRP on an annual basis and considers the appropriateness of the RRP for Franchised Bakeries and consumers at that time.
- 5. Paragraph 2.2, 2.4 – dispute resolution
 - (a) As stated in Bakers Delight's further submission dated 20 October 2023, dispute resolution mechanisms already exist in the Franchise Agreement and under the Franchising Code of Conduct.
- 6. Paragraph 2.3 – surcharging
 - (a) Changes in surcharging policies are irrelevant to the Application. The payment gateway platform is a separate platform to the POS System.
 - (b) Nonetheless, Bakers Delight submits that a different payment gateway platform and software to the new POS System is responsible for any changes to surcharging within the Bakers Delight Network.

7. Paragraph 2.4 – misalignment of interests between Bakers Delight and Franchised Bakeries
- (a) Whilst Bakers Delight is paid royalties on the Net Sales of Franchised Bakeries, Bakers Delight submits that it is incorrect that the interests of Bakers Delight and Franchised Bakeries are misaligned.
 - (b) Bakers Delight holds approximately 95% of the head leases for Bakery Premises, and enters into Occupancy Licences with Franchisees granting the Franchisees the ability to use and occupy the Bakery Premises for the duration of their franchises.
 - (c) If Franchised Bakeries fail, become insolvent or otherwise cannot continue to operate then Bakers Delight as tenant will be responsible for occupancy costs pursuant to the head lease with the landlord. This creates significant exposure for Bakers Delight and provides an added incentive for Bakers Delight to want to ensure the profitability of Franchised Bakeries.
 - (d) It is also in Bakers Delight's best interests that Franchised Bakeries are successful because it reflects positively on the reputation of the entire Bakers Delight Network.
8. Paragraph 2.4, 2.8 – mandatory Promotion Discounts
- (a) Approximately **[CONFIDENTIAL]**% of all Promotion Discounts are mandatory for Franchised Bakeries to range.
 - (b) In the new POS System it is easier for Franchised Bakeries to distinguish which Promotion Discounts are mandatory and which ones are optional.
 - (i) Franchisees can choose what of the optional Promotion Discounts to range.
 - (ii) At the point of checkout, if the Individual Products that make up a Promotion Discount are selected then the new POS System will detect the relevant Promotion Discount. The price tier chosen by the Franchisee Bakery will then automatically be applied.
 - (iii) If the Promotion Discount is not mandatory then the prices of the Individual Products that make up the Promotion Discount will be displayed. The Franchisee Bakery can then select the price of the Individual Products.
 - (c) The detriments associated with limiting the Promotion Discounts to five price tiers only affects mandatory Promotion Discounts for all Franchised Bakeries. Bakers Delight Bakeries otherwise can select which Individual Products and optional Promotion Discounts to range.
9. Paragraph 2.4 – Franchisee Bakery input about pricing strategies
- (a) Bakers Delight reiterates its position that it does not and will not discuss pricing strategies with Franchised Bakeries, as it would potentially constitute cartel conduct.
 - (b) Bakers Delight will continue to use data extrapolated from the POS System and other technology in selecting the RRP and proposed price tiers.
 - (c) Bakers Delight conducts an annual review of the RRP. Throughout this evaluation, Bakers Delight takes into account factors such as the costs of labour, goods, electricity and other supply-side elements. The aim is to establish a

revised RRP that minimises adverse effects on the profitability of Franchised Bakeries, while also considering market tolerance for price adjustments. The process involves striking a balance to ensure a reasonable pricing strategy.

10. Paragraph 3.7, 3.31, 3.51 – increase in costs regardless of change in POS system
 - (a) It is true that costs generally will increase for reasons other than the transition to the new POS System.
 - (b) If Bakers Delight remained with current POS system then the costs incurred by Franchised Bakeries would increase. To curtail this, Bakers Delight sought out the new POS System supplier which offered similar costs but with more features and reliability.
 - (c) Bakers Delight's Application intends to minimise costs that are above and beyond the fees associated with the change to the new POS System.

11. Paragraph 3.10 – limitation on price gouging
 - (a) Of all existing Promotion Discounts reviewed by BDH, 70% of all price deviations occurred within three price tiers from the RRP, and 80% of all deviations occurred within 4 price tiers from RRP.
 - (b) Only 3% of the 278 deviations were more than \$4.00 above the RRP, and 5% were \$3.00 above the RRP.
 - (c) Based on Schedule 4 of the Application
 - (i) Combination F – RRP \$12.00, one price deviation that is \$4.00 (33%) above the RRP;
 - (ii) Combination G – RRP \$6.50, one price deviation that is \$5.50 (85%) above the RRP;
 - (iii) Combination H – RRP \$8.00, one price deviation that is \$5.50 (69%) below the RRP but two price deviations that are \$10.80 (135%) above;
 - (iv) Combination I – RRP \$7.50 – two price deviations above \$12 (more than 60% above RRP).

12. Paragraph 3.19 – customer experience with and without Proposed Conduct
 - (a) Bakers Delight submits that the customer and franchisee experience with the new POS System will not be the same with and without the Proposed Conduct.
 - (b) If the Proposed Conduct is not authorised and Bakers Delight is required to allow Franchised Bakeries absolute flexibility to select the price of each Promotion Discount in accordance with Option 1 of paragraph 1(i) then the performance of every transaction will deteriorate due to the large number of Promotion Discount Records, regardless of whether the transaction relates to Individual Products or Promotion Discounts.
 - (c) The overall shopping check out experience would be adversely affected and worse than the current performance.
 - (d) If Bakers Delight purchases a larger server to facilitate the Promotion Discount Records and maintain a performance quality that is similar to the current POS system, then all Franchised Bakeries will incur an additional \$300 per year in technology fee as outlined in paragraph 1(j)(ii).

- (e) Franchised Bakeries are likely to on-charge the additional costs to consumers by way of increasing the price of Bakers Delight products.

13. Paragraph 3.57 and 3.58 – royalty fee

Range of royalty fees

- (a) Bakers Delight allow Franchised Bakeries to select from three royalty fee arrangements to suit their needs, namely:
 - (i) The payment of the standard upfront franchise purchase fee (Franchise Fee), with the corresponding standard (lower) royalty fee of a%;
 - (ii) The payment of a lower Franchise Fee, with a 0.5% higher royalty fee of b% which effectively means the Franchise Fee is payable over the term of the Franchise Agreement; or
 - (iii) The payment of c% royalty fee, being 1% higher than the standard royalty fee, plus a leased asset fee.
- (b) These arrangements were introduced after receiving feedback from Franchised Bakeries.

Cash flow – lower Franchise Fee, higher royalty fee

- (i) The royalty fee arrangement under paragraph 13(a)(ii) is usually selected by Franchised Bakeries who may not have the ability to pay the standard upfront Franchise Fee, or prefer this option as a way to manage their cash flow.
- (ii) This arrangement allows the Franchised Bakery to pay the equivalent of the standard upfront Franchise Fee in royalty fees payable over the term of the Franchise Agreement.

Business Lease

- (iii) In typical Franchise Agreements, the Franchisee Bakery owns the bakery assets in the business. The royalty fee arrangement under paragraph 13(a)(iii) is only available for Business Lease franchise arrangements which are offered to prospective franchisees who may not be able to secure external finance to fund all or part of the costs of the acquisition of a Franchised Bakery.
 - (iv) In a Business Lease arrangement, the Franchisee Bakery does not own the bakery assets, rather the Bakers Delight owns them and leases them to the Franchisee for a fee. Business Lease arrangements are short term arrangements, with the Term being three years on average.
 - (v) The Franchisee enters into a Franchise Agreement with Bakers Delight with additional provisions for the lease of the bakery assets. The Franchisee receives full disclosure of information in compliance with the Franchising Code of Conduct.
- (c) Bakers Delight reiterates that the range of royalty fees were introduced to allow Franchised Bakeries to select the royalty fee and upfront Franchise Fee that most suits their financial situation.

Definition of royalty fee

- (d) Bakers Delight submits that paragraphs 3.57 and 3.58 incorrectly state that Franchised Bakeries pay royalty fees based on gross sales.
- (e) Under the Franchise Agreement:
 - (i) The royalty fee is a percentage of '*Net Sales plus GST*';
 - (ii) Net Sales is defined as '*Gross Sales excluding GST*'; and
 - (iii) Gross Sales is defined as '*the total dollar amount of all sales of any goods in or from the Bakery Business or from the Bakery Premises, including sales on credit, online sales through the E-Commerce Service and/or any Third Party Online Ordering Services and including any GST included in such amount*'.
- (f) Accordingly, there is a positive correlation between the profitability of Franchised Bakeries and Bakers Delight. It is in Bakers Delight's best interests for Franchised Bakeries to set their own prices at optimal prices because the royalty fee payments are a percentage of the Franchised Bakeries' Net Sales.

14. Further submissions by Bakers Delight

- (a) Bakers Delight has communicated to Franchised Bakeries about the Proposed Changes on previous occasions – see further submission dated 2 October 2023.
 - (i) These communications did not receive any negative feedback or criticism from the Franchised Bakeries.
 - (ii) Furthermore, changes to the POS System were discussed with the franchisee roundtable which consists of a number of franchisees. No objections to the Proposed Conduct were raised in this forum.
- (b) It is noted that these communications did not explicitly state that all Franchised Bakeries would incur additional costs of around \$300 per year if the Proposed Conduct is not authorised.

Yours sincerely



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Principal

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