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Causes of disruption to franchise operations

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Abstract

In this paper, factors that disrupt the operations of a franchisor are examined. Two variables, franchise disputes and franchised outlet conversions, proxy for franchise disruption. This study investigates two possible causes of disruption to the franchise: lack of franchisor support and stage of franchise life cycle. Data obtained from a survey of the population of Australian franchisors in 1998 are analyzed using structural equation modeling (SEM: Amos). The analysis concludes that the provision of support services to franchisees is not a significant cause of system disruption. However, the stage of life cycle development is significant with older and larger franchises experiencing greater levels of disruption.

Keywords: Causes of disruption; Franchise disputes; Franchised outlet conversions

1. Introduction

Much of the early franchising literature was concerned with the ownership redirection thesis, that is, whether vertically structured franchise systems would revert to integrated horizontal structures of predominantly company-owned outlets in the latter stages of their life cycles (for example, Oxenfeldt and Kelly, 1968; Caves and Murphy, 1976; Lillis et al., 1976; Brickley and Dark, 1987). In this paper, the franchise life cycle is examined from the perspective of its disruptive effect on the franchise.

Previous researchers argued that firms used franchising as a means of rapidly penetrating new markets where capital constraints would normally hinder such expansion. Under this view, franchisees were seen as a means of supplying the necessary monetary and human capital to enable firms to achieve optimal size. Then, when the firms were well established, it was theorized that franchisors would buy back the most profitable outlets to retain as company-owned outlets. Franchising was regarded as a short-term approach enabling firms to expand into markets using franchisee capital, with a strategy of acquiring the more profitable outlets for company ownership in the long run.

Results are mixed in the ownership redirection literature regarding this thesis of organizational development. In their meta-analysis of studies of ownership redirection, Dant et al. (1996) highlight the inconsistencies of methodological issues in the literature such as sampling frame and operationalization of variables, no doubt leading to such widely mixed results (for example, Martin, 1988; Carney and Gedajlovic, 1991; Lafontaine, 1992; Dant and Paswan, 1996). Hence, the issue of ownership redirection in the latter stages of the franchising life cycle remains unresolved.

Life cycle patterns have also been examined from the perspective of small business and franchise failure rates (for example, Evans, 1987; Bates, 1995; Bates and Nucci, 1989; Castrogiovanni et al., 1993) where age and size of firms have been isolated as contributing factors in the survival of both independent and franchised businesses.

In this research, the life cycle perspective is extended to develop a model of disruption in franchise systems. The model is developed in the next section.

2. Model of franchise system disruption

What constitutes success or failure in business operations is a matter of definition. Because of the difficulty of measuring firm performance via an economic analysis, most studies have resorted to surrogate measures of failure (Everett and Watson, 1997). For instance, measures such as closure of the business (Bates and Nucci, 1989; Dunne et al., 1989), changes in ownership of the business (Star and Massel, 1981; Stewart and Gallagher, 1986; Williams, 1993), bankruptcy (Hall and Young, 1991), and inadequate

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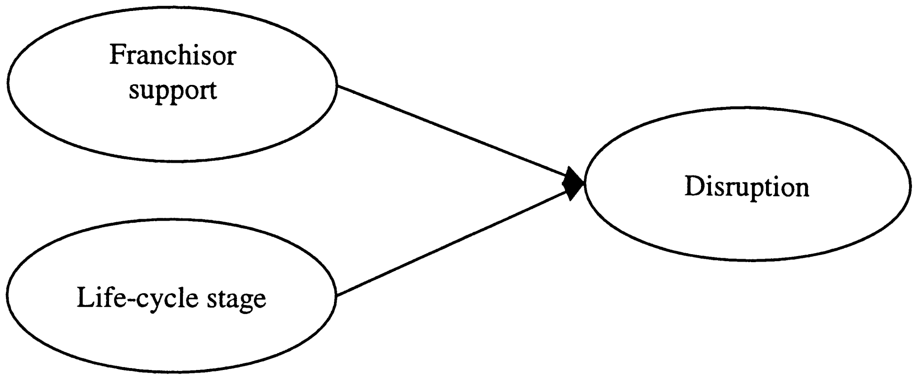

Fig. 1. Model of franchise disruption.

financial returns (Williams, 1987) have been used in studies of business failure.

When extending the analysis of business failure to franchising, the problem of data collection becomes apparent. No comprehensive database of franchisors or franchisees is available in Australia, so researchers must develop their own. While franchisors may be willing to disclose information about the history of their franchised outlets, it is not possible to access failed franchisors. The magnitude of such franchise system failures is unknown but may be disturbingly high. For instance, in a report using the same data as the present paper the authors found that in the 6-month period from checking firm details in the Telstra White Pages on the Internet (updated daily) to follow-up of non-respondents, 13.4% (127 out of 946 firms) could not be located and were presumed to be no longer operating (McCosker and Frazer, 1998). With the franchisor no longer in operation, the destiny of associated franchisees is unknown.

This data availability constraint means that franchise system failure is difficult to analyze and new constructs of interest must be developed. While franchise failure is final, it is at the end of a progressive continuum beginning with the seeds of franchisee discontent and moving through various stages of disputation, contract terminations and sale or conversion of outlets, before finally resulting in closure (Holmberg and Boe, 1996). Hence, there may be factors that are associated with disruption in the system that ultimately affect the well-being of the franchise.

In this research, two main factors associated with disruption are proposed: (1) communication problems leading to disputes and (2) the conversion of franchised outlets to some other form of ownership. When a communication breakdown occurs between a franchisee and franchisor that is serious enough to result in either litigation or mediation procedures, a negative impact will most likely flow on to the franchise (McGlinchey and Thompson, 1991). Likewise, dilution of the franchise's brand name capital may result where previously franchised outlets are taken over as company-owned outlets (either bought back or acquired) or are closed or leave the system to operate independently (Manolis et al., 1995).

In this paper, two constructs (franchisor support and life cycle stage) that are believed to be associated with disruption in a franchise are analyzed (Fig. 1). The hypotheses are developed next.

3. Hypotheses development

3.1. Franchisor support

One of the attractions of franchising for prospective franchisee investors is the provision of start-up and ongoing support by the franchisor (Sherman, 1993). Franchisees are often inexperienced in running a business or are new to self-employment and so turn to franchising as a means of acquiring the necessary expertise through a successful franchisor's blueprint. There is some evidence to suggest that franchisees are willing to pay more than independent business owners (in terms of capital outlays and franchise fees) to enter franchising and presumably benefit from franchisor support services (Knight, 1984).

The success of a franchisee's outlet is very much dependent on the assistance provided by the franchisor (Terry, 1993). Many franchisors will select franchisees who have no previous experience in the industry (Mendelsohn, 1993; McCosker and Frazer, 1998) and some even actively recruit inexperienced franchisees because they feel they will be easier to indoctrinate into the system. For example, Oz Design Furniture claims that 'no experience is necessary, as design buying, training, and marketing are provided' (Switzer, 1995, p. 86). Normally, this lack of knowledge and experience would provide a barrier to entry for an independent operator. However, entry is made possible for these franchisees due to the comprehensive nature of training and other support provided by the franchisor (Hall and Dixon, 1989).

Franchises that have well-developed start-up support services (such as comprehensive initial training and de-