

Franchise turnover and failure New research and perspectives

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Abstract

Entrepreneurship literature has long noted likely significant new venture failure rates. This paper's new franchise failure concept reconciles many prior, seemingly inconsistent study results based largely on franchisor's surveys. Data include more than 800 franchise systems and 250,000 franchise outlets over four consecutive years and are based on state-required Uniform Franchise Offering Circular (UFOC) registration data. Overall franchisee turnover rates are significant and appear to have increased. The result is a 1997 median franchisee turnover with a transfer rate of 10.49% (8.86% in 1994). Franchisee failure and turnover are important areas that merit further study and analysis. © 2002 Elsevier Science Inc. All rights reserved.

1. Executive summary

Entrepreneurship literature has long noted significant new venture failure rates. Furthermore, few franchise topics have generated more interest over the years than franchise failure rates. Past franchisee failure literature, based largely on franchisor surveys, used very divergent concepts and indicated widely ranging failure estimates. On the low end, many studies used the old Department of Commerce numbers in the 4–5% range. On the higher end, some estimates were in the 25–35% range (Hartnett, 1992).

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This paper presents both a broader concept of franchisee failure and new longitudinal data. The new concept is significant because it reconciles many of the prior, seemingly inconsistent study results. These new data are significant because of their scope (more than 800 franchise systems and 250,000 franchise outlets), the duration (four consecutive years), and the validity of being provided under oath (required by state registration statutes). The new concept and data combination facilitates new explorations of research questions surrounding franchisee failure.

The facet of failure studied was “turnover,” the term specified in the Uniform Franchise Offering Circular (UFOC) disclosure documents. Whether viewed as means or medians, and with or without transfers, overall franchisee turnover rates appear to have increased noticeably over the 4-year study period. The result is a 1997 median turnover with transfer rate of 10.49% (8.86% in 1994).

A broader stakeholder view of franchisee failure that goes beyond the franchisor and franchisee reveals many additional actual and/or opportunity costs/losses. Suppliers, financial institutions, customers, investors, and others all suffer as the circle of real and/or opportunity cost/loss widens because of franchisee turnover. Franchisee turnover itself, however, is only one step on the failure continuum. If recognized and managed at earlier steps on the continuum, systematic risk mitigation strategies might be developed, losses minimized, and turnover possibly avoided. Hence, these strategies may avoid real and/or opportunity costs if franchisor–franchisee relationships, business issues, and failure risk are managed appropriately.

This paper’s increased UFOC data validity and franchisee turnover insights represent new and important information for existing and prospective franchisee ventures. Franchisee failure and turnover are important areas that merit further study and analysis.

2. Divergent franchisee “failure” concepts/definitions and research methodologies in perspective

Entrepreneurial new venture creation and entrepreneurial activity, in general, has long been seen as a significant contributor to economic growth and development and individual enterprise advancement (Falbe et al., 1998). Franchise systems constitute one form of entrepreneurial ventures that have contributed significantly to economic development results in the United States and other countries. Franchising has also been seen as an alternative to individual self-employment decisions to start an independent small business (Kaufmann, 1999; Williams, 1998). Central to these new venture alternative decisions is the likelihood of success or failure. This study focuses on the critical importance of failure prospects and failure management strategies on entrepreneurial franchise decisions.

Prior research studies (Cross, 1994, 1998; Castrogiovanni et al., 1993) and the International Franchise Association have pointed to the need for more reliable franchise failure studies. Franchise failure research is strongly influenced by the failure concept underlying the study’s research perspectives, data collection, analysis, and resulting research conclusions (Bates, 1995b; Stanworth and Dandridge, 1994). Diverse franchisee “success” or “failure” realities and perceptions exist among researchers and franchise system stake-

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