



## A model of trust and compliance in franchise relationships

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### ABSTRACT

Despite the danger of franchisee non-compliance as a severe impediment to overall franchise operation and performance, there is currently minimal understanding of the key factors that lead to these behaviors. Using a foundation of relational exchange theory, we construct and test a model that demonstrates how two distinct forms of trust, based upon perceptions of franchisor integrity and franchisor competence, are critical to explaining the roles that relational conflict and satisfaction play in influencing franchisee compliance. Implications of these findings are then demonstrated to have compelling relevance to the effective management of franchise systems.

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### 1. Executive summary

Business format franchise organizations recognize that the success of their system is directly influenced by their ability to design and enforce rigid operational standards across their network of retail units. Yet franchise networks can be characterized as a community of entrepreneurs, each of which has aspirations toward autonomy and innovativeness. As a consequence, a significant challenge for franchisors concerns their ability to enhance franchisee compliance with these standards without thwarting franchisee ambition.

While dysfunctional relationship conflict has long been understood to adversely affect franchisee compliance (Grünhagen and Dorsch, 2003), the mechanisms by which this occurs are not well understood. Although trust has been advanced as playing a critical role in facilitating relational exchange and reducing the harm that conflict exerts on compliance, limited attention has been given to the specific role that trust and its various dimensions play in franchisee compliance.

Using a theoretical foundation of relational exchange to explain the critical role that trust plays in enhancing franchisee compliance, the authors advance a series of multidimensional models which clarify the interrelated roles of satisfaction, conflict, and trust as they relate to levels of compliance. These models are then assessed empirically by comprehensively surveying 135 franchise entrepreneurs belonging to a single automobile service franchise system. Confirmatory factor analysis is used for validation of our measures, and structural equation modeling is used to test our hypotheses.

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The results of our analyses clearly distinguish between trust in franchisor *integrity* and trust in franchisor *competence*, and demonstrate that each is differentially impacted by relationship conflict. We further demonstrate that these two forms of trust are robust predictors of franchisee compliance to organizational norms. We contend that this multidimensional conceptualization of trust within conditions of relational exchange offers significant advantages to franchisors in their efforts to improve franchisee compliance with organizational policies.

Further, by positioning our results within the context of relational exchange theory, we argue that contractual parameters of a franchise relationship, while necessary, are generally insufficient for aligning the interests of franchisors and franchisees such that compliance is optimized. To augment contractual policies, norms of reciprocity can be invoked by introducing relational forms of governance (Blau, 1964). In franchise environments characterized by high levels of perceived integrity—and to a lesser extent, competence—and where entrepreneurial aspirations for autonomy are supported, these norms of reciprocity can then be expected to lead to cooperative behaviors and a higher level of compliance with relational expectations.

## 2. Opportunities, entrepreneurship, and franchising

In constructing a framework for conceptualizing the domain of entrepreneurship, Shane and Venkataraman (2000) distinguish between two distinctive processes by which entrepreneurs engage in market opportunities: discovery and exploitation. This domain of entrepreneurship can extend to those who can fully exploit the opportunities made available to others, including the acquirers of these opportunities (Shane and Venkataraman, 2000). Franchising is a system of economic and relational organization (Venkataraman, 1997) that first identifies opportunities in the marketplace and then furnishes these opportunities to other entrepreneurs. Franchising thus represents a compelling area of business research, as it introduces creative means–ends (Eckhardt and Shane, 2003) in its embrace of both the fundamental *object* of entrepreneurship (opportunity), and also a fundamental *process* by which the major barriers to entrepreneurial exploitation of these opportunities are diminished.

Franchising also importantly embodies a unique form of business collaboration between multiple entrepreneurs (Baucus et al., 1996; Leblebici and Shalley, 1996; Shane and Hoy, 1996). As a carefully orchestrated entrepreneurial partnership, franchising requires the complex delineation and integration of individual entrepreneurial roles for both franchisor and franchisee (Kaufmann and Dant, 1998). Functioning in diverse roles by developing new markets and products, identifying new pockets of demand, supplying necessary capital, and in absorbing the risks associated with these activities, franchisees become indispensable partners in the economic ventures of the retail franchisor (Kaufmann and Eroglu, 1999; Minkler, 1992). This complex entrepreneurial partnership, which is a distinctive feature of franchising, creates unique opportunities and hazards for each partner within the relationship.

Unique hazards exist within franchising because the profitable and comprehensive exploitation of market opportunities depends heavily upon the dedicated and unconditional compliance of all entrepreneurial partners. Although franchising represents one form of entrepreneurship where autonomy and dependence can coexist synergistically (Dant and Gundlach, 1998), franchisees typically have similar motivations to those of conventional entrepreneurs (Stanworth, 1995). This makes the necessary balance between process conformity and entrepreneurial autonomy a major challenge in franchising.

Despite the potential benefits that arise from this balance between autonomy and imposed control, and despite franchisees' initial acceptance of control at the commencement of the franchise relationship, issues of compliance are likely to emerge in the evolution of their association as sources of conflict. This is because as relationships evolve, franchisees gradually learn their franchisor's operational methods and strategies, as well as their strengths and weaknesses. With increasing tenure and success, franchisees are more likely to believe their performance is attributable to their own entrepreneurial skills and efforts. In this way, ambitious and successful franchisees can lose their commitment to the operational formula of the franchise organization as they become more confident in their own entrepreneurial abilities (Buchanan, 1992), leading to lower levels of compliance as experience is gained (Stanworth, 1995). This confidence is reinforced by the tendency of entrepreneurs to display significant levels of self-serving attribution bias (Rogoff et al., 2004) or from entrepreneurs' significantly greater likelihood of believing in their own self-efficacy (Chen et al., 1998).

As a partial consequence of these biases, franchisees will tend to progressively reassess relative franchisor value over the course of the franchise relationship (Morrison, 1998; Grünhagen and Dorsch, 2003; Phan et al., 1996). Consistent with this, Gassenheimer et al. (1996) observed that franchisees' assessments of the competitive position of the franchise system decrease as they gain greater franchise experience. As a result, the perceived contribution and role of the franchisor becomes marginalized and its relative knowledge-based power erodes. The franchisee will then often begin to question the fairness of the contract and become dissatisfied. When these perceptions collectively increase across the population of franchisees, the balance of power can shift away from the franchisor and begin to favor the franchisees, leading to system-wide hazards to commitment and compliance.

The challenges that accompany efforts to balance franchisee aspirations for entrepreneurial autonomy with the franchisor's efforts to enforce compliance to operational standards are likely to intensify as the relationship matures, resulting in progressively more conflict. In most of these partnerships, the relationship evolves through various stages where conflict, trust, and efforts to enforce compliance take on various degrees of importance to each partner at different times. As a result of this complex and continual metamorphosis within a franchise relationship, this area merits particular investigation within the research domain of entrepreneurship (Kaufmann and Dant, 1998).

According to Geyskens et al. (1999), few prior studies have been able to shed light on understanding the determinants of relative channel partner performance or satisfaction. Consequently, the purpose of this research is to more fully understand the nature of the intricate relationship between franchisor and franchisee, and the influences on this relationship with regard to issues

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