How Can Regulation be Enhanced? New Perspectives on the Causes and Continuation of Franchising Conflict in Australia

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Abstract

Although federal Australian franchising sector regulation promotes franchise system disclosure and provides for mandatory conflict mediation, there is some concern that inequities exist within the conflict management process. As a result regulators are reviewing existing regulation and investigating alternative dispute resolution options in an attempt to proactively manage franchising conflict. Central to this process is identifying the sources of conflict in the franchising relationship. *Conflict* refers to the existence of deep underlying differences between involved parties that result in responses to potential or actual obstructions that impede one or more parties from realising their goals. This inductive research extends the conflict literature in dyadic exchange relationships through investigating antecedent influences upon franchising conflict from the franchisor and franchisee perspectives. A total of 24 interviews was conducted with lawyers, mediators, brokers, franchisors, franchisee advocates, franchise consultants, franchising academics, franchisor industry representatives and franchising media representatives. The key findings suggest that a lack of due diligence is associated with the formation of unrealistic expectations which increases the potential for future relational conflict. Although franchising experience impacts upon operational approaches and conflict, the role played by third parties and market conditions both appear to exacerbate dissatisfaction in most franchise systems. The concept maps and preliminary conceptual models presented in this paper will be tested in a large quantitative survey of key franchising stakeholders in the near future.

Introduction

Although Australia has been coined the 'franchise capital of the world' (Walker 2004, p. 36) due to its impressive growth in franchise units and sector turnover, the Australian franchising sector is not without its problems. In 2006, some 17 percent of franchisors reported being in significant conflict with franchisees (Frazer et al. 2008). *Conflict* refers to the existence of deep underlying differences between involved parties that result in responses to potential or actual obstructions that impede one or more parties from realising their goals (Bradford, Stringfellow, & Weitz, 2004). Within the franchising context conflict may culminate in substantial disputation between franchisors and franchisees in which matters are referred to external advisors (such as lawyers and mediators) for action (Giddings et al. 2008). Moreover, numerous reports in the media concerning rogue franchisors using their dominant power position to force concessions from inexperienced and vulnerable franchisees have called into question the effectiveness of current federal regulation (Frazer et al. 2007). Although the Franchising Code of Conduct (the 'Code') was introduced in 1998 to improve disclosure provisions and address the perceived imbalance of power in franchising relationships (Lim & Frazer 2002), there are concerns as to its effectiveness in conflict management (Featherstone 2006). In particular, a recent series of governmental inquiries into the effectiveness of current 'Code' provisions and franchise operations is testament to growing public concern about levels of franchising disputation and the fairness of current sector regulation. This research takes a preliminary step towards developing strategies to complement existing federal regulation through examining potential sources of conflict in franchise systems.

The Australian franchising sector incorporates 71 400 units belonging to 1 100 systems that contributed AUD$130 billion to the local economy in 2007 (Frazer et al. 2008). Given the sector's importance to the national economy it is not surprising that the sector has attracted specific regulatory measures to safeguard the interests of inexperienced and less powerful franchisees. The Code requires disclosure of information to potential franchisees and participation in mandatory dispute resolution processes in the event of conflict in the system. However, compulsory mediation may not be the optimal method for addressing franchising conflict and it appears that it is often used as a remedial method of conflict resolution rather than a proactive approach to managing sustainable franchising relationships (Giddings et al. 2008). What is needed is a better understanding of the *antecedent influences upon conflict* (from both a franchisor and franchisee perspective) so as to inform franchising partners and public authorities about effective franchise conflict management.

There has been considerable research conducted into conflict between exchange partners in channel relationships (e.g. Dant & Schul 1992; Spinelli & Birley 1998). Dant & Schul (1992) identified that conflict resolution strategies in asymmetric exchange relationships were dependent upon the characteristics of the issue (intensity, complexity and financial stake associated with the issue in dispute); the relationship between principal and agent (e.g. trust, dependence and relationism); individual personality characteristics of the parties (e.g. importance placed upon autonomy); external influences (market demand); and the organisation's structural characteristics (level of bureaucracy). However, in its submission to

the 2000 review of the Franchising Code of Conduct, the National Alternative Dispute Resolution Advisory Council (NADRAC) identified a range of further causes of franchising disputes (e.g. external advisor influences, financial issues stemming from family/personal issues), suggesting that previous research may not have captured the full range of factors impacting upon conflict in franchising (NADRAC 2000). Thus, this paper fills an i*mportant gap* in the literature through investigating the following research question:

RQ. What are the antecedent influences upon franchising conflict from both a franchisee and franchisor perspective in the highly regulated Australian franchising sector?

Franchising regulation in Australia

Since 1998, franchise practice in Australia has operated within the framework of a mandatory Code of Conduct (Franchising Code of Conduct 1998). The Code, administered by the Australian Competition and Consumer Commission (ACCC), was enacted to assist both franchisors and franchisees to make informed decisions prior to entering franchise agreements, and also provide enforceable guidelines to facilitate efficient and effective dispute resolution. Specifically, the Code requires disclosure of pertinent information to prospective franchisees and participation within the dispute resolution process in the event of conflict. However, while mediation appears to be a low risk coordinative mechanism to alleviate distrust between franchise partners (Dant & Schul 1992), a number of dispute resolution commentators (e.g. Levingston 2008; McGillicuddy et al. 1987) have questioned the effectiveness of compulsory mediation given the power imbalance observable in franchise relationships. As a result of this, and a number of high profile franchising disputes (e.g. closure of a Kentucky Fried Chicken (KFC) store in Western Australia after 20 years) (SBDC 2008), a number of state and federal enquiries have been conducted into the operations of the sector.

From 2006 to 2008 no less than four major franchising sector enquiries were conducted in Australia. The salient recommendations from these inquiries included the need for better franchisee education, more effective disclosure requirements regarding potential franchisee liability in the event of franchise system failure, clarification of member rights in franchise unit renewals, and less flexibility in mediation processes to ensure greater equity in negotiations. In the most recent inquiry into the Franchising Code of Conduct, the Federal Parliamentary Joint Committee on Corporations and Financial Services recommended changes to the content and timing of disclosures, Code enforcement provisions and the introduction of a good faith clause in the Code. However, there is some suggestion that a '…more comprehensive analysis of dispute resolution options could have been expected from these inquiries' (Giddings et al. 2008, p. 2). In particular, conflict theorists and mediation specialists have called for a greater understanding of the *causes* of disputes to ensure the adoption of workable systems-based approaches to franchise conflict management (e.g. Constantino & Meerchant 1996; Levingston 2008). To this end, this research will utilise an inductive methodology to extend our current understanding of the causes of franchising conflict in the Australian franchising sector.

Method

The objective of this research was to investigate *antecedent influences upon franchising conflict in Australia*. An exploratory semi-structured interview approach was adopted to gather in-depth information within a real-life context with the aim of building theory (Eisenhardt 1989). Given the nature of the research problems, a realism research design was adopted to facilitate understanding, capture the complexities of this subject area and triangulate multiple perceptions about the nature and form of reality so as to arrive at analytically generalisable results (Patton 2002). Although qualitative research is often criticized for lacking objectivity and rigor (Johnson 1997) we believed it to be the most efficacious approach for obtaining 'rich', 'deep' and 'real' information (Deshpande 1983, p. 103) through 'tracking down patterns [and] consistencies' (Mintzberg 1979, p. 584) so as to arrive at credible and confirmable results (Merriam 1998; Yin 2003).

The importance of appropriate sample selection is acknowledged in the research methods literature (e.g., Miles and Hubermann 1994). In this research, sample selection was purposive and theory driven (Gubrium and Holstein 2001) and lawyers/mediators, franchisors, franchise consultants, franchising academics, franchisee advocates, franchise brokers, franchisor representatives and franchising media representatives were interviewed. Expert interviews were chosen to ensure broad coverage of a range of issues surrounding franchising conflict from multiple stakeholder perspectives. In addition, these interviewees had knowledge of franchising regulation and were able to draw upon their many years of experience and recount numerous examples (of disputation) to provide a comprehensive picture of franchising conflict. A snowball sampling technique was used in which each respondent was asked to suggest another person with similar characteristics (Aaker et al. 2005). Nominated participants were then contacted by phone or email and sent an information sheet explaining the purpose of the research (via email or fax) and inviting them to participate in the study. Assurances were given as to the ethical conduct of the study and provisions to ensure interviewee anonymity and confidentiality.

Consistent with expert recommendation, interviews were conducted until data reached a point of saturation and no new themes emerged (Patton 2002). As a result, a total of 24 semi-structured in-depth interviews was conducted. The sample size was adequate in that it captured variability within the respondent groups and the dimensions in which we were interested (individual, situational and structural) from both the franchisor and franchisee perspectives. In total, four mediators, six lawyers, two franchisors, three franchisee advocates, one media representative, one franchisor representative, three franchising consultants, two franchising academics and two franchise brokers were interviewed. Face-to-face interviews were conducted in major centres throughout the east coast of Australia and generally lasted between 1 and 1.5 hours in duration.

Strategies used to both understand and control for researcher bias were reflexivity (Lietz et al. 2006) and negative scenario sampling (Patton 2002). In particular, the interviewers embarked upon a process of critical self-reflection to gain clarity of vision and sought to disconfirm emerging trends so as to promote the validity of the field study (Douglass and Moutstakas 1984). While this did not result in a complete suspension of personal expectations and judgment, it nevertheless did allow the researchers to actively listen and record (with permission) what the respondents were saying. A research protocol was used to enhance validity through ensuring broad consistency across cases. Initial questions covered background and demographic facts. The second section of the interview protocol focused on respondent perceptions of the sources of conflict in franchise systems. Respondents were

initially asked to detail their current understanding of influences upon franchising conflict and then further probing questions were used to elicit greater meaning and detail. Questions were deliberately broad in scope:

In your experience, what misconception do franchisees have when they first join a franchise system?

What is the role of third parties in the dispute resolution process?

How effective has compulsory mediation been in averting further litigation?

Each broad question was followed by probing questions to elaborate on key issues presented in the answer and to ascertain examples of purported behavior. Consistent with expert recommendation, the research team reviewed several of the (initial) interviews to evaluate the need for any additional probing questions and highlight issues relevant for the remaining interviews (Dick 1990).

The data-mining tool Leximancer was used to analyse the interviews and develop a conceptual map for each category of analysis. Leximancer undertakes a form of automatic content analysis (Smith & Humphreys, 2006) thus reducing potential researcher bias (Nisbett & Wilson, 1977). Based on the notion that words tend to correlate with other words over a certain range within the text stream (Beeferman et al., 1997), Leximancer examines the text data to develop a ranked list of lexical terms based around frequency and co-occurrence usage (Smith & Humphreys, 2006). By means of a process including seeding a bootstrapping thesaurus builder, these terms are then used to develop both a text concept index and concept co-occurrence matrix which, subsequently, are used to produce a two dimensional concept map via a clustering algorithm (Smith & Humphreys, 2006). Additionally, Leximancer has been shown to address issues of reliability (Alexa & Zuell, 2000) and to improve validity in qualitative research (Smith & Humphreys, 2006).

Franchisee perspectives on conflict

Findings are categorised into ex-ante and ex-post influences upon franchising conflict from both the franchisee and franchisor perspective. Concept maps for franchisees and franchisors are presented in Figure 1. Conceptual models depicting franchisee and franchisor influences upon franchising conflict are presented in Figures 2 and 3 (respectively).

INSERT FIGURE 1 ABOUT HERE

Ex-ante influences

Findings 1: Individual influences upon conduct of due diligence (prior to franchise unit purchase) and franchise system conflict

Franchising research has identified that channel member misconceptions impact upon future goal alignment and performance (Hing 1996) and that these misconceptions are largely dependent upon a prospective franchisee's inability to conduct adequate due diligence regarding the business concept prior to purchase (Giddings et al. 2008; Terry 2008). Although many franchisees are precluded from attaining sound advice due to limited financial capability, there is some suggestion that an individual's education and experience impacts upon access to networks, opportunity recognition and business success (Robinson &

Sexton 1994). Given this, it appears reasonable to assume that education and previous employment experience will impact franchisee approaches to due diligence prior to entering the franchise relationship. Indeed, previous research suggests that franchised businesses are more likely to fail than independent businesses due to lower levels of formal education in the franchisee population (Bates 1995). In a recent Franchising Australia national survey, less than half of franchisees had prior self employment experience or had completed secondary education (Frazer et al. 2008), lending tentative support to the possibility that many franchisees may not know what questions to ask, or where to get appropriate advice and assistance during the business assessment process. Moreover, in a recent report by the Federal Parliamentary Joint Committee on Corporations and Financial Services, reference is made to problems associated with under-capatilised and ill-informed franchisees that receive limited or incorrect advice prior to entering franchise agreements[1].

In this research, a majority of interviewees suggested that most franchisees in conflict with franchisors had not conducted adequate due diligence prior to entering the franchising agreement. Overall, there was consensus that franchisees who did not adequately review the franchise business concept or had not fully assessed their capacity to fulfil their role as franchisee were more likely to possess unrealistic expectations of future unit performance. This was viewed as contributing to reduced levels of franchisee satisfaction and increased levels of unit underperformance and relationship conflict. A strong majority of interviewees attributed the lack of personal and financial risk assessment to financial constraints and lack of business acumen. For instance, '…franchisees often have unrealistic expectations. They don't always know what they are signing – even acknowledgement statements do not…mean they know what they should expect as a franchisee' (Lawyer).

Many interviewees suggested that franchisees that had not had previous self-employment experience were less likely to know what questions to ask, or who to approach for assistance in assessing their suitability to the franchising concept. In addition, half the respondents suggested that these individuals often did not have access to personal or financial networks, which has been shown to assist in the assessment of business opportunities (Ardichvilli et al. 2003). Ten interviewees also nominated that prospective franchisees with less formal education were less likely to enlist the support of qualified external advisors to assist in reviewing the business model prior to purchase. Thus, it is postulated that:

P1a A prospective franchisee's financial capability is positively related to the conduct of adequate due diligence prior to the purchase of a franchised unit.

P1b A prospective franchisee's business experience is positively related to the conduct of adequate due diligence prior to the purchase of a franchised unit.

P1c A prospective franchisee's level of formal education is positively related to the conduct of adequate due diligence prior to the purchase of a franchised unit.

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[1] See http://www.aph.gov.au/senate/committee/corporations_ctte/franchising/report/index.htm

P2 A prospective franchisee's conduct of adequate due diligence prior to the purchase of a franchised unit is negatively related to the formation of unrealistic expectations regarding anticipated outcomes associated with the purchase of a franchised unit.

<u>Ex-post influences</u>

Findings 2: Individual influences upon unit performance and franchise system conflict

The extant literature has identified the relationship between an individual's management of work/life balance and satisfaction with employment outcomes (Parasuraman & Simmers 2001). In particular, individuals that do not reconcile competing work and life demands are more likely to be adversely affected by stress induced illness from overwork often resulting in reduced levels of productivity and higher levels of absenteeism (Posig and Kickul, 2004). Although franchising is often promoted as a lifestyle choice, there is evidence that this approach is inconsistent with the reality of operating franchise businesses (NADRAC 2000). Most interviewees in this research indicated that franchising conflict was often due to changes in the franchisee's personal circumstances, sentiments echoed in the NADRAC submission report to the 2000 'Franchising Code' enquiry (NADRAC 2000). Nominated factors included 'increased financial demands', and recognition of a lack of 'family time'. However, the majority of interviewees indicated that most conflict arose when franchisees' initial expectations regarding anticipated leisure time were not realised. Another factor nominated by interviewees related to the personalities of individual franchisees. In particular, those that sought greater independence and autonomy through entering franchising were often less likely to comply with system directives, putting strain on their relationship with franchisors. As a result, these individuals were more likely to enter into conflict wit the franchisor, usually early in the franchising relationship (6-12 months).

P3 The greater the personal demands placed upon a franchisee (financial, work-life balance), the more likely that he/she will encounter conflict with the franchisor.

P4 Franchisees with a high desire for autonomy are less likely to comply with system directives and are more likely to encounter conflict with the franchisor.

During the course of the interviews it became apparent that most interview participants believed that franchisee unit performance was largely dependent upon the franchisee's ability to recruit and manage competent staff who would add value to the intra-system brand. Most agreed that franchisees with less business experience were less likely to design systems to recruit and manage appropriate staff. In particular, issues such as staff absenteeism, staff turnover and unproductive employee outputs were regularly discussed. Although most agreed that this was somewhat dependent upon the level of training and support provided by the franchisor, most believed that previous business experience acted as a surrogate indicator of a franchisee's potential to minimise moral hazard (ie. put in the required level of effort in the business) and adverse selection (ie. hire competent staff), and the propensity for franchisees to encounter conflict with franchisors. For example, '…when they are relatively new at franchising it can be disastrous…they don't know the first thing about staffing. Sure

they may get some help, but it's a steep learning curve and it…hits hard in the short-run' (Mediator).

P5a Franchisee experience is positively associated with the development and operation of effective intra-system human resource systems.

P5b The development of effective intra-system human resource systems is negatively associated with conflict in the franchise system.

Findings 3: Franchisee opportunism and franchise system conflict

Franchisee goal alignment is largely operationalised as compliance with system directives in the franchise system (Weaven & Frazer 2007). While franchisee compliance with system directives is likely to be greater in the early stages of the franchisee life-cycle due to the provision of franchisor support (Thompson 1971), this is likely to change over time as franchisees gain more experience in the system (Grunhagen & Dorsch 2003; Kaufmann & Kim 1995). In particular, franchisee comparison levels change and they may be more likely to engage in opportunistic behaviours (e.g. not following quality procedures, purchasing unauthorised products etc) (Hadfield 1990; Wathne & Heide 2000). Most interviewees agreed that franchisees who resisted complying with the terms of the agreement (both explicit and implicit franchise agreement provisions) were more likely to encounter conflict with the franchisor. Common opportunistic strategies employed by franchisees included breaching tying arrangements by selling competing product or additional product lines, breaching territorial restrictions, not maintaining minimum service and quality standards and refusing to honour systemwide promotions.

Most interviewees agreed that while non-compliance often resulted from dissatisfaction with the performance of their franchise unit(s), conflict was sometimes evident even when franchise units were profitable and enjoying sales growth. In particular, non-complying franchisees had often been within the system for a number of years and were of the opinion that they could operate their unit more effectively through adapting to local conditions without franchisor consent. In addition, many of these franchisees perceived little value in paying royalties to franchisors and they had adapted their unit operations beyond the initial franchising business concept. For instance, one consultant stated that '…after they get familiar with the processes and have been in the market a while, franchisees will ask themselves "why am I paying him [franchisor] all this money when he really isn't offering me anything anymore"…this is where it gets complicated'. This has some support in previous research examining how franchisee comparison levels change during the course of the franchising relationship (Peterson & Dant 1990). Thus,

P6a The longer that a franchisee remains in the system, the more likely that he/she will engage in opportunistic behaviours and encounter conflict with the franchisor.

P6b Franchisees that adopt opportunistic operational practices are more likely to encounter conflict with the franchisor.

Findings 4: External influences upon franchise unit performance and conflict

A central theme of the interviews concerned the role of third parties involved in providing advice to franchisees as part of their function in recruiting franchisees for franchisors. All interviewees confirmed that a majority of third-party recruitment firms were unqualified to offer business advice to prospective franchisees and were often ill-informed as to the nature of the franchise business proposition, unaware of the multiplicity of roles that franchisees were required to fill, and were unqualified to advise and/or recruit suitable franchisee candidates. In particular, these third-parties were referred to as 'cowboys' who were motivated by the franchise sale, rather than a long-term value proposition for the franchise system. A majority of interviewees believed that these agents were comfortable with the idea of 'churning' franchisees as they were only motivated by the initial sale and did not have a financial interest in the ongoing success of the franchisee in the system. Somewhat of concern was that most interviewees believed that these third-parties did not tend to work closely with franchisors (as they often represented many franchisors) and that franchisors would delegate the recruiting responsibility to external agencies to ensure system growth and minimise recruitment expenses (e.g. HR staff, advertising, time investment etc). As a result unsuitable franchisee candidates were chosen, which tended to contribute to conflict in franchise systems. Furthermore, the interviewees consistently mentioned that these agencies often provided limited or incorrect advice regarding situational influences upon future franchise unit profitability such as site suitability and existing competition. For example, '…they (third party recruitment agents) do not really know the industry like the franchisors do. They tend to make wild claims just to ensure the sale' (Lawyer). Therefore, the following proposition is presented.

P7 The greater a franchisee's involvement with third-party recruitment agents prior to purchase of a franchised unit, the more likely the franchisee will subsequently encounter conflict with the franchisor.

A majority of interviewees identified the role of future situational influences upon franchisee performance and market based conflict which has some support in the extant literature (Clarkin & Rosa 2005; Phan et al. 1996). Commonly cited issues related to changing economic conditions (e.g. reduction in consumer's discretionary income), increased levels of competition, and challenging staffing issue. Thus,

P8 The greater the market demands placed upon a franchisee (competition, economic conditions), the more likely that he/she will engage in conflict with the franchisor.

Findings 5: Franchisee association and franchise system conflict

Just over half of the interviewees nominated that franchisees were more likely to enter into conflict with their franchisors if they had associated with other franchisees within their system, or sought involvement with franchisee representative bodies. In particular, these franchisees were viewed as being less likely to communicate with franchisors and seek to resolve potential problems before they escalated to formal mediation and litigation. Moreover, association with other franchisees tended to alert franchisees to other problems in the system even though these issues were not the main areas of concern impacting upon

franchisee performance when conflict arose. In addition, eight of the interviewees nominated that peer pressure by other disgruntled franchisees in the system also contributed to a franchisee's commitment to pursue recourse against franchisors. Thus it is proposed that:

P9 The greater the level of association a franchisee has with other franchisees in the system, the more likely that he/she will encounter conflict with the franchisor.

Franchisor perspectives on conflict

Ex-ante

Findings 6: Influence of franchisor experience upon conduct of due diligence (prior to purchase) and franchise system conflict

The selection of suitable franchisee candidates remains one of the most critical decisions in franchising (Clarkin & Swaverly 2006). Previous research has identified that franchisors utilise specific financial and non-financial criteria to ensure appropriate franchisee selection which has been shown to positively influence levels of intra-system cooperation and minimise conflict (Cohen 1971; Jumbulingham & Nevin 1999). However, there is some evidence that less experienced franchisors (in systems with less brand name capital value) approach recruitment on an ad hoc basis, often relying upon potential franchisees meeting set financial criteria rather than non-financial standards (for example, education, industry experience etc) (Weaven & Herington 2007). Moreover, less experienced franchisors may not have the resources or ability to engage in sophisticated recruitment practices, such as psychological profiling, and may find it advantageous to outsource these activities to third-party service providers in the short term (Clarkin & Swaverly 2006; Price 2006). In support of this, there is some evidence that the management of collaborative relationships and determination of optimal management practices, including approaches to recruitment, is reliant upon an entrepreneur's prior business experience (Sampson 2005), and that Australian franchisors favour utilizing franchise brokers in the early stages of the franchise system life cycle (Frazer et al. 2008). However there is also some suggestion that the use of third party recruitment agencies encourages disputation due to intentional or unintentional misrepresentation during the sales process (NADRAC 2000).

In addition to issues surrounding franchisee recruitment, the interviews revealed problems associated with franchisor due diligence regarding the suitability of their business concept to franchising. In particular most interviewees believed that inexperienced franchisors (in their first three years of franchising) were not fully aware of the nature of their business concept and possessed unrealistic expectations regarding the management and future success of their franchise systems. For example, one interviewee commented that 'I've seen a lot of new systems…they…don't have the experience or the resources…they don't even understand what they can do' (Mediator). Although these franchisors complied with Franchising Code of Conduct (1998) guidelines, many were still unaware of the support systems and technical guidance needed to ensure effective implementation of the franchising concept. Furthermore, these franchisors tended to favour a 'unit growth' strategy and were less likely to reject financially-capable applicants. As a result many utilized (internal and external) ad-hoc

approaches to franchisee recruitment, focusing upon building franchise sales, rather than adequately assessing the suitability of potential franchisee candidates. This strategy has some support in the recent literature, with more experienced franchisors adopting consolidatory (rather than rapid) franchise system growth strategies (Hossain & Wang 2008). Although most interviewees did not believe this to be overtly opportunistic behaviour, they did agree that as a result of ineffectual recruitment practices and/or ill-informed third-party legal and business advice, inexperienced franchisors often possessed unrealistic expectations regarding future franchisee performance in the system.

Thus,

P10a Franchisor experience is positively associated with the conduct of adequate due diligence regarding the franchise business proposition.

P10b Franchisor experience is positively associated with the conduct of adequate due diligence regarding the future capacity of prospective franchisees to add value to the system.

P11 Franchisors that utilise third-party agents in the franchisee recruitment process are less likely to avoid the creation of unrealistic franchisee expectations regarding anticipated outcomes.

P12a A franchisor's conduct of adequate due diligence (system) is negatively related to the formation of unrealistic expectations regarding anticipated outcomes associated with franchise system performance.

P12b A franchisor's conduct of adequate due diligence (franchisees) is negatively related to the formation of unrealistic expectations regarding anticipated outcomes associated with the sale of a franchised unit.

P13 Franchisors possessing unrealistic expectations regarding anticipated outcomes associated with the sale of a franchise unit are more likely to encounter conflict with franchisees.

Findings 7: Franchisor opportunism and franchise system conflict

There is considerable evidence that poor recruitment practices by franchisors result in franchisee disinterest, non-compliance, underperformance and conflict (Altinay & Wang 2006; Baucus et al 1996; Dewhurst & Burns 1993; Weaven & Frazer 2007). Although previous research suggests that inexperienced franchisors may recruit suboptimal franchisee candidates to alleviate resource constraints (Frazer et al. 2006), there are also allegations of 'churning' within the franchising sector both in Australia and overseas (Stanworth et al. 2001). Issues surrounding poor recruitment practices by franchisors and deliberate churning strategies were raised in the interviews. In particular all participants agreed that poor recruitment practices fostered franchisee misconceptions regarding their role in the franchise and likely future performance of their franchise unit. Over three quarters of the respondents suggested that franchisors frequently used advertising 'teasers' focused upon lifestyle benefits that did not fully represent the work commitments required when entering systems as

a franchisee. Furthermore, nine interviewees mentioned that many of the franchisors with whom they had contact (in conflict situations with franchisees) had pursued high growth strategies in preference to system development. Many had not fully assessed issues such as site suitability, product supply, or the franchisee's capacity to successfully replicate the franchise business concept. In addition, franchisors' use of third-party recruitment agencies was perceived as beneficial in sourcing franchisee candidates, but often resulted in conflict with franchisees due to misrepresentation issues. Thus,

P14 Franchisors that adopt opportunistic recruitment practices are more likely to encounter conflict with franchisees.

Ex-post

Findings 8: Franchisor support and franchise system conflict

Studies within the small business literature suggest that an entrepreneur's business experience is predictive of future venture success (e.g. Birley & Westhead 1993; Jennings & Beaver 1997). Within the franchising context research has linked the successful operation and survival of franchise systems to the level of prior business experience of the franchisor (e.g. Lafontaine & Shaw 1998). Moreover, the quality of franchisor provided services such as training, has been shown to influence relationship quality in franchising (Spinelli & Birley 1998). Previous research suggests that less experienced franchisors tend to provide more individual support to franchisees (e.g. site selection, financial assistance etc) which often represents a significant cost to the system as they have not yet developed set (and replicable) criteria in these areas (Hossain & Wang 2008). This may result in over-stretched support systems that put significant strain on the franchise relationship, and fuel increased levels of conflict and franchisee discontinuance (Frazer et al. 2006; Quinn 1999). However, using franchise system size as a proxy for franchising experience, there is countervailing evidence that larger systems in Australia are not necessarily better at franchise operations (Frazer & Winzar 2005).

In this research, a majority of interviewees identified that inexperienced franchisors often did not provide adequate support services to franchisees which inevitably led to relational problems and conflict. Generally this was linked to insufficient capitalisation, and lack of the franchisor's management experience. Commonly cited issues related to insufficient management skills, IT capacity and experience, product procurement and supply, financial assistance, suitability of support staff and inappropriate royalty or advertising levy charges. Eight interviewees suggested that franchisors often experienced conflict resulting from their inability to realise initial promises relating to media exposure and local market support due largely to insufficient advertising levy charges. Often franchisors in this situation only disclosed limited information to franchisees in an attempt to minimise franchisee dissatisfaction with current advertising expenditure. This finding resonates with previous research investigating the role of information asymmetry and passive opportunism in channel relationships (e.g. Wathne & Heide 2000). Thus,

P15a Franchisor experience is positively associated with the provision of adequate support services (training, support) to incumbent franchisees.

P15b A franchisor's provision of adequate support services (training, support) is negatively associated with franchise system conflict.

Findings 9: Franchisor approach to negotiation and mediation and franchise system conflict

Negotiation strategies are interaction approaches used by parties in conflict to reach resolution (Ganesan 1993). Furthermore, parties are more likely to resolve issues when parties demonstrate cooperative intention (Leonidou et al. 2002). However, previous marketing channel research has established that dependency between channel members encourages the exercise of power (Shipley & Egan 1992) and franchisors (as channel leaders) tend to use coercive power in managing franchising relations (Hunt & Nevin 1974). In support of this, most interviewees in this research suggested that franchisors in conflict with their franchisees often tended to leverage their dominant power position throughout the negotiation process. Under the Franchise Code of Conduct provisions, franchising parties in dispute are legally obligated to attend mandatory mediation (Franchising Code of Conduct 1998). While this appears an inclusive and fair dispute resolution approach, there is some indication that franchisors threaten franchisees with the possibility of paying the franchisor's legal costs as a method of avoiding involvement in the mediation process. This is supported by recent work by, Levingston (2008) who documents a number of deficiencies associated with the current mandatory mediation framework. These include the inequity of negotiating power in the franchising relationship, the attendance of third party advisors with limited authority, and the attendance of ill-prepared franchisees that often fail to get sufficient independent advice due to their financial circumstances (Giddings et al. 2008; Levingston 2008). In support of this, one interviewee commented that '…they know the franchisees' financial situation and they know they are not able to pay for legal costs…' (Lawyer). However, many interviewees believe this to be a short-term strategy that was not successful in avoiding ongoing conflict or future litigation.

In addition, several interviewees recounted difficulties associated with the introduction of third party representatives in the negotiation process. Many of these agents had minimal or no contact with franchisees since they were first introduced to the franchising concept, but were often brought into the mediation process to substantiate (or deny) any pre-sale representations made to the franchisees. As many of these agents had minimal communication with the franchisor (as they often represented multiple franchise systems), they were often ill-informed about the franchise concept, operation and expected performance. Over half of the interviewees inferred that these agents often made representations about the franchising concept without prior consent from the franchisor. However, this was difficult to prove due to their association (and allegiance) towards the franchisor. Based upon the preceding discussion, it is posited that:

P16 Franchisors that opportunistically use their dominant power position in the negotiation process are more likely to encounter conflict with franchisees.

Findings 10: Franchisor approaches to communication approaches and franchise system conflict

Within the marketing channels literature, timely and participative communication has been shown to reduce dysfunctional inter-organisational conflict, promote collaborative conflict-resolution behaviours and instil ongoing trust between partner entities (Dwyer, Schurr & Oh 1987; Mohr et al. 1996). In addition, it has been shown to facilitate the transfer of knowledge between partners (Koza & Dant 2007) and is an antecedent to the success of these partnerships (Mohr & Speckman 1994). Moreover, within the franchising context participative communication has been shown to promote goal alignment between principal and agents and contribute to positive feelings regarding the nature of the franchising relationship (Gassenheimer et al. 1996). Although a majority of interviewees concurred with these sentiments, most emphasised advantages associated with informal communication in minimising the potential for conflict. In particular, most agreed that as franchisees were attracted to franchising to 'be their own boss', they preferred ongoing decision-making involvement in processes designed to address potential conflicts. Moreover, a strong majority of interviewees believed that this was necessary in building franchisee efficacy in how they approached potential conflict situations, which has some support in the 'management of teams' literature (Alper et al. 2000). In addition, most interviewees believed that conflict resulting from resistance to adopting system-wide changes (e.g. re-branding, raising royalty rates) could be avoided by effectively communicating the need for change with franchisees prior to implementation. The above discussion gives rise to the following proposition.

P17 Franchisors that emphasise inclusive communication with franchisees are more likely to promote franchisees' feelings of 'conflict efficacy' and are less likely to escalate conflicts with franchisees.

INSERT FIGURES 2 AND 3 ABOUT HERE

Conclusions and future research directions

Given the importance of franchising to the Australian economy, there is little doubt that the sector will continue to attract some scrutiny from regulators as they struggle to promote equitable and efficient franchising practice. One important part of this process is identifying the sources of conflict in current franchising practice. This inductive research assists in this process by providing a preliminary snapshot of the factors influencing franchising conflict within the highly regulated Australian franchising environment. The key findings suggest that a lack of due diligence is associated with the formation of unrealistic expectations which increases the potential for future relational conflict. Although franchising experience impacts

upon operational approaches and conflict, the role of third parties and market conditions appear to exacerbate dissatisfaction in most franchise systems. Although one franchisor commented that 'If they [franchisees] are making money you never hear from them…', it appears that franchising conflict is a more complex proposition encompassing individual, relational and situational elements. These elements will be tested in a large quantitative survey of key franchising stakeholders in the near future.

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Figure 1: Concept Maps of Antecedent Influences upon Franchising Conflict

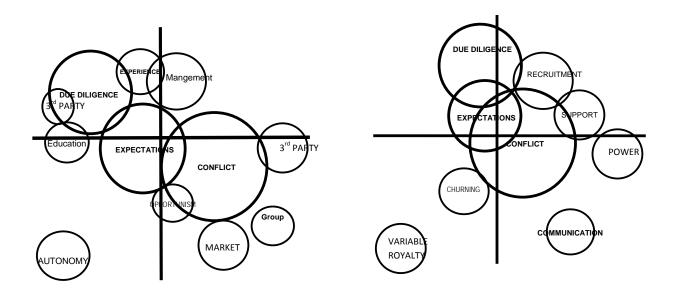(A). Concept Map Franchisee Influences   (B). Concept Map Franchisor Influences

Figure 2: Franchisee influences upon franchising conflict

Figure 3: Franchisor influences upon franchising conflict