

Brand Piracy By Franchisees

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Abstract

This research explores the situation in which a franchisee exits the franchise system but continues to operate independently. This action is a form of brand piracy as the former franchisee exploits the intellectual property of the franchisor. A franchisor, a former franchisee and a current franchisee from six franchise systems were interviewed in order to obtain diametrical viewpoints. It was concluded that brand piracy has serious implications in franchising because operators were continuing to use the franchise's intellectual property and customer base, with potential damaging effects on the franchisor brand and system.

Keywords: brand piracy, franchising, competition, intellectual property

Background

A great deal of attention has been devoted to the reasons why people *choose* franchising, rather than an independent operation, as a means of entering business. However, the focus of the current study is to explore why they exit franchising, and in particular, *why some franchisees continue operating the same business after leaving the system*. This action is a form of brand piracy. The subjects of interest in this research are people who opt out of franchising in pursuit of independent business ownership, taking with them the knowledge and experience gained from the franchise. In order to explore why they make such a choice it is necessary to consider what originally attracted them to franchising. There is sufficient evidence to suggest that the decision to enter franchising is a sub-set of the overriding decision to become self employed (Felstead, 1993; Peterson and Dant, 1990), and that the decision to select a suitable industry occurs prior to choosing the franchise vs independent route (Kaufmann and Stanworth, 1995).

Franchising provides an opportunity for people without prior business experience (Kaufmann, 1999) or who have low levels of technical skills to enter business (Williams, 1998) as the franchisor provides the necessary training in these areas. For an inexperienced operator, the association with a successful and established franchise organisation is regarded as a strong incentive (Hunt, 1977; Knight, 1986; Peterson and Dant, 1990). Similarly, some franchisees may be attracted to the unique product offered by the franchisor (Housden, 1984; Price, 1997). The support structure offered by the franchisor has been found to be an attractive incentive for self-employed people to join a franchise, whereas salaried employees value the relative independence of franchising more (Kaufmann and Stanworth, 1995). However, (Felstead, 1991b, p.37) notes that franchisees are best described as being in 'controlled self-employment' due to the operational restrictions imposed by the franchisor.

Rather than isolating specific attributes of franchising that are attractive to potential franchisees, perhaps it is the entire franchise package that is appealing (Mendelsohn, 1999). Some franchisors offer complete 'turnkey' operations including site selection and fit-out, initial training and start-up support, operations manuals, marketing activities, accounting services and centralized booking services (McCosker and Frazer, 1998), thus easing the franchisee into the business. Franchising may offer a sense of security to novice entrepreneurs, particularly those who are risk averse (Williams, 1998). It offers a unique

ability to belong to a large chain and thereby receive various benefits of that association, whilst at the same time allowing the franchisee a degree of independence (Hunt, 1977). Franchising is often held out to be a less risky means of entering business than independent business ownership but a great deal of debate surrounds this assertion (Bates, 1995).

In addition to many of the above (perceived) benefits associated with franchising, there are other external reasons why people may become franchisees. Growth in franchising is thought to boom during recession or in periods of economic downturn (Hall and Dixon, 1989). Similarly, the downsizing of large corporations and high levels of unemployment have been linked to growth in self-employment in general (Feldman and Bolino, 2000; Stanworth et al., 1989). Certain 'push factors' such as redundancy, career stage or family situation are thought to create greater interest in franchising (Boyle, 1994; Price, 1997). Indeed, many franchisors encourage the prospective investor to 'buy yourself a job' in their promotional campaigns. Franchisees are generally in the middle of their career path, aged 30 to 50 years, and with access to capital (McCosker and Frazer, 1998), thus allowing them the luxury of a career path switch when they are ready to change direction. In addition to the above reasons for entering franchising, we must also consider the factors that impact on a franchisee's decision to remain in the system. Overall satisfaction with the franchise is important, as well as the franchisee's level of trust in the franchisor (Chiou et al., 2004). Also relevant is the franchise system's competitive advantage; franchisees will have an incentive to exit if the system does not remain competitive in the market place (Chiou et al., 2004). When franchisees exit but continue operating, piracy of the franchisor's brand is a potential problem. This issue of brand piracy is explored next.

Piracy of the franchisor's brand

An explanation of brand piracy and counterfeiting may potentially provide a framework by which some of the reasons for franchisees leaving a franchise system, but remaining in a competitive position, can be explored. This body of literature analyses the ever-increasing phenomenon of brand-counterfeiting but remains focussed on a global perspective (Green and Smith, 2002). Parts of these perspectives, however, can be adapted to categorise some of the activities identified in this study. Firstly, a distinction should be drawn between counterfeiting and piracy. Counterfeiting refers to the 'unauthorized production of goods that are legally protected by trademarks, copyrights or patents' while *brand piracy* is defined as the 'unauthorized use of copyrighted or patented goods or ideas' (Shultz and Saporito, 1996, p.27). Hence, brand piracy occurs when a former franchisee continues to use the intellectual property of a franchisor.

The brand, especially in franchising, can be the most valuable asset possessed by a firm resulting from extensive resources being invested over a long period of time. A franchised organisation's intellectual property can be threatened by brand piracy. Imitations of a franchise system are common after the franchisee has exited the system. While the use of the original brand name does not usually take place (although there have been cases of similar names and logos being used, such as Winner's for Wendy's in Korea (Schuman and Gibson, 1998)), a continued use of key facets of the intellectual property remains, such as operations procedures, marketing techniques, colour schemes and the use of the data base built up while the former franchisee was operating within the original franchise system. This imitation system is then presented to the already established clientele as a bona-fide replacement for the original brand.

Some consumers certainly see the original brand as the most secure source of product or service. However, there is evidence that suggests that some consumers will use a former franchisee operator on the basis that there is no difference in the quality of the product or service (Nia and Zaichkowsky, 2000). Indeed, some consumers will actively evaluate the original brand and subsequent imitations in order to obtain the best value for money (Gentry et al., 2000) This tends to occur when brand equity begins to symbolise strongly an image rather than more tangible product attributes. Hence, consumers may begin to regard the brand and the product as different entities serving different purposes (Gentry et al., 2000)

The type of product or service, the competitive nature of the industry, and the operators themselves will dictate the level of brand imitation involved (Chaudhry and Walsh, 1996; Gillespie et al., 2002). Further, former franchisees may evaluate the extent to which they compete with the franchise system in question, given the non-competition constraints active in the franchise agreement, the level of conflict evident between the franchisor and franchisee at the time of exiting (evaluation of any potential litigation), and the degree to which customers will accept a replacement brand for the particular product or service involved (evaluation of potential profit). An examination of these factors is described next.

Methodology and analysis

Methodology and data collection

As it was necessary to identify franchise systems that had experienced franchisee exits, the *first stage* of the research involved a survey of the population of franchisors in Australia (Frazer and Weaven, 2004). The survey was conducted electronically via the internet. An online survey was chosen because it was an efficient and cost-effective means of survey administration. Some 148 useable responses were received from 700 franchisors surveyed, resulting in a response rate of 21.1 percent, which is regarded as satisfactory for business surveys (Malhotra et al., 2002). Tests for nonresponse bias indicated that this was not a problem in the sample. In addition to collecting demographic information about these franchise systems, franchisors were asked if any of their franchisees had left but continued to operate independently. One third (33.1 percent or 50 franchisors) indicated this practice had occurred in their systems, but most often with only one franchisee in breach. Almost one quarter (23.8 percent) of franchisors had, or intended, to take legal action against their former franchisees. A spread of industries, sizes and ages of franchises was involved, indicating that this practice was widespread and not common to a particular type of franchise.

Respondents were asked to indicate if they would be prepared to participate in further in-depth research and so the *second stage* of the research involved interviewing this convenience sample of franchisors. A qualitative approach was used to gather data that included descriptions of experiences and emotions. Hence, interviews were deemed most appropriate for gathering this rich, deep data (Patton, 2002). Due to the sensitive nature of the research question as well as the geographical spread of respondents, telephone interviews were conducted. The interviews were not taped but notes were taken by the researcher. Following each interview, the interviewers categorised the data obtained in order to identify themes to explore in subsequent interviews. For instance, as the interviews progressed it became evident that franchisees perceive the value of franchisor services differently, depending on their level of satisfaction with the franchise. Franchisors were asked to provide contact details of an ex-franchisee as well as a current franchisee in order to investigate various points of view. Some 6 franchise systems were included in the research, providing a total of 18 separate interviews. At this point the data appeared to have reached saturation as

no new themes were emerging and respondents reported a consistent pattern of experiences (Gummeson, 2005). A single researcher, with industry experience in the franchising sector as well as holding legal qualifications and accredited mediation skills, conducted the full set of interviews. This was regarded as a critical aspect of the project as enlisting participants proved to be challenging. In many cases, the relationship between the franchisor and ex-franchisee portrayed high levels of conflict and/or adversity, thus requiring a sensitive approach by the researcher. Following an analysis of the data, the following themes were observed.

Findings

In none of the six systems did the ex-franchisee continue to use the franchisor brand name. However brand equity was pirated (that is, without payment) in all cases through use of the intellectual property of specific business system knowledge, skills and experience, and in some cases by serving the same customers or staying in the same locality. In all cases the ex-franchisee was in direct competition (but not necessarily in the same area) with the franchisor. Attribution of blame was polarised, with each blaming the other. Essentially the franchisor saw the ex-franchisee as a low to medium performing franchisee who was not complying and was also under-performing. In contrast, the ex-franchisee perspective was that they were not receiving enough service from the franchisor and felt disconnected from the franchisor and their system. As expected the views of current franchisees (nominated by the franchisor) were fairly similar, but not entirely consistent with the franchisor. There were a couple of cases where the current (often highly performing) franchisee was slightly critical of the franchisor, but generally their views were congruent with those of the franchisor. We do not use this agreement of thinking to show that the franchisor is right and the franchisee is wrong. Rather we infer that the franchisees that leave and pirate are different to those franchisees that stay in the system. Most franchisees more or less receive the same services from the franchisor. However, in one group these services are not appreciated, forming the basis of disconnection from the system and subsequent conflict. Thus, brand piracy is an option for some franchisees who leave systems. How can one explain these different perceptions? Our analysis turns away from blame to that of explaining the different trajectories of relationship between the franchisor and different franchisees.

What is the process by which the well-developed relationship between the franchisor and the franchisee dissolves in an adversarial, even litigious way? The seeds of discontent that grow to become very severe commence after a (variable rather than fixed) number of years if, for some reason, the franchisee starts to stagnate. In extreme cases this could be due to burnout or simply losing interest in the business. Everything becomes more difficult for the franchisee from this point. All aspects of the business start to suffer, including both marketing and operations. Compliance to the franchisor standards starts to deteriorate. Gradually this type of franchisee disconnects from the system. Services will still be received, but the franchisee will not appreciate these services in the way that more involved franchisees do. The franchisee will eventually perceive that they are being neglected by the franchisor even though initially the franchisor may not in practice have done anything to justify this view. Continued stagnation of the franchisee's business combined with a perception of being isolated and neglected eventually leads to animosity on behalf of the franchisee towards the franchisor. Although their performance has dropped, the franchisee actually believes that they have done fairly well given the (perceived) lack of support from the franchisor. At this stage the franchisee has almost totally disconnected from the system and starts to question why they should pay fees and stay in the system. Not only are they ready to leave the system, but the sour relationship and negative attitude towards the corporate office gives them the

“right” to set up in opposition to the franchisor. There is usually some reluctant admission that they have benefited from the franchisor, but do not give this much weighting. All of the franchisors were prepared to take legal action (from letters of demand through to litigation) against the ex-franchisee. However, some are deterred from litigation in the court system because of the high legal costs (especially if the franchisor has previous litigation experience). This is reinforced by the lack of clarity about the outcomes of the court system because of the general perception of restraint of trade covenants in franchise agreements. The more experience the franchisor has in litigation, the more they negotiate a commercial outcome prior to total disconnection of the franchisee, rather than post-disconnection/exit litigation.

Discussion and managerial lessons

This exploratory research into the reasons why some franchisees leave the system but continue operating provides some insights as to why brand piracy in franchising occurs. If franchisees experience disappointment with the services provided by the franchisor or frustration with the restrictions imposed, they may consider exiting and becoming solo operators. For every franchisee that takes this course of action, however, many others do not. The difference in attitude may be linked to the individual’s sense of ethical business behaviour, but also relates to their (peculiar) perception of support services received.

Whilst most franchise agreements contain non-competition covenants, if drafted too widely they may be difficult to enforce (Felstead, 1993). The courts often find them too restrictive and disfavour them (Johnson and Greenstein, 2002). Franchise agreements may be unenforceable if the process and equipment used to provide the service are generic and readily accessible outside the franchise (Felstead, 1991a). Similarly, the degree of copying of the system and the extent to which the ex-franchisee relies on the franchisor’s intellectual property or know-how is often considered by the courts (Germann, 2003). In addition, franchisors need to be motivated to pursue offenders and must balance up the cost of the exercise against the effectiveness of the action, including the message it sends to other franchisees. Particularly if a franchisee feels that his/her success is due largely to personal effort and not to the franchise system, that franchisee may be able to justify withdrawing from the franchise. Our research highlights the franchisor’s need for an effective franchisee exit policy. Pirating franchises are an extreme example of a dysfunctional relationship. There may be other examples of dysfunctional relationships that simply result in stagnation or delayed exit, but without major breaches of the contract. Franchisors can minimise these problems by more proactive management of franchisees when signs of stagnation appear. Franchisors can facilitate the early departure of franchisees in some cases (before disconnection and resentment occurs) or provide means of motivating franchisees to re-energise their business.

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