

## CHAPTER 1

### BACKGROUND TO THE PROBLEM

#### 1.1 BACKGROUND

Franchising has shown significant growth and tremendous economic benefits not only in the United States of America, Britain and Australia, but also in South Africa (Gordon 1998-1999; Maitland 1991; The Franchising Handbook 1993).

Owing to the growth and opportunities created by franchising, it has become a much talked about subject. One of the aspects that are talked about frequently in franchising circles is the relationship between franchisees and franchisors and the most effective methods of managing the relationship. There has been a great deal of speculation regarding the aspects that influence relationships and the role that franchisors play in managing these aspects. There seems to be a certain mystique surrounding the behaviour (and the reasons for behaviour) of both franchisees and franchisors. Franchisors frequently wonder why franchisees behave in a certain fashion, for example, why they rebel against the relationship after a few years and why they suddenly want more independence from the franchisor. They wonder why relationships that started out in a very positive manner sometimes end up with a great deal of conflict and unhappiness.

A need to better understand the franchisee-franchisor relationship, especially the life cycle of franchisees (with the management implications that life cycle phases might have), lead to a literature study which showed a general lack of empirical research available in this field (not just in South Africa, but on an international level).

The franchising industry in South Africa is one in which not much research has been done nor are reliable industry statistics available. Considerably more research on franchising has been done internationally. Most of the body of

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franchising research focus on aspects such as the nature of franchising (Elango and Fried 1997), reasons for franchising (Oxenfeldt and Kelly 1968-69; Carney and Gedajlovic 1991), power (Sibley and Michie 1982; Hunt and Nevine 1974), conflict, motivation (Stanworth and Kaufman 1996; Knight 1986; Peterson and Dant 1990), failure rates (Boe, Ginalski and Henward 1987; Castorgiovanni, Justis and Scott 1993) and co-operation (Sibley and Michie 1982).

Elango and Fried (1997: 68-82) also identified the need for empirical studies relating to the relationship between franchisees and franchisors. They suggest that possible future research should examine the stability of the franchisee-franchisor relationship and more particularly: *“changes in the relationship between the franchisee and the franchisor have been largely ignored by researchers.”*

Owing to the increasingly important role of franchising, the apparent lack of scientific and empirical research in this field, and the need for relationship research that has been identified by fellow scholars, the researcher decided to investigate the franchisee-franchisor relationship in an empirical research study.

### **1.1.1 Definition of the research problem**

The suggested study of the relationships that exist between different franchisors and their franchisees will attempt to model the life cycle of franchisees from the perspective of the franchisee-franchisor relationship. This will be done by determining the correlation between the life cycle stages of a franchisee and the effective management of the franchisee–franchisor relationship.

### **1.1.2 Research objectives**

In order to obtain satisfactory answers to the research problem, the following research objectives will have to be achieved. In order to do so, it will be necessary to determine:

- which aspects influence the relationship quality between franchisees and their franchisors.



- the commitment-trust scores for franchisees
- franchisee satisfaction levels
- the relationship quality index levels of franchisees.
- the evolution of a typical franchisee relationship (life cycle).
- the franchisee life cycle stages.
- the duration of the relationship between a franchisee and a franchisor.
- how the relationship quality of a franchisee differs between different life cycle stages.

### 1.1.3 Research propositions and hypotheses

The research proposition and hypotheses will only be mentioned in the next section and will be discussed in more detail in the chapter on methodology.

**Table 1.1 – Summary of Research Proposition and Hypotheses**

$P_1$	=	There are distinctive phases in the relationship between franchisees and the franchisor that follow a typical life cycle format.
$H_1$	=	There are significant differences in the commitment-trust dimensions representing the franchisee-franchisor relationship between each life cycle phase.
$H_2$	=	There are significant differences in the relationship quality index levels representing the franchisee-franchisor relationship between each life cycle phase.
$H_3$	=	Franchisees in the first life cycle phase will have significantly higher commitment–trust dimension scores than franchisees in the successive life cycle phases.
$H_4$	=	Franchisees in the first life cycle phase will have significantly higher relationship quality index levels than franchisees in the successive life cycle phases.
$H_5$	=	There are significant differences in the commitment-trust dimensions of each life cycle fit category.
$H_6$	=	There are significant differences in the relationship quality index levels between each life cycle fit category.
$H_7$	=	Franchisees that move through the life cycle phases in the expected time (exact fit) will have significantly higher relationship quality levels than those that move slower or faster.

### 1.1.3.1 The existence of distinct life cycle phases

The development of the relationship between franchisees and the franchisor has distinctive phases that follow a predictable pattern (cycle). Identification of these distinct phases will have a significant effect on the management of franchisee-franchisor relationships based on the different needs of franchisees in the differing phases.

Proposition 1 = There are distinctive phases in the relationship between franchisees and the franchisor that follow a typical life cycle format.

### 1.1.3.2 Significant differences between life cycle phases

Each of the identified (distinct) life cycle phases will yield significantly different commitment-trust dimension scores based on the progress of the relationship. It is suggested that the commitment-trust dimension scores will be the most positive in the beginning of the life cycle with a decrease in the dimension scores as the relationship continues.

H<sub>1</sub> = There are significant differences in the commitment-trust dimensions representing the franchisee-franchisor relationship between each life cycle phase.

H<sub>2</sub> = There are significant differences in the relationship quality index levels representing the franchisee-franchisor relationship between each life cycle phase.

H<sub>3</sub> = Franchisees in the first life cycle phase will have significantly higher commitment-trust dimension scores than franchisees in the successive life cycle phases.

H<sub>4</sub> = Franchisees in the first life cycle phase will have significantly higher relationship quality index levels than franchisees in the successive life cycle phases.

### 1.1.3.3 Varying speed of movement through life cycle phases

Franchisees can move through the life cycle phases at different speeds. Franchisees can either move through the life cycle phases slower than expected (lagged fit), faster than expected (pre-mature fit) or at an expected rate (exact fit). The speed of movement will have a significant effect on the relationship quality levels.

H<sub>5</sub> = There are significant differences in the commitment-trust dimensions of each life cycle fit category.

H<sub>6</sub> = There are significant differences in the relationship quality index levels between each life cycle fit category.

H<sub>7</sub> = Franchisees that move through the life cycle phases in the expected time (exact fit) will have significantly higher relationship quality levels than those that move slower or faster.

### 1.1.4 Operational Definitions

In the previous sections, a number of terms and concepts were introduced that were not defined. This section will clarify some of these terms by stating operational definitions.

- **Distinctive life cycle phase:**

A phase in the existence of a franchisee's business, that has significant differences with other phases with regards to the relationship duration.



- **Typical life cycle format:**

A predictable / characteristic series of events that is regularly repeated in the same order. In this case, used with specific reference to the relationship between franchisees and franchisors.

- **“Expected” speed of movement through life cycle stages:**

The “expected” speed was ascertained through modelling of the research results and it was found that the expected duration of a phase (or speed of movement through the phase) is approximately one year.

## 1.2 LITERATURE REVIEW OF THEORETICAL MODELS

In order to better understand the nature of this study a brief conceptual framework is discussed after which the planned methodology is reviewed.

This study has three distinct concepts that need to be understood in order to grasp the nature of this study. These concepts are franchising, life cycles and relationship management. Each of these concepts is discussed in detail in chapters 2 – 4. A short overview of these issues, discussed in each of the chapters, will now be given.

### 1.2.1 Franchising

The franchising concept and supporting literature is discussed in chapter 2. The aspects mentioned below are all dealt with in detail and provide valuable insight into the franchising domain.

The fact that different types of franchising exist creates a problem when a singular definition of franchising is sought. It is therefore much easier to define franchising in terms of shared characteristics that franchise businesses should have in common (Maitland 1991). Differing perspectives on the concept of franchising are considered (Brown and Dev 1997; Kirkham and McGowan in

The Franchising Handbook 1993; Mendelsohn 1992; Fulop and Forward 1997; Stanworth and Kaufmann 1996; Elango and Fried 1997).

The parties involved in franchising are defined, and specific attention is given to different types of franchisees (Maitland 1991; The Franchising Handbook 1993; Hall and Dixon 1993; Elango and Fried 1997).

The different types and definitions of first generation franchising such as licenses, distributorships / dealerships, right to use a trade mark and concession as well as second generation franchising such as business format franchising and conversion franchises are discussed (Hall and Dixon 1988; Nathan 1993; Fulop and Forward 1997; Goncalves and Duarte 1994; Maitland 1991; Mendelsohn 1992; Friedlander and Gurney 1990).

The benefits and drawbacks of franchising for both franchisors and franchisees are highlighted (Maitland 1991; Hall and Dixon 1988).

It is not clear, exactly where and when franchising started, and some of the differing opinions on the history of franchising are acknowledged (The Franchising Handbook 1993; Hall and Dixon 1988; Goncalves and Duarte 1994; Mendelsohn 1992).

The different perspectives on franchising such as franchising as a business strategy, a marketing system, a distribution network and a method of expansion are described (Brown and Dev 1997; The Franchising Handbook 1993; Friedlander and Gurney 1990; Mendelson 1993; Fulop and Forward 1997; Oxenfelt and Kelly 1969; Hunt 1972; Caves and Murphy 1976; Combs and Castrogiovanni 1994; Sen 1998)

The current state of franchising is also discussed on both an international and national level and the importance of franchising for the economies of many countries is shown.

The growth, importance and future of franchising on an international level are firstly reviewed. Statistics for the growth and economic impact of franchising and the employment created by franchising are given (The Franchising Handbook 1993; Maitland 1991; Mendelsohn 1992; Stanworth 1995; Fulop and Forward 1997).

The South African franchise situation is discussed with reference to growth of franchising, employment created by franchising, reasons for growth, and the future of franchising in SA with specific reference to aspects that might hinder the growth of franchising in SA (Gordon 1998-1999; Scholtz 1996; Zeidman and Feirman 1995).

Numerous articles have been written on franchising. Topics usually refer to aspects such as the nature of franchising, reasons for franchising, growth rates, failure rates and reasons for failure. Other aspects frequently researched are franchisee co-operation, the role and types of power in franchising, conflict and franchisee satisfaction (Elango and Fried 1997; Oxenfeldt and Kelly 1968-69; Carney and Gedajlovic 1991; Combs and Castrogiovanni 1994; Fulop and Forward 1997; Stanworth 1995; Lafontaine and Shaw 1998; Connell 1997; Stanworth, Purdy, Price and Zafiris 1998; Boe, Ginalski and Henward 1987; Castorgiovanni, Justis and Scott 1993; Sibley and Michie 1982; Hunt and Nevine 1974; Strutton, Pelton and Lumpkin 1995; Schul, Little and Pride 1985; Knight 1986; Mendelsohn 1992; Spinelli and Birley 1996; Gaski 1984; Hing 1996; Lewis and Lambert 1991; Gassenheimer, Baucus and Baucus 1996; Peterson and Dant 1990). The research done in these areas is briefly mentioned and reviewed in chapter 2.

### **1.2.2 Life cycles as a business phenomenon**

Chapter 3 introduces the phenomenon of life cycles and the following aspects are reviewed:

After considering the meaning and definition of life cycles and defining the scope of life cycles that were considered in this study, a closer look is taken at



different life cycle concepts and the research that has been done on life cycle concepts. It is important to note that there are differences between life cycle concepts and curves and these differences are dealt with in the discussion (vide page 46).

The discussion on life cycle concepts started with the diffusion curve and how it relates to the product life cycle, which is probably the most well-known life cycle concept in the economic sciences literature. The product life cycle concept describes and models the stages through which a product passes (Kotler 1984; Hisrich and Peters 1991; Harrel and Taylor 1981; Rosenbloom 1991). The stages of the product life cycle and some alternative curves are discussed in depth in chapter 3.

Other life cycles such as industry life cycles (De La Mare 1982) and corporate life cycles (Adizes 1988; Smith, Mithchell and Summer 1985) are also discussed.

Various authors have studied the life cycle of franchising systems. In this thesis the contributions of these authors are discussed. The discussion starts with the franchising concept life cycle (Fulop and Forward 1997) that summarises the historical development of franchising and divides the franchising life cycle into three stages.

Secondly, the life cycle model of franchising (also called resource scarcity model) developed by Oxenfelt and Kelly (1968) is stated. This model attempts to explain the reasons for franchising. Differing opinions on the resource scarcity model as stated by other authors (Carney and Gedajlovic 1991; O'Hara and Musgrave 1990; Lafontaine and Shaw 1999; Lafontaine and Kaufmann 1994) are cited and explained.

The abovementioned is followed by a discussion of the franchise life cycle model by Lillis, Narayana and Gilman (1976). The model explains the differences in importance of competitive advantages in the different stages of the franchise life cycle.

The last model to be discussed in this section is the corporate evolutionary and growth process of a franchise company or franchisor (Slavin in The Franchising Handbook 1993). Slavin (in The Franchising Handbook 1993) states that companies and people follow a predictable course of evolution with distinct stages of growth. He identified five stages of growth, which are discussed in more detail in the chapter in question.

Various authors have also completed research on the life cycles of franchises. Achrol, Etzel and Gundlach (1995) studied a franchise unit's life cycle of evolution and the environmental conditions faced by those units from a product life cycle perspective.

The franchisee failure continuum (Holmberg and Morgan 1996) is also discussed since it suggests a possible progress of events that might be considered part of a franchisee life cycle.

Very little attention has been given to franchisee developmental life cycles from a franchisor-franchisee relationship perspective. In this section of chapter 3 the various speculated stages of the franchisor-franchisee life cycle as suggested by authors, are described (The Franchising Handbook 1993; Maitland 1991; Mendelsohn 1992; Stanworth and Kaufmann 1996).

Only a few authors, amongst which, Nathan (1993) as well as Hall and Dixon (1988) have proposed a specific relationship life cycle of franchisees. The views of these authors are provided. Hall and Dixon's (1988) franchisee life cycle is stated first, and is then followed by Nathan's (1993) franchisee curve of disenchantment (also called the E-Factor). Although none of the published work on franchisee life cycles has been empirically tested, it forms the basis of the current research study and were used as the point of departure.

### **1.2.3 Relationship management**

Chapter 4 provides some insight into relationship management and the concepts that form part of this construct.

The nature of relationships are defined by Liljander and Strandvik (in Ewing 1996:63) as consisting of episodes. Miettala and Tornroos (in Ewing 1996) indicate various conditions that must be present for a relationship to exist. Hutt and Speh (1995) describe various types of relationships ranging from pure transactional exchanges to pure collaborative exchanges. The contributions of these authors are described in depth in chapter 4.

Relationship management is a broader term than relationship marketing and this aspect is shortly touched upon in this section in chapter 4.

The concept of relationship marketing encompasses many aspects such as relational exchange (Morgan and Hunt 1994; Dwyer, Schurr and Oh 1987), relational contracting (MacNeil 1980), relational marketing (Dwyer, Schurr and Oh 1987), working partnerships (Anderson and Narus 1990), symbiotic marketing (Varadarajan and Rajaratnam 1986), strategic alliances (Day 1990), co-marketing alliances (Bucklin and Sengupta 1993) as well as internal marketing (Berry and Parasuraman 1991; Iverson and McLeod 1996).

Various authors have provided their views on the nature of relationship marketing. Sheth and Parvatiyar (1995) state that the main focus of traditional marketing was on transactions and exchanges, but that this orientation is changing from transactions to relationships which, gives rise to the concept of relationship marketing. Various other authors agree that a paradigm shift away from a transactional approach towards a relationship oriented approach has occurred (Morgan and Hunt 1994; Berry and Parasuruman 1991; Grönroos 1994; Gruen 1995).

The axioms of transactional marketing and relationship marketing (Sheth and Parvatiyar), the six markets model of relationship management (Payne et al 1995) and the different relational exchanges in relationship marketing (Morgan and Hunt 1994) are considered.



Relationship marketing theories are also described, of which the most important marketing theory discussed is the commitment-trust theory of relationship marketing (Morgan and Hunt 1994), which formed one of the key building blocks for the current research.

This model states that commitment and trust is central to successful relationship marketing efforts because they encourage marketers to work at preserving relationship investments and resist attractive short-term alternatives. The model with antecedents and outcomes are discussed in depth.

The relevance of relationship marketing and the commitment trust theory in franchising is described in detail. The exchange relationship between franchisees and franchisors can be compared to exchange relations found in relationship marketing literature. The relationship marketing concept is therefore very relevant to the franchising industry with specific reference to the relationship management between the franchisor and the franchisee. The works of various authors are cited to prove the relevance of relationship marketing in the franchising context (Hall and Dixon 1988; Nathan 1993; The Franchising Handbook 1993; Morgan and Hunt 1994).

The relationship marketing model of Gruen (1995) and the reasons for not using this model are discussed. Although Gruen's model was not used for the research in question, he did however make a very compelling argument for the inclusion of satisfaction in relationship marketing research, which lead to the inclusion of satisfaction measures in the questionnaire.

The importance of relationship quality in relationship marketing is discussed in this section of chapter 4 (Crosby et al 1990; Hutt and Speh 1995; Liljander and Strandvik 1994; Bejou et al 1996). Different views and definitions of relationship quality are cited and the difference between relationship quality and relationship satisfaction is discussed in detail (Crosby and Stephens 1987; Bejou et al 1998; Dwyer 1980).

A closer look is taken at where franchising “fits into the picture” of relationship marketing. Vertical marketing systems are defined, classified and discussed in terms of their implications in channel management (Kotler 1996; Bowersox and Cooper 1992; Rosenbloom 1991). The reasons for failure of vertical marketing systems are also discussed in detail.

The aspects discussed in this section, again confirm the relevance of the commitment-trust model of relationship marketing (Morgan and Hunt 1994) in the study of relationships between franchisees and franchisors.

Franchising and the type of relationships that exist between franchisees and franchisors are mentioned. The role of satisfaction in the relationship between franchisees and franchisors are also discussed and clarified (Hall and Dixon 1988; Hing 1996). The last part of chapter 4 focuses on the link and integration of relationships and life cycles (Dwyer et al 1997; Nathan 1993).

### **1.3 RESEARCH DESIGN AND METHODOLOGY**

The research methodology is discussed in more detail in Chapter 5. A detailed discussion of the research problem, research objectives, hypothesis testing theory and hypotheses formulation is done in the first part of chapter 5. This is then followed by a discussion on research design issues. The research design was executed in two broad phases, namely the exploratory phase (literature and qualitative phase) and the descriptive-empirical phase.

#### **1.3.1 Exploratory phase**

The literature study provided a background on all related theories and information that are relevant to the study in question. Aspects relating to franchising, life cycles and relationship management were investigated.

Apart from an extensive database search for relevant literature on franchisee relationships, the exploratory phase of the project involved in-depth personal

interviews with franchising consultants, opinion leaders in the franchising industry as well as selected franchisors. The information obtained in the exploratory phase of the research process was used to design the research instrument (questionnaire / measure).

This phase of the research also involved an extensive process of sourcing franchisor and franchisee information. The reason for this process is the fact that no reliable comprehensive database of franchises exists in South Africa, despite the fact that various separate databases seem to exist.

### **1.3.2 Descriptive empirical phase**

After completion of the exploratory phase the next step of the research process could be undertaken. The descriptive empirical phase of the research pertains to the measurement instrument, the sampling frame of the research and the physical data collection.

#### **1.3.2.1 Measures**

The design of the measurement instrument is based on two basic foundations, namely franchisee life cycles and franchisee-franchisor relationships.

Firstly, the measurement of the franchisee life cycle was operationalized using Nathan's (1993) Disenchantment Curve (E-factor approach). Descriptors of the different stages proposed by Nathan were presented to franchisees. Franchisees were then required to choose the stage which best described their state of mind and attitude and the relationship they have with their franchisor.

The second foundation of the measurement is the relationship between franchisees and the franchisor. In this case the Commitment-Trust theory of Morgan and Hunt (1994) was used as a model by customizing the instrument for the franchising industry. The instrument was also pre-tested to determine if the constructs were sufficiently operationalized and whether franchisees



understood what was being asked. Changes to the instrument were made based on the pilot tests that were done.

Various other questions pertaining to relationships (relationship continuation, continuation of use of products and services, use of additional products and services and recommendation rate) and satisfaction levels (relationship, service quality, products, personnel, agreements and the franchisor organization) were also included as overall measures. The overall franchisee satisfaction level was also measured using a Customer Satisfaction Index.

Various other classification questions such as the duration of relationship, the number of stores owned by a franchisee, the brand strength and profitability, age of franchisee and gender (to mention a few) were also measured.

#### **1.3.2.2 Sample design**

The selected sample design was based on the need for a representative, national perspective on franchisee-franchisor relationships that cover the whole spectrum of different franchise systems. A multistage sample design was used. Firstly, a proportional number of FASA (Franchising Association of Southern Africa) affiliated franchisors and non affiliated franchisors were selected. Secondly, the number of franchisors selected was made proportional to criteria such as size of the franchisor (small, medium and large), different franchise systems and available contact details for the particular franchisor. Individual franchisees (of the chosen franchisors) were selected at random from the contact database (supplied by the franchisors) for inclusion in the study.

#### **1.3.2.3 Data collection and processing**

The data was collected using Computer Aided Telephonic Interviewing (CATI). A sample of franchisees of various franchise systems (in different industries, of various sizes, etc) was interviewed. The research was aimed at franchise owners (franchisees) and company owned outlets and their managers were not included in the research.

Thanks to the CATI system used, no coding or data capturing was necessary. The data file was exported to a statistical software package (Statistica) and the data cleaned and analysed. Reliability analysis, validity analysis, correspondence analysis and cross tabulations were performed on the data.

## **1.4 DATA ANALYSIS, STATISTICAL ANALYSIS AND INTERPRETATION**

The study used scientifically acceptable methods to ensure reliability and validity. These methods are briefly discussed below.

### **1.4.1 Reliability analysis**

Reliability pertains to consistency and the extent to which the same results would be obtained if the measure were repeated. According to Cooper and Emory (1995:148) reliability has to do with the accuracy and precision of a measurement procedure.

The Cronbach's Alpha reliability test was used to determine the internal consistency of the measurement instrument. The Cronbach's Alpha was used because Cooper and Schindler (1998:173) suggests that this technique is best suited to multi-item scales at the interval level of measurement.

### **1.4.2 Construct validity analysis**

Internal validity is the extent to which a measurement instrument actually measures what it intends to measure. According to Cooper and Emory (1995:149) validity is the extent to which differences found in the research reflect true differences among respondents.

A principal component factor analysis was performed on the results obtained in order to determine to what extent the instrument measured what it was supposed to.

### **1.4.3 Correspondence analysis**

In order to overlay / match the franchisee life cycle stages and the duration of the relationship it was necessary to find a technique that would allow this type of data manipulation. Correspondence Analysis was chosen because it is a descriptive/exploratory technique designed to analyse measures of correspondence between the rows and columns of tables. The results, which are similar in nature to factor analysis, allow one to explore the structure of categorical variables (StatSoft 1995).

### **1.4.4 ANOVA and MANOVA**

ANOVA is used to determine if there are significant differences between two or more means at a selected probability level and is useful for studies involving two or more groups (Gay and Diehl 1992). MANOVA is an extension of ANOVA and is used when more than one dependent variable and one or more independent variables are involved in a study. These techniques were used to determine if significant differences existed between variables and were used for hypotheses testing purposes.

## **1.5 SUMMARY AND OUTLINE OF CHAPTERS**

This dissertation consists of six chapters. Chapter 1 shortly introduced the main subject and extent of the study, including the research problem, goals of the study, hypotheses and methodological considerations.

The following three chapters (Chapters 2 – 4) describe the theoretical background and relevant literature pertaining to this study in great detail. Chapter 2 is devoted to Franchising and aspects such as definitions of franchising, the parties involved in franchising, the types of franchising, the history, statistics and benefits of franchising.



