“We are very focused on the muffins”: Regulation of and compliance with industrial relations in franchises’

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**‘We are very focused on the muffins’:
Regulation of and compliance with industrial
relations in franchises**

Abstract

The highly successful franchising approach contains features of both large and small firms. We develop a ‘diverse accountabilities’ model of franchise organisation of employment relations, acknowledging the limitations of agency theory in explaining differences between franchisors’ treatment of product and employment matters, particularly those associated with compliance with industrial legislation and awards. The model was broadly consistent with existing literature and our own multiple-case study of Australian food franchises. High rates of compliance with industrial relations (IR) standards were unlikely. The involvement of franchisors in franchisees’ IR activities appeared to vary substantially, but was always well below that provided in other human resource management (HRM) or product-related issues. Evaluation and monitoring of franchisee behaviour is often neglected, and instead the consequences of non-compliance, if discovered, are potentially serious for the franchisee. Our approach helps explain the treatment of IR in terms of financial benefits for franchisors of operating a business model with marketing and product management features - and to some extent HRM features - of a large business, but the IR characteristics of small businesses.

Keywords: Franchises; labour standards; compliance; small business; wages.

The franchise model of business operation has transformed modern food retailing on an international scale. Franchising has enabled large corporations to establish dominant positions in a sector which otherwise would be characterized by numerous independent small businesses. Franchises contain features of both large and small business, making for what might seem complicated or paradoxical management systems. There are well known differences between IR in large and small organisations: the former are much more likely than the latter to have a union presence and structured relations through an HR department, employment specialists or an HR strategy (Cairncross and Buultjens 2006, Edwards and Ram 2009, Forth, Bewley and Bryson 2006). There are also important differences between large and small businesses in compliance with employment regulation, with small businesses more likely to breach labour standards (Bhorat, Kanbur and Mayet 2012, Buultjens 1994, Gindling and Terrell 2010). Compliance with industrial regulation appears to be a problem in Australian food franchises: there have been widespread complaints about poor treatment and underpayment of often young and vulnerable employees in Australian hospitality organisations (Fair Work Ombudsman 2010, 2013b); in some states, rates of compliance were as low as 45 percent (Fair Work Ombudsman 2013a); and many of the contravening organisations have been franchises, with fines in the order of hundreds of thousands of dollars plus substantial salary back payments.

In this article we seek to investigate the treatment of IR and particularly compliance with industrial regulation, in Australian franchises. Australian franchises operate within an industrial relations system in which minimum wage rates for individual occupations are set by tribunal-determined ‘awards’, which directly set the pay and conditions of around one in six employees but disproportionately more amongst low

wage earners, and hospitality and retail workers (ABS 2012, Healy 2009, Sappey, McPhail, Loudoun and Wilkinson 2009). Our focus is on the burgeoning cafe franchise sector where we have undertaken three extensive case studies. In particular, we ask:

1. Does the high control context of franchise systems translate to high compliance by franchisees in IR?
2. What level of involvement do franchisors have in IR activities in franchise units?
3. How closely are IR activities in franchised units monitored by the franchisor, and what are the outcomes of misconduct?
4. Can a model based around the diverse accountabilities within franchises help explain franchise behaviour on IR issues including compliance?

Background literature and model

Franchising systems

In half a century, franchising has become a highly effective, profitable and widely adopted business strategy. In the United States, almost one million franchise units employ over eight million people (PricewaterhouseCoopers 2011). The British market employs half a million people, while Australia, despite a lower population, employs 700,000 staff and operates over 50 per cent more units than the British system (British Franchise Association 2011, Frazer, Weaven and Bodey 2012).

A typical franchise system comprises a ‘franchisor’ – an individual or corporate organisation that owns and controls the franchise ‘brand’ – and ‘franchisees’, who own one or multiple business units. The franchisor may also directly own and control

some units themselves. As franchising has evolved, the level of franchisor support provided to franchisees has increased. Modern franchise systems now typically provide franchisees a full system for business operation, including support in site selection, marketing, initial training and developing supply relationships (Justis and Judd 2003). With additional support from the franchisor comes an increased level of intervention and control. Standardization by franchisors across units creates cost efficiencies and consistency in the brand image (Kaufmann and Eroglu 1998), though some see disadvantages through denying franchisees autonomy to adapt certain processes (Baucus, Baucus and Human 1996).

While franchised units belong to a network which, in its entirety, is comparable to a large organisation, individually the majority of units in Australia are considered small to medium sized enterprises (SMEs) (ABS 2008). This distinction is important as organisational size is a key factor in explaining employment practices. Limited evidence suggests franchisor involvement in employment processes is higher in larger systems (Doherty 2007, Fair Work Ombudsman 2010), and higher in corporate than franchisee-owned units (Brand and Croonen 2010, Weaven and Herington 2007). Likewise, small workplaces of larger organisations also have higher use of formal HR procedures than independent small businesses (Storey, Saridakis, Sen-Gupta, Edwards and Blackburn 2010). The franchise relationship is a complex mix of control, autonomy, standardisation and adaptation. The degree of franchisor involvement in IR – including provision of support, monitoring of behaviour and the consequences of misconduct – is important, because it directly affects the welfare of employees and franchisees

Agency theory, control and a model of compliance

Agency theory has been frequently used to analyse issues in franchises. An agency relationship exists when a principal delegates work to an agent (Eisenhardt 1989). Agency theory suggests that the agent works in their best interests, which may diverge from the principal's (Castrogiovanni, Combs and Justis 2006, Eisenhardt 1989). In franchising, while both parties' interests are aligned with successful performance of the unit, the franchisor aims for maximisation of franchisee turnover (as they typically receive a percentage of franchisee turnover) and maintaining brand reputation, while the franchisee is more interested in profits (Dant and Nasr 1998, Felstead 1991). Hence 'opportunistic franchisees may attempt to obtain higher levels of short-term profitability (say, by cost-cutting measures injurious to the brand) even at the expense of brand equity' (Dant and Nasr 1998: 8).

Agency theory proposes that opportunistic behaviour can be reduced if principals (franchisors) increase control and monitoring of agents (franchisees) (Belaya and Hanf 2009, Quinn and Doherty 2000). Activities most closely linked to customers' perceptions of the brand are those exposing the organisation to the highest risk and should be subject to the greatest control (Pizanti and Lerner 2003). Through the franchise agreement, the franchisor has power to force or coerce franchisees to behave appropriately (Belaya and Hanf 2009, Felstead 1991). While franchisors may use other forms of punishment for misbehaviour, it is arguably the underlying threat of termination of the franchise agreement which most deters franchisees from acting opportunistically (Blair and LaFontaine 2005).

While agency theory has some merits, we need to extend it to explain IR practices in franchises. We focus on compliance with IR regulations, as unionisation tends to be very low in industries where most franchises operate (Royle 2010) and compliance is both interesting in its own right and a proxy for (poor) practices including pay and employment conditions. A national hospitality industry campaign indicated compliance with workplace legislation was below 50 per cent in Victorian hotels and bars (Fair Work Ombudsman 2013a). The most extensive Australian academic research on industrial non-compliance has been undertaken by Goodwin and Maconachie. At the national, systemic level, they observed how compliance fell in the 1990s shifting from routine audits to complaints-based investigations by government officials, before ‘target campaigns’ were (re)introduced from 2006 (Goodwin and Maconachie 2007, 2010). Although they have not specifically examined franchises, they offer the key insight that non-compliance ‘is arguably a calculated business decision, prompted or facilitated by intense competition, precarious employment (particularly female and youth), non-unionised workplaces and under-resourced enforcement agencies’ (Maconachie and Goodwin 2011).

Regarding franchises, we posit a model that differs from agency theory in distinguishing between the treatment of products (such as our eponymous muffins) and labour. The model is illustrated in Figure 1. Our starting point is recognition that franchises exist in the context of the transfer of risk from capital to labour (Beck 1992, Rafferty and Yu 2010). Franchises are a modern form of organisation developed to maximise advantages and revenues from ‘common branding’ of a product while minimising administration costs. They are also an organisational structure that transfers risk from franchisor to others, both in terms of obvious risks

associated with setting up a new (branch of a) business in a new location, and less obviously the low wages, insecurity and lower IR compliance that exists in small businesses. A key element of costs is employment costs. Yet there is a different relationship between the franchisor and employee than between the franchisor and customer. The customer usually cannot know whether the outlet from which they are buying is company-owned or franchisee-owned, so they attribute the product characteristics to the franchisor. If they do not like their muffins, they will cease buying from that outlet, and also likely cease buying from *all* outlets thus branded. In that sense, both the owner of the outlet and the head office of the franchisor are accountable to the customer, as indicated by the horizontal arrows in the top half of Figure 1, in the same way as either a small firm or a large firm selling muffins would be. It is therefore in the interests of head office to maintain tight control over product quality, and create mutual obligations and information transfers via the franchise contract as per the two-way vertical arrow illustrated.

Figure 1: A diverse accountabilities model of employment relations in franchises

*Note: 'Owner' includes 'owner of a franchise outlet' (i.e. a franchisee) and 'head office' includes head office in both large organisations and franchises.

The employment relationship in franchises is different. As shown in the bottom half of Figure 1, it is the owner of the outlet – the franchisee – who is accountable to the employee for compliance with legal obligations (in the sense that an employee can take a complaint to an industrial inspector). The head office franchisor is not usually directly liable. Moreover, while franchisors seek to maintain control over product quality, they also seek to do so at the lowest possible cost, and this is achieved partly through, in effect, contracting out employment. Thus it is in the interests of franchisors to put in place systems (such as turnover-based payments) that create incentives for franchisees to operate at the lowest possible labour cost. This is not the

only motivation for franchises – there is considerable literature demonstrating other motives as well (for discussion see Dant 1995) – but it is a motivation that is not considered adequately. Nor need it even be a conscious motivation; rather, it is the logic of the franchise system to minimise costs and transfer risk in this way. To the franchisor, the way in which lower costs are achieved by franchising rather than owning outlets is a ‘black box’; only the fees they charge are revealed by the market transactions associated with franchise contracts. This structure also means that head office franchisors have little or no accountability to the employee, and that it is in franchisors’ interests to put the full onus on franchisees for labour administration and compliance.

As government inspection agencies found, while routine inspections and education generate higher compliance, they are more costly to undertake than simply penalising revealed non-compliance (Goodwin and Maconachie 2007, 2010). So franchisors can minimise costs by having a penalty-based regime for non-compliance with IR regulations. While the franchise agreement typically addresses franchisee responsibilities for compliance on quality, marketing, opening hours, presentation, reporting, finances and training (Blair and LaFontaine 2005, Justis and Judd 2003), *detailed* references to employment-related requirements are uncommon (Brand and Croonen 2010). Agency theory argues that franchisor control should increase in areas of greatest risk to the brand (Pizanti and Lerner 2003), however our diverse accountabilities model indicates control and compliance with employment requirements would be limited, or at least variable.

Resources available to managers to obtain ‘knowledge’ of IR will be greater in large firms than in small firms, and so inadvertent non-compliance will likely also be greater in small firms. Just as wages are lower in small businesses than large businesses (Haltiwanger, Hyatt, McEntarfer and Sousa 2012, Revesz and Lattimore 1997), labour standard compliance is typically also lower in small businesses (Bhorat et al. 2012, Buultjens 1994, Gindling and Terrell 2010, Strobl and Walsh 2003). However, where large firms have a strong organisational interest in disseminating knowledge about obligations to all workplaces and ensuring compliance to avoid liability, large franchise firms will not face the same incentives (except with respect to company-owned outlets). Indeed they may have less incentive than conventional large firms to even devote central resources to obtaining IR knowledge.

In this model, then, franchises exhibit some of the HR characteristics of large organisations (such as rule making) while having many of the IR characteristics of small organisations (such as low unionisation and low labour costs). Having some of the HR characteristics of large organisations enables them to install processes that support the consistent quality of product necessary to maximise positive brand image. Having IR characteristics of small businesses enables them to operate with low wages and also allows flexibility to deny responsibility for breaches of IR law and even terminate franchisees who ‘get caught’ for such breaches. Under agency theory, principals are faced with dilemmas arising from their use of agents and have to devise means of creating incentive and compliance systems to deal with the misalignment of principals’ and agents’ objectives. Under our ‘diverse accountabilities’ model, the principal-agent issue is not really a dilemma that inevitably arises in franchises; rather, franchises are the outcome of a decision to run a business model that takes

advantage of the structural differences between franchisees and franchisors, reaping advantages from control over product and processes of a large organisation while extracting some of the rents accruing from the low-wage and low-compliance model of small businesses.

This model leads to several predictions: that franchisors will devote considerably fewer resources to compliance with IR matters than to maintenance of product quality; that, while it is in franchisors' interests to minimise industrial non-compliance amongst franchisees, and they may therefore provide them limited IR support, franchisors will give less support to franchisees on IR matters than product-related issues, instead relying on heavily penalising breaches; and that non-compliance with IR law will be a phenomenon in franchises that is more frequent than in large, conventional organisations but less frequent than in conventional small businesses.

IR compliance and franchising

In investigating labour standards compliance in the US hospitality and accommodation industry, Weil (2012) found that branded businesses were likely to have better rates of compliance than independent businesses. He also found that company units exhibited higher rates of compliance than franchised units, particularly in food-based systems. IR misbehaviour can attract significant attention. In Australia the 'POW Juice' franchise was best known for offering a substandard Australian Workplace Agreement (AWA) in 2006 to a young worker, for which it was prosecuted and received substantial adverse publicity. By 2010 its name was deregistered (Australian Securities & Investments Commission 2014), but it is difficult to know whether this reputational loss associated with its AWAs was critical.

Work Choices was an era of heightened media consciousness of issues regarding exploitation; far more instances of underpayment go unreported in the media, particularly in recent times.

Most of the features described earlier by Maconachie and Goodwin characterise the hospitality sector. Underpaying staff – although illegal – benefits the franchisee unless they are exposed and fined. Media and government reports suggest franchisee non-compliance in IR is prevalent in Australia and franchisor intervention is minimal. This is particularly the case in the hospitality industry, from where the Fair Work Ombudsman reports it receives the majority of complaints (Fair Work Ombudsman 2013b). For example, the Fair Work Ombudsman prosecuted a *Subway* sandwich chain franchisee that failed to comply with four Notices and underpaid employees despite pay rates being ‘well known’ to the franchisee;ⁱ and launched legal action against a franchisee from the *La Porchetta* pizza chain regarding allegations of a total of \$250,000 in underpayments (Fair Work Ombudsman 2013c).

Investigations (referred to in our findings as ‘external audits’) are regularly conducted by government bodies including the Fair Work Ombudsman in response to complaints or as part of a geographical or industry sector inquiry. Such an investigation into Sydney convenience stores followed complaints from employees about the *7-Eleven* franchise, amid suspicions franchisees were altering salary records and paying below the minimum wage (Workplace Ombudsman 2009). The investigation, which included 49 businesses, found around one third were non-compliant on wages, resulting in almost \$60,000 in back-payments. The same rate of non-compliance was reported by the Fair Work Ombudsman (2010) following an investigation of 87

businesses in the fast food sector, also initiated following employee complaints. The report noted that:

Those employers who were members of an employer association and/or received regular industrial relations assistance from their franchisor were better informed of their obligations. Consequently they were more likely to be found compliant compared to other employers...[T]here was a clear distinction between the level of industrial relations assistance offered by the larger and smaller franchisors to their franchisees. Many of the larger franchise chains offered regular industrial relations technical seminars which they invited their franchisee to attend.

(Fair Work Ombudsman 2010: 3)

The Fair Work Ombudsman's report highlights that offering franchisees guidance can improve compliance. After all, 'knowledge of regulation, coupled with the internal capacity to respond positively, can and does enable (small) business owners to adapt business practices' (Anyadike-Danes, Athayde, Blackburn, Hart, Kitching, Smallbone and Wilson 2008). The Ombudsman's remarks on system size and relative support are consistent with results from the Franchising Australia report (Frazer et al. 2012), which found that only around one third of franchisors employed HR or IR professionals, provided access to external HR or IR services, or conducted internal audits of employment processes, and that involvement was higher in larger franchise systems (over 50 units). Those with such access to more developed support systems could undertake more stringent audits, leading to fewer violations.

Influences on franchisor IR control

Where franchisor control over IR is limited, the franchisor might be avoiding the costs and risks associated with providing support and monitoring behaviour.

Provision of IR support is not typically a stipulation in the franchise agreement (Brand and Croonen 2010). The complexity of employment matters increases the cost of hiring specialists to provide support and increases some risks to the franchisor.

There is evidence (reference to be reinserted post review) that franchisors avoid offering HR and IR support as a means of avoiding the risk of liability from providing the franchisee with information that is incorrect, as a franchisee provided inaccurate instructions may seek compensation for damages. Accordingly, a number of US court cases have found the franchisor could be deemed the legal employer of franchisee staff if they intervene too strongly in the franchisees' management of employees (Brand and Croonen 2010).

In the remainder of this article we explore how our model helps understand franchisor control and franchisee compliance with IR among three case organisations. First, we discuss our methodology.

Methods

Given the limitations of extant research, a qualitative case study approach was deemed most suitable. While case research is criticised for small and unique samples that limit generalisability, it can be valuable for exploring a topic about which little is known (Denzin and Lincoln 2000). We selected three 'representative or typical cases', as opposed to 'critical, unique or revelatory cases', as such an approach may increase the relevance of the findings (Yin 2009) at least for franchises in the same

industry sector. Following a pilot study, three similar Australian-owned food service franchises were selected to participate in the main study. Each is mature (established 20-30 years ago) and operates the majority of units in the domestic market. Units in each chain were small businesses employing between around 10-30 employees on various types of contract (full/part time and casual). To maintain anonymity, each franchise has been given a pseudonyms: *Café Latte* (the largest), *Cappuccino* and *Short Black* (the smallest). Key characteristics and interviewee numbers of the cases are shown in Table 1.

Table 1: Case and Interviewee Details

	<i>Cafe Latte</i>	<i>Cappuccino</i>	<i>Short Black</i>
Company ownership	Australian	Australian	Australian
Store locations	International	International	International
Total units (approx.)	1000	300	70
Corporate interviews	7	7	3
Franchisee interviews	7	7	6
Total interviews	14	14	9

Data were collected between July 2009 and February 2011. Qualitative methods were selected to provide rich and descriptive data, and to allow the context surrounding the research phenomena to be captured (Neuman, 2011). The primary investigator was in frequent communication with a key contact person in each franchise, conducted interviews, attended informal meetings, participated in employment-related workshops and seminars, and gathered documentary evidence of the HR strategy and systems. The contact person at *Cappuccino* was the HR Manager, while in the other cases it was the person to whom the HR Manager reported. The contact person provided access to the investigators and assisted in arranging interviews. Interviewees

were selected using a purposeful sampling approach (Neuman 2011), the limitations of which are acknowledged to include potential for bias due to involvement of the contact person in selection (Cavana, Delahaye and Sekaran 2000).

A semi-structured interview protocol was developed centring on key themes to encourage an informal atmosphere with participants. Interviewees included the contact person, other corporate employees involved with delivering employment related support (including Training Managers, IR Advisors and Legal Advisors), and 20 franchisees with varying tenure and unit ownership types (single and multiple-unit owners). In total, 37 interviews averaging one hour were conducted with 32 interviewees (five repeat interviews were conducted with HR and training managers at *Cafe Latte* and *Cappuccino* for further insight).

All interviews were recorded and transcribed; transcripts, field notes and electronic documentary evidence were inputted into *NVivo*. Data were analysed using a two-step coding procedure based on the 'inductive analysis' technique (Patton 2002). This involved reading and re-reading data, and assigning keywords (second-order categories) to passages of text to facilitate sorting and identification of emerging themes (first-order categories). The lead investigator first coded the data, then the research team came together for discussion. A process of creating, deleting, merging and dividing themes and categories occurred until agreement was reached unanimously. Randomly selected sections of coded data were cross-checked by team members throughout the process to test the internal reliability of the coding technique, with a high level of consistency.

The process of analysis resulted in four themes and twenty sub-categories. The first three themes relate to design, implementation and evaluation of HR strategy and systems, and the fourth concerns factors that influence the franchisor's approach to HRM. As this article presents the findings of a study focusing more broadly on HRM as well as IR, this paper refers only to the following sub-categories, as discussed in the findings: franchisee compliance; franchisor involvement; franchisee monitoring; internal assessments; external assessments; outcomes on non-compliance.

Research findings

Franchisee compliance

We first sought to understand whether the high control context of franchises translated to high compliance by franchisees in IR. Overwhelmingly we found franchisees experienced low franchisor involvement and control over IR and a concurrent high instance of IR misconduct – both intentional and unintentional. The following franchisees provide examples of how there is a potential to make errors in IR:

[I] provided everyone with the Award and a summary of the main points. It's open to so much interpretation and I am sure if one of the team really wanted to take it word for word there could be an argument. (Franchisee 6, Cafe Latte)

Sometimes you forget about it. 'Oh I have been meaning to do that, I have a new cook and I haven't done his offer letter yet.' I can forget about it and it may never get done. Same thing with his superannuation. If I miss that, all of a sudden the tax man rocks up

on the door and says, 'hey!' I think that is where Short Black needs to lift their game. (Franchisee 5, Short Black)

Franchisees stressed that it was not only the complexity of IR but their heavy workload which could lead to them misinterpreting or overlooking their responsibilities, an aspect of unit management which Franchisee 5 suggested could be alleviated if *Short Black* provided more IR support. Many franchisees were inexperienced in managing employment matters, and a few indicated that they felt lucky to have previous experience. For example:

I think there was something in the paper a year or so ago about someone from Cafe Latte who got fined over \$100,000 because they weren't paying their staff right or something. It hasn't really been an issue for me because I am 99 per cent sure that I have paid everyone right and I know, within reason, all the rules. But again, if I had never run [previous franchise] before I would probably be in a difficult situation. (Franchisee 5, Cafe Latte)

As explained in more detail in the following section, *Cappuccino* was deemed to provide the most IR support to franchisees. Despite this, there were still many examples provided by *Cappuccino* franchisees of how they perceived or experienced inadequate employment-related support to pose a risk to themselves or the organisation:

The HR Manager is spread very thin. I don't think the directors or the company understand how important it is. I think we've been lucky that no-one has done anything where we've really needed it... like unfair dismissal. There are no steps as to what you should do or how you should handle it. They've listed your warnings and stuff like that. But what paperwork should you keep? Should you have a witness?
(Franchisee 6, Cappuccino)

Every now and then I'll get someone come in and we'll go through the interview process and they'll say it to me, 'I'll work for cash'... I know other places that are doing it. I know other Cappuccino stores that are doing it. I won't do it. As soon as I do it, I'll get caught. I just know it.
(Franchisee 2, Cappuccino)

I would guess half the franchisees didn't go (to IR workshops). The ones that didn't wouldn't give a shit. They won't be paying in accordance to any award, they pay what they can get away with and no one is going to know until an employee says something.
(Franchisee 5, Cappuccino)

Although agency theory suggests activities most likely injurious to the brand are those which should be most heavily controlled (Belaya and Hanf 2009, Quinn and Doherty 2000), our findings suggest that, consistent with our model, this does not apply to management of labour.

Franchisor involvement in franchisee IR

Our second question asked about the level of franchisor involvement in franchisees' IR activities. *Cappuccino* was the only case that addressed IR in their franchisee induction, through a 2-hour module, facilitated by the HR Advisor, covering basic employment conditions. The HR Advisor then designed and facilitated on-going workshops, including National Employment Standards and dismissal. These were supported by extensive documentation such as a 'Fair Work kit' including a 'checklist' that 'went through the award bit by bit and pulled out all of the really important things' (HR Advisor, *Cappuccino* interview 1).

The HR department at *Short Black* did not have the expertise required to provide that level of support. The franchisor enlisted support from external advisors and an advisor from the legal department. This legal advisor provided ad-hoc assistance to the HR department on workplace legislation matters. The legal advisor also received occasional calls from franchisees, who she would direct to the Fair Work Australia website or provide general information. The legal advisor briefly addressed franchisees during induction and collected a range of documentation from the Fair Work Australia website:

Everybody is really confused, nobody knows what to do... I show them online how to get to the Fair Work Australia site, and go through briefly some of the things that are important that they could refer to... I have pulled out things that are important to them, or could be important to them, and put it into a handy little book so they don't have to try and find everything. (Legal Advisor, Short Black)

Franchising is based around devolving responsibility, and in the case of IR advice this usually means either devolving it to individual franchisees or alternatively contracting out. Prior to the Fair Work legislation, *Short Black* invited a third party advisor – owner of a business dealing in IR for small firms – to brief franchisees on how legislative changes would affect their businesses. The franchisor selected this company to develop enterprise agreements for their corporate units, hoping it would lessen the impact of wage increases associated in some states with forthcoming modern awards. The franchisor also had the company draw up template agreements for franchisees. Following an advisor-run information session at the conference, the franchisor strongly recommended that franchisees use that company, at franchisees' expense, for creating enterprise agreements. Franchisees could use the company's templates or 'pay extra money and [the company] can work with them on a one-on-one [agreement]' (Services and Support Manager, *Short Black*).

According to later franchisee interviews, many franchisees signed up with the company to have enterprise agreements created. The company asked for an immediate deposit from franchisees. While the first few franchisees who submitted paperwork were able to have agreements approved, the company then went into liquidation and the majority of franchisees lost their investment.

Towards the end of the data collection period, franchisees indicated there was considerable tension between themselves and the HR department. They also suggested the HR department had pulled back from offering further advice or support to franchisees on employment matters – rather than increasing IR support, it was further decreased.

At *Cafe Latte*, franchisor involvement in IR was even more restricted. The franchisor provided no introductory or on-going training, or information sessions regarding IR. The franchisor did not become involved in franchisee problems and directed franchisees to seek independent advice (although they did not recommend particular advisors). Their view was ‘At the end of the day, it’s up to [franchisees] to go back to their legal representative or accountant to see what type of awards or things they should be paying’ (HR Advisor, *Cafe Latte*). The Operations Manager of *Cafe Latte* compared its strategy with that of the *McDonalds* franchise:

[McDonalds] actually go to their franchisees and say, we’ve got our advice about it, here’s what you need to do... they will lobby with the government to make sure that the award suits them, whereas we probably tend to be a little bit reactive and we have to deal with the cards that we’ve got and then have our franchisees deal with the cards that they’ve got. (Operations Manager, Cafe Latte (interview 1)

Among our mostly non-union franchises, franchisors involvement in IR activities was generally low, though it varied substantially between cases: ranging from no involvement, and outsourcing the provision of advice (sometimes to unreliable providers), to at best a moderate level of guidance by in-house HR specialists – and was always well below that provided on other HRM or product-related issues.

Monitoring of franchisee behaviour

Our third question concerned how closely IR activities in franchised units are monitored by franchisors, and the outcomes of misconduct. First we consider each

organisation's methods of evaluating franchisee IR performance, and particular activities assessed, then we explore outcomes associated with franchisee results. Consistent with other food services franchises (Felstead 1991), all three of our case organisations conducted frequent scheduled assessments of franchisee performance in a number of aspects of business management. Assessments in all cases were administered by a representative of the franchisor and included a checklist of activities in areas such as coffee preparation, store presentation, food safety and financial indicators. These assessments were conducted with a dual purpose: to identify areas where franchisees needed to improve performance and ensure satisfactory compliance. At *Cappuccino*, a major audit of each unit was conducted annually, with mini audits conducted every eight weeks. *Cafe Latte* consultants conducted formal assessments twice annually. This was preceded by a 'help day', where consultants visited the franchisee and assisted with preparation for the assessment. *Short Black* conducted an assessment annually.

These assessments were a strict evaluation of franchisee adherence to rules and procedures, with negative consequences associated with poor performance. Only *Cappuccino*, however, included HRM or IR related assessment items. Of the 200 items on its major annual checklist, twenty eight items concerned employee management, including nine IR items such as legislative compliance, awards, disciplinary processes, harassment and pay slips.

The approaches of these three organisations to audits of franchisee IR behaviour differed. *Cappuccino* was proactive in detecting and recognising franchisee indiscretions through regular evaluations, while the other cases preferred to take a

reactive stance. *Short Black* and *Cafe Latte* relied on external sources (other franchisees, unit employees, the Fair Work Ombudsman or other government bodies) to identify misconduct. The Operations Manager at *Cafe Latte* explained, ‘the Fair Work Ombudsman are going on a blitz, so we will see what falls out of that.’ There was a similar perspective at *Short Black*, where the National Training Manager commented ‘there are already checks and balances in the government that are doing that anyway’.

The reactivity exhibited by these cases to IR contrasted with approach to other operational activities. All cases conducted thorough and frequent assessments of store performance in other aspects of business:

You can give them all the tools but that doesn't necessarily mean they'll follow them. That's probably the hardest thing for us. I'll give you an example: superannuation. We can tell them you've gotta pay it, here are some common superannuation funds, this is what you must do. But inevitably, if I audited my stores today on who is 100 percent compliant and up to date with super, I would probably be horrified... We can tell them to do it but there are certain things we don't audit them on... So for us we are very focused on, say, the muffins. We are very focused on following up on the operational kind of things. (Services and Support Manager, Short Black)

Said another franchisor manager:

You think a company have got their shit together. You think, 'they can't be this big and not have this stuff'. Then you start to dig and

think, 'what the?' It's funny, companies like Cafe Latte take food safety so seriously. The systems around that stuff are astronomical. They would be like 99 out of 100 – and HR, five out of 100. And you think the risks of somebody getting a cockroach in their coffee versus a team member, something happening. They don't see the same exposure. (Global Training Manager, Cafe Latte (interview 2)

In sum, our findings suggest that, consistent with our model and prior research, IR activities are not monitored to a high degree by the franchisor, particularly in comparison to monitoring of the product. In the next section we examine the outcomes associated when franchisees are found to be non-compliant with IR legislation or internal regulations.

Outcomes of non-compliance

In all cases there were similar consequences of non-compliance, dependent on whether the action was deemed by the franchisor as critical or non-critical. Critical incidents were those that breached legislative or regulatory requirements, while non-critical incidents breached company guidelines or recommendations. For example, critical incidents included underpayment of staff, failure to pay superannuation, unfair dismissal or discrimination. Non-critical incidents included failure to conduct performance reviews, provide new staff with the company information booklet or not have them complete an online induction.

Each franchisor reported that 'critical' non-compliance with the requirements of the franchise agreement could be recognised as a breach of contract and result in the franchisee's unit being revoked:

As a very last recourse we will get out the big stick and we call it the 'managing non-aligned behaviour process.' And the franchisee knows that if they get into that process we will go to 'breach' unless they rectify it. (Global Training Manager, Cafe Latte (interview 1))

We will write to the franchisee and tell him to stop [the misconduct], because if that continues we have the ability to breach him. Part of the franchise agreement is that you have to comply with the legislation... All laws and legislation require people to be paid. (HR Manager, Cappuccino (interview 1))

There are a small percentage of franchisees that are ripping off their staff. They are the ones we get really aggressive with. We can go down the track and default them. A default is a process of getting rid of the franchisee because there is a gross misconduct. For example, if they stopped paying the rent, if they are maliciously ripping off staff even though we warned them. So we don't audit it, but when it does happen and we hear about it, we react very strongly. (Services and Support Manager, Short Black)

While the consequences for a breach of contract – including critical employment related misconduct – were severe and clearly defined, the outcomes for non-critical incidents were far less serious:

There's fluffy HR and critical IR. We don't mess around with the fluffy HR stuff. We train them and educate them but don't audit it. They have the tools, they should be doing it. But the serious stuff, not being paid properly, being paid cash in hand, we'll come down on them for that when and if we find out about it. (Services and Support Manager, Short Black)

While it is clear that the franchisors in this study shared the same distinction between critical and non-critical incidents and treated intentional misconduct as a serious breach of contract, these findings contrast with the lack of monitoring of franchisee behaviour. Most mechanisms of franchisee monitoring require direct observation and impose a significant administrative expense for the franchisor (Combs and Castrogiovanni 1994). However, expenses resulting from exposure of franchisee misbehaviour to the media, which could be avoided through monitoring mechanisms, are likely to be greater.

Discussion and conclusion

We are mindful that this is an Australian sample of cases and that the system in Australia has elements of IR exceptionalism which limits the generalisation of our findings. However, this is more than compensated by the fact that research in the IR (and indeed HRM) realm of franchising is somewhat limited. Franchises are a global business and employment phenomenon and future research across various contexts (both nations and sectors of the economy) is called for to assist in better understanding IR practices.

In this article we first asked, does the high control context of franchise systems translate to high compliance by franchisees in IR? Our findings were consistent with other literature in suggesting that high compliance with IR standards was unlikely. Franchisors expressed scepticism about the degree of compliance with IR regulations, and franchisees themselves expressed similar concerns.

We then sought answers to two related questions. What level of involvement do franchisors have in IR activities in franchise units? This appeared to vary substantially between cases, ranging from no involvement, and outsourcing the provision of advice (sometimes to unreliable providers), to a low-moderate level of guidance by in-house HR specialists; but it was always well below that provided on other HRM or product-related issues. How closely, then, are IR activities in franchised units monitored by the franchisor, and what are the outcomes of misconduct? Again, monitoring and evaluation varied from zero internal involvement to annual evaluations at *Cappuccino*. In both *Cafe Latte* and *Short Black*, franchisors were largely content to rely on external sources for reporting misconduct. Size was not critical: *Cafe Latte* had over 1000 outlets - around 15 times the size of *Short Black* - but was keenest to leave IR matters to franchises. Importantly, all franchisors defined IR breaches as ‘critical’ incidents in terms of their contracts with franchisees, and so retained the ability to deliver the same harsh responses to critical incidents – more so than for failure to adhere to internal financial and production procedures.

Franchisees had a strong incentive to adhere to IR laws, but at the same time they were part of the small business sector which has been associated with poor compliance with employment legislation due to financial pressures and lack of

institutional enforcement (Bhorat et al. 2012, Buultjens 1994, Gindling and Terrell 2010, Strobl and Walsh 2003). If, as Goodwin and Maconachie (2007) argued, the shift from routine inspections by government agencies reduced the probability of detection of industrial breaches and encouraged evasion, then the lack of routine franchisor inspections of IR compliance likely promoted non-compliance amongst franchisees.

The approaches we observed were not consistent with agency theory propositions that the franchisor must control and monitor franchisees when they are likely to act in their own self-interests (Castrogiovanni et al. 2006, Eisenhardt 1989). Rather, in our sample, franchisors take advantage of the ultimate ability to dissociate themselves both legally and morally, from misbehaving franchisees, consistent with the diverse accountabilities model.

Franchises are based on transfer of risk – most obviously the transfer to franchisees of the financial risk involved in opening a branch of a business in a new location, but less obviously the transfer of IR risk – to the small businesses that act as franchisees, and their employees. This transfer of risk reflects a power differential between franchisor and franchisee. Thus it need not be in franchisors' interests to devote extensive central resources to IR monitoring and compliance. *Cafe Latte* and *Short Black* adopted a reactive stance to IR evaluation, choosing to respond to notifications of misbehaviour from external sources rather than discover them through franchisee monitoring, as seen at *Cappuccino*. While some activities such as preparing the product were given high priority in evaluations of franchisee behaviour, employment matters held far less weight. To franchisors, 'good IR' was exhibited by a lack of

known indiscretions. They were more focused on the muffins, on the internal regulation of product quality, than on IR.

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Endnotes

ⁱ Fair Work Ombudsman v Nicole Patrice Dawe [2013] FMCA 191, 17, 30.