

## **Why McDonalds is Attractive to Franchisee Investors**

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### Published

2004

### Conference Title

Marketing Accountabilities and Responsibilities - Conference Proceedings of ANZMAC 2004

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# Why McDonalds is Attractive to Franchisee Investors

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## Abstract

*Previous exploratory and explanatory research into the factors influencing an individual's decision to purchase a franchise has largely focused upon the franchisor's perspective, with comparatively less attention being given to that of the franchisee. Within the single unit context, franchising is said to be successful as it affords satisfactory levels of independence, together with training and support that reduces risk relative to entering an independent business. While research has examined factors affecting the decision to purchase a franchise within the context of the broader decision to become self-employed, there is some evidence that the findings may not be applicable within the Australian franchising sector. This research aims to build theory through the presentation of a set of general propositions explaining the decision to franchise as a function of work and family conflict, the provision of employment for family members and employees, self employment history, and the level of prior experience within the franchise system. Data was drawn exclusively from franchisees in the McDonalds restaurant chain. Overall, the qualitative findings confirmed the validity of the general propositions in preparation for future empirical testing.*

Keywords: Franchise, Services Marketing

## Introduction

Although there has been considerable examination of the perceived advantages of the franchising form from the franchisor's perspective, there has been comparatively little investigation into the motivational incentives governing franchising choice from the franchisee's perspective (Grünhagen and Mittelstaedt 2001; Weaven and Frazer 2003). This may be the result of a belief that the decision to franchise ultimately lies with the franchisor (Kaufman and Stanworth 1995), or be due to a difficulty in obtaining valid data from the franchisee population (Peterson and Dant 1990), or may reflect a myopic assumption that both franchisees and franchisors possess symmetry of motives (Kaufmann 1999). Whatever the reason, an understanding of franchisee motivations has important implications for the creation and management of franchising relationships. In particular, knowledge of the factors that drive franchising choice should facilitate the design of promotional campaigns that serve to attract suitable franchisee candidates. This, in turn, should encourage incentives alignment between the principal and agent, thus promoting operational efficiencies during the term of the franchise agreement.

This paper examines issues surrounding the reasons why individual entrepreneurs choose to buy a franchise. The data is drawn from franchisees in McDonald's, which is regarded as a model of good franchising practice in the services sector (Frazer 2003; Morrison 2000). This paper proceeds in the following order. The next section incorporates a review of the literature and presents the research problem. Then, the methodology used to conduct the study and the findings are explained. Lastly, the theoretical and practical ramifications of this study are discussed.

## Literature Review

Given that researchers and practitioners espouse the financial benefits associated with the recruitment of suitable franchisee candidates that will operationalise the franchisor's goals (for example, Jambulingam and Nevin 1999), it is odd that so few studies have been conducted into why individuals choose to become franchisees (Hough 1986; Phan, Butler and Lee 1996). Through understanding franchisee motivational incentives, franchisors should be better able to attract and qualify suitable potential incumbents and select those individuals who will add value to their network (Achrol 1996). This is particularly important in reducing the coordination and adaptation costs associated with ongoing compliance within the franchise system (Jambulingam and Nevin 1999). Although it may be difficult to accurately gauge what motivates individuals to join franchise systems due to the complexity and heterogeneity of their personalities, and situational and economic contexts (Peterson and Dant 1990), it is nevertheless critical in ensuring that the expectations of franchisors and franchisees are compatible.

As suggested above, previous motivational analysis often views franchising as a small business alternative to fully independent business ownership, within the broader context of the individual's drive toward self-employment. In particular, franchising offers a comparatively easier method of small business ownership and provides opportunities for job and wealth creation for incumbent families (Leach 1994). Although it has been suggested that franchisees are little more than employees (Rubin 1978), a more encompassing view is that it represents a method of controlled self-employment (Felstead 1991) within an 'entrepreneurial partnership' (Kaufmann and Dant, 1998, p.11). This dyadic relationship affords franchisees many advantages, which may be broadly categorised as marketing, financial and operational benefits (Hing 1995). The following discussion will review these advantages with reference to social motivations relevant to the decision to adopt franchising arrangements.

*Marketing benefits* refer to those advantages ensuing from the nature and implementation of the franchising concept (Housden 1984) and include a recognised and supported '...name and reputation, widely advertised brands, popular store design, carefully chosen location, standardised procedures and operation, and initial and ongoing assistance' (Diaz and Gurnick 1969, p.12). Specifically, franchisees are said to benefit by partnering an experienced franchisor in a system with an established company trade name, reputation and solid market positioning (Hing 1995; Stanworth and Kaufmann 1996). This ensures that franchised units have immediate sales due to a loyal and brand aware customer base (Housden 1984; McCosker 1989). In addition, the collective nature of the franchising network allows franchisees to access market information and benefits commensurate with large scale advertising campaigns that would not be realisable independently (Cherkasky 1996). Therefore, individuals may be motivated to enter franchising arrangements as they promise marketing benefits consistent with *large scale operations*.

Franchising may offer franchisees various *financial benefits*. As franchise systems are built upon a proven concept, franchisees may perceive an advantage in eliminating unnecessary start up costs, and accessing franchisor extended credit on business supplies (Mendelsohn 1990). Furthermore, franchisees may find initial investment capital easier to obtain from financial institutions (Bucknell 1990). In addition, franchisees may obtain cheaper supplies due to the purchasing power of a large network organisation (Bureau of Industry Economics 1990) although this contention has not received majority empirical support (Hunt and Nevin

1977; Ozanne and Hunt 1971). While franchising agreements obligate a financial commitment to franchisors in the form of fees, royalties and levies, many franchisees may place greater importance upon the perceived reduction in financial *risk* as opposed to fully independent business ownership.

Franchising may be viewed by potential franchisees as an efficient method of distribution affording an interdependent power sharing arrangement in a protected and yet independent organisational environment. *Operational benefits* may include greater operational independence than achievable in salaried employment and, initial and ongoing training and support (Peterson and Dant 1990). However, many researchers have questioned the equity of the power-dependence relationship in franchising arrangements (for example, O'Donnell 1984; Rubin 1978). In particular, franchise contracts sometimes stipulate working hours, products, supplies, supply resale prices, staff and service levels, equipment levels and maintenance, and payment schedules (Felstead 1991; Housden 1984). These provisions guide and enforce franchisee compliance in line with the franchisor's goal of maintaining system uniformity, thus supporting the franchisor's authoritative position in the franchising relationship. However research suggests that franchisors may not use this power to enforce explicit contractual provisions, relying instead on implicit persuasion (Hadfield 1991; Stanworth, Curran and Hough 1983). Therefore, issues of *autonomy, dependence, power and communication* will impact upon the perceptions of a discerning franchisee candidate.

Overall, previous conceptual, exploratory and explanatory studies have focused upon identifying the importance franchisees place upon many of the economic and social advantages associated with the traditional single unit franchising model. Early research nominated affiliation with a nationally known trademark as the most important advantage of franchising (Stanworth 1977). A Canadian study found that respondents place greatest value on the firm's brand followed by increased levels of operational independence and personal job satisfaction (Knight 1986). Other researcher found that franchisees sought to minimise risk through association with a proven business with a proven track record of performance (Baron and Schmidt 1991). A Canadian study identified a proven business format as the most important benefit of franchising (Withane 1991). Similarly other research found that the decision to franchise was predicated upon value associated with an established name and lower initial development costs (Peterson and Dant 1990; Knight 1986). In addition to the propositions presented in the next section, this research will attempt examine the relative importance that franchisees place upon the franchise trademark, proven concept, organisational training and support, perceived future autonomy and operational independence, in making their decision to enter franchising.

Although these studies provide valuable information as to the benefits associated with franchising, they have not been formally examined within the Australian franchising sector. In addition, recent research suggests that these studies may not have captured the full range of motivational incentives (Grunhagen and Mittelstaedt 2000; Kaufmann 1999; Weaven 2004). Thus, this research addresses gaps in the literature through the investigation of the following research question:

*What are the motivational incentives governing single unit franchising adoption?*

## **Motivational incentives governing single unit franchising adoption**

### **Provision of employment for friends and family**

Research suggests that franchising provides opportunity for employment of friends and family (Kaufmann and Stanworth 1994). In particular, franchising may provide a solution to family member employment problems or as a means of socialising family members into the family business (Kaufmann 1999). In contrast to salaried employment, there are no restrictions on the employment of family members in franchise firms. This has received some recent anecdotal support in the trade literature (Morgan 2000). Thus, it is proposed that:

*P1: Individuals with the desire to provide employment for friends or family members are more likely to purchase a franchise than individuals without these needs*

### **Previous work and family conflict**

There is some evidence in the literature that conflict in the family or at work impacts upon an individual's level of job satisfaction (Boles 1996). Research indicates that franchising may offer greater flexibility than salaried employment (Knight 1986). However, a recent United States study did not show an association between levels of family and work conflict, and the desire for individuals to seek self-employment (Kaufmann 1999). Given this apparent disparity in research findings, and the fact that this proposition has not been formally tested in Australia, it is posited that:

*P2: Individuals with greater work and family conflict are more likely to purchase a franchise than those encountering less family and work conflict.*

### **History of self-employment**

Research suggests that franchising choice is embodied within the broader context of an individual's desire for self-employment (Peterson and Dant 1990; Kaufmann 1999). This may be because franchising offers underperforming entrepreneurs the opportunity to maintain self-employed (Kaufmann and Stanworth 1994). Early descriptive research found that more than half of the surveyed franchisees had been previously self-employed (Stanworth 1984) and that franchisors often chose franchisees that had a history of self-employment (Edens et al. 1976). However, a more recent study found that probability of becoming a franchisee was negatively associated with a history of self-employment (Williams 1994). Thus, there does not appear to be consensus in the literature. Therefore it is posited that:

*P3: Individuals with prior self-employment history are more likely to purchase a franchise than those without self-employment experience.*

### **Work experience within the franchising sector**

There is some anecdotal evidence that individuals with franchising experience tend to maintain an association with the sector (Meij 2002). It is likely that these potential franchisees would have greater insight into system operations and unit performance than individuals without experience in the system. Exchange theory research suggests that experience is associated with higher order comparison levels that may result in a more critical evaluation of the advantages associated with franchising (Peterson & Dant 1990). However,

this would most likely impact upon brand, rather than sectoral choice (Kaufmann 1999). Therefore it is posited that:

*P4: Individuals with prior experience within the franchising sector are more likely to purchase a franchise than individuals without prior experience.*

## **Methodology**

Qualitative methods were used in this research as the topic is in an early stage of theory development and hence quantitative findings may be premature and inconclusive (Eisenhardt 1989; Parkhe 1993). A clinical non-directive method known as convergent interviewing was used to provide an in-depth understanding of franchisee motivations and incentives governing franchising behaviour (Rubin and Rubin 1995) through obtaining ‘rich’, ‘deep’ and ‘real’ information (Deshpande 1983, p. 103) and ‘tracking down patterns [and] consistencies’ (Mintzberg 1979, p. 584). The convergent interviewing approach is an unstructured process where the information given by interviewees is not as a result of answers given to questions predetermined by the researcher, but is the result of information given and developed from respondent information.

Confidential telephone interviews were conducted with 10 single unit franchisees within the McDonalds restaurant chain in the south east Queensland region. This was slightly more than originally anticipated, but was necessary in gaining convergence of opinion between respondents.

## **Analysis of Research Findings**

### **Overview**

All franchisees nominated that they were particularly satisfied with their choice of a McDonald’s franchise. All respondents believed that the system trademark or brand as greatest advantage associated with franchising. Most respondents ranked the proven concept or ‘business formula’ as the next important, followed by anticipated financial returns and organisational training and support. Less than half of the interviewees nominated financial security as a motivation to enter the franchising system, which appears consistent with overseas findings (Stanworth 1999). In addition, two respondents nominated previous franchisor performance as an important determinant of their decision to enter the system. In particular, one interviewee self-identified marketing innovation and competitive positioning as important factors in the decision to purchase a franchise.

### **Propositions**

Three propositions were supported. Proposition 1 was *not supported*. Less than half of the interviewees agreed that the provision of future employment for friends and family was an important determinant of their decision to enter franchising. Only three franchisees nominated an interest in finding a business that would accommodate them working with their spouse or partner, which appears consistent with overseas findings (Kaufmann and Stanworth 1994). Proposition 2 received *weak support*. Six respondents nominated previous work and family conflicts as motivating their decision to enter self-employment through franchising.

Of these, four suggested that franchising offered a means for them to accommodate unforeseen family demands as they had more control over their working hours. These results lend support for the contention that individuals are attracted to franchising as it affords them greater autonomy and operational independence (Weaven 2003).

Just over half of the franchisee respondents indicated that they had some history of self-employment. Most had no prior work experience within the quick service restaurant industry, which may lend some preliminary support to the contention that franchisees choose the brand before the industry (Kaufmann 1999). Thus proposition 3 received *weak support*. Most respondents indicated that they had prior experience within the franchising sector. Seven respondents indicated that this had given them a unique perspective on the factors critical to ensure success within the sector. Most nominated the importance of choosing a system with an internationally recognised brand and large customer base while less importance was placed upon territorial issues and franchisor support. Interestingly, four franchisees had been previously employed within the McDonald's system, which lends support to earlier findings (Meij 2002). Thus proposition 4 received *strong support*.

### **Conclusion and Recommendation for Future Research**

Generally, the qualitative findings of this research confirmed the proposed theoretical relationships between identified constructs. However, more research is needed to verify and test the proposed theoretical relationships. It is envisaged that this will be done in a future large-scale quantitative survey of franchise systems.

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