Franchisee-franchisor compatibility: It's a two-way street

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Franchisee-franchisor compatibility:
It's a two-way street

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Abstract

This paper aims to extend the current literature on franchisee-franchisor compatibility. The main focus of previous literature has been on franchisee selection and the importance of recruiting and selecting suitable candidates. However, the issue of choosing a suitable franchisor has been largely neglected, although it is argued here that franchisees need to be proactive in choosing a compatible franchisor. It is also argued that franchising provides a means of overcoming the problems associated with independent small business ownership, including human capital deficiencies. This paper proposes a model of competencies and qualities of an ideal franchisor as a basis for potential franchisee consideration.

Introduction

Franchising has grown dramatically in Australia since its origins in the 1970s (Terry and Giugni 1998). In 2002, approximately 700 franchise systems existed in Australia, operating a total of 49,700 franchised units. Fully 92 percent of these systems are Australian based franchises (Frazer and Weaven 2002). However, the franchising sector is increasing at a declining rate, therefore suggesting that the sector might be in its maturity stage (Frazer 2000). Many franchisors now report difficulty in attracting and recruiting suitable franchisees (Frazer and Weaven 2002), possibly due to the increased regulation of the sector as well as macro economic forces.

The relationship between a franchisor and franchisee is special, and therefore different from most business relationships (Mendelsohn 1999). This relationship is one that is built on a win-win situation whereby franchisors do not stand to gain if their franchisees fail in their respective businesses. Franchising is about gaining a competitive edge through the *sharing* of knowledge and resources (Nathan 1999), where the franchisor provides the knowledge of running the business and the franchisee provides the labour and capital resources to conduct the business. As such, it is essential that compatible partners who share similar goals are chosen to ensure a positive, long-term relationship (Nathan 2000). Therefore, this paper presents the desired qualities of both franchisors and franchisees, as well as suggesting guidelines for selecting compatible partners in this unique relationship.

Benefits of Franchising to Aspiring Business Owners

The downsizing of large corporations has resulted in many employees leaving to start their own businesses (Mazzarol, Volery, Doss and Thein 1999). Such small businesses which usually employ fewer than 20 employees (Watson and Everett 1993), involving one or two persons in the critical decision making process (Watson and Everett 1996) account for 97 percent of all private sector businesses in Australia (ABS 1996). However, many of these aspiring business owners fail to adequately consider the risks and requirements of business ownership, resulting in the closure of the business within its early years (McMahon, Holmes, Hutchinson and Forsaith 1993).

Franchising may offer an attractive alternative for risk-averse entrepreneurs who desire the independence of being their own boss, yet want the support of a well-established brand name and proven business format. Franchisors provide training and guidance to franchisees, therefore reducing the risk of failure. Common causes of SME failure are managerial incompetence, lack of experience, poor financial control, failure to plan, inappropriate location, lack of inventory control, inappropriate business strategy, product design problems, improper attitudes and human resource problems (Kuratko and Hodgetts 2001, Zimmerer and Scarborough 1996).

These factors are now considered in more detail. *Managerial incompetence* is one of the most cited causes of business failure as most new businesses fail chiefly due to poor decision making and management inexperience (Sadler-Smith, Hampson, Chaston and Badger 2003). Franchising may reduce the possibility of this occurring as franchisors provide training for franchisees in management and organisational skills, as well as guiding and supporting franchisees, and offering advice when required. Next, *lack of experience* occurs when entrepreneurs have insufficient exposure in the chosen business or industry. In franchising, however, franchisors provide training to franchisees on the day-to-day operations of the franchise business, thus eliminating the need for prior experience or industry exposure. As well, *poor financial control* is a problem because profit margins are often narrower in new businesses (Zimmerer & Scarborough 1996). As such, it is important that entrepreneurs are not undercapitalised. Entrepreneurs who are part of a franchise network will have the benefit of the franchisor's advice on investment of fixed assets and cash flow. Indeed, some franchisors also provide administration support in accounting for their franchisees (McCosker and Frazer 1998).

Failure to plan is a common problem for many small business owners, resulting in a lack of strategic planning for the business, and thus weakening the organisation as a whole. Those who are part of a franchise network have the benefit of a franchisor to plan for the future of the franchise system – providing administration, research and development, and public relations and marketing support for the franchise system. The next common problem faced by SMEs, particularly those involved in retailing, is the choice of an *appropriate location*. Unfortunately, many entrepreneurs lack foresight in the choice of business location, while others decide on the location without much research (Zimmerer & Scarborough 1996). Franchisors become experienced at identifying desirable unit locations, assisting potential franchisees to select appropriate sites, or at least, providing advice on site selection, therefore reducing the possibility of an unsuitable location. Another common problem, *lack of inventory control* is one of the most neglected of all managerial responsibilities (Zimmerer & Scarborough 1996). Maintaining sufficient stock level to meet customers' demands is especially critical in the retail industry since insufficient inventory leads to shortages, resulting in lost sales, and perhaps customers, as disillusioned customers may choose not to return. On the contrary, many small firms have an excessive amount of working capital tied up in an accumulation of needless inventory. The benefit of franchising in this instance is the franchisor's advice to franchisees about inventory control. In addition, field representatives regularly check on the inventory levels of franchisees.

Inappropriate business strategy is again an obstacle for many aspiring business owners. Some entrepreneurs are uncertain about the goals and direction of the business, causing firms to undergo constant change and therefore lack stability. Next, *product design problems* occur when entrepreneurs launch their business without conducting sufficient market research. However, the chances of both of these factors happening in franchised outlets should be greatly reduced, as the concepts and products are usually pilot tested and proven to be successful prior to being franchised (Mendelsohn 1999).

Finally, two personal factors can be considered. The *improper attitudes* of entrepreneurs refers to their work ethic, such as working long hours, being positive and optimistic, and prepared to face new challenges. Although franchising cannot totally solve these problems relating to personality traits and attitudes, it is the franchisor's responsibility to select franchisees who are suited for the business, and who share similar goals as the franchisor. *Human resource problems* involve the difficulties small businesses face in attracting appropriate skilled personnel to manage the business. Franchisees are often required to manage the business personally, thus minimising the risk.

Desired Qualities of Franchisors

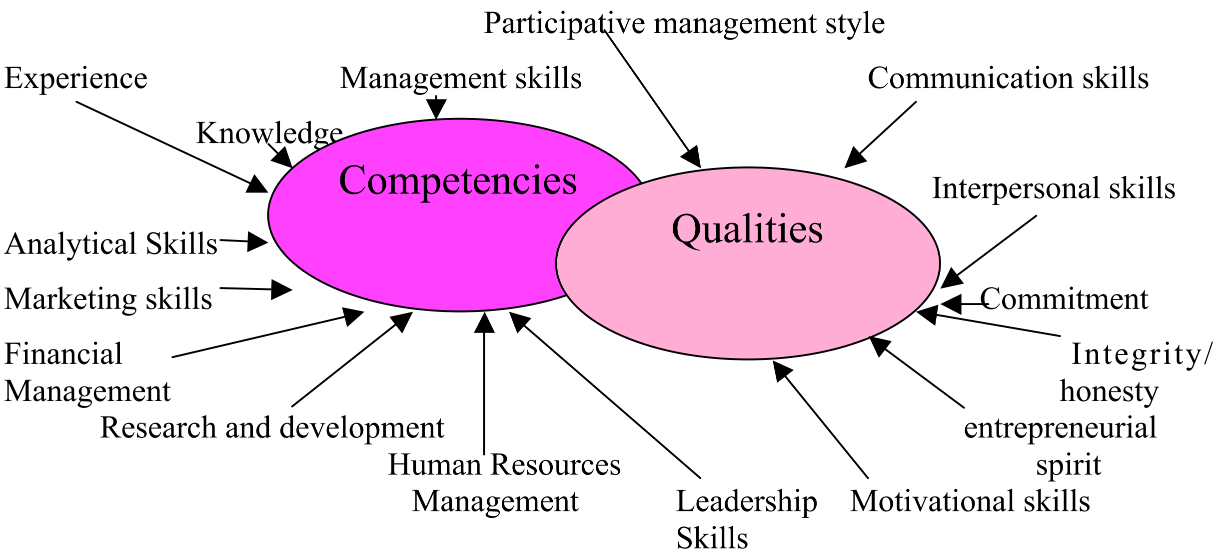
Franchisors are essentially entrepreneurs and managers of their own organisation, as well as playing the role of consultant or advisor to their franchisees. As such, franchisors, need to be competent in managerial skills, as well as playing the advisory role, possessing strong participative management skills.

Similar to SME owners, franchisors need to possess extensive knowledge about the industry in which they are operating, including being well-informed about customer needs and competitor activities. In order to keep abreast of industry trends, franchisors should conduct relevant market research. Strong analytical skills are crucial in order to spot opportunities and threats in the dynamic business environment.

In addition, because franchisors need to train and guide franchisees in operational and technical skills, they must be well-versed in the business so as to be able to spot problems and take corrective action accordingly. Therefore, franchisors need to operate in the industry long enough to understand the market and gain sufficient experience with the business prior to franchising. *Experience* affects entrepreneurial ability (Cross 1981). It is particularly important and relevant for franchisors in the retail industry to be experienced in sales and marketing. Prior experience in management positions allows entrepreneurs to acquire numerous useful and critical *management skills* such as negotiation and problem solving skills, planning, organising, production and management skills (Barkham 1994). Furthermore, strong exposure in the industry provides the entrepreneur with foresight to identify opportunities and rectify crises, (Hill 2001, Greiner 1972). It also provides the entrepreneur with strong operational skills, although some may argue that the need for technical skill becomes less important as managers move up the management hierarchy in an organisation (Miller 1998). As well, franchisors should be competent in handling the operational demands of the business.

In brief, it is important that franchisors be well educated, or at least continually upgrade their knowledge and skills, because business is dynamic and therefore constantly changing. Franchisors should also have exposure in a managerial position prior to franchising, and to be in the business long enough to acquire sound business skills in the area of marketing, human resources and financial management. Figure 1 below summarises the competencies and qualities required of a franchisor. Competencies in this instance refer to tangible skills that can easily be learned, while qualities are intangible skills that are innate in a person, and often difficult or impossible to acquire via training.

Figure 1 Competencies and Qualities required of a Franchisor



Desired Qualities of Franchisees

Having discussed the desired qualities for franchisors, it is also essential to analyse the desired qualities of franchisees, since the franchisor-franchisee relationship is an interdependent one, and like any other relationship, both parties play a part in contributing to the success of the relationship (Nathan 2000). Earlier discussion demonstrated that franchisors provide most training and guidance in the area of management and operational skills. As such, most franchisors do not require franchisees to have prior industry experience, although some business and management ability is desirable, but not an absolute necessity. Instead, franchisees must have a strong work ethic

However, little can compensate for a franchisee with an unsuitable personality. Ideally, franchisees should be able to work independently and be motivated, yet able to work within set guidelines, and have strong team-spirit in order to work amicably with other franchisees within the system. Franchisees should also hold similar goals and be compatible in management and working style to their franchisors.

Guidelines for Franchisee Selection

Franchisors should therefore undertake a systematic screening process to identify desired qualities in their franchisees. When a potential franchisee expresses an interest in a franchise system, the franchisor should arrange an informal *meeting* to provide the potential franchisee with basic information about the system. After that, if the potential franchisee expresses further interest in this investment, he or she should be asked to fill out a well-designed *application* form which may be used as a screening device to weed out unsuitable applicants. Next, in-depth interviews (Marshall and Kleiner 1999) and careful post-interview checks (Newton and Kleiner 1999) should be followed, such as reference checks. In-depth interviews allow franchisors to assess the background experience, knowledge and capability of potential franchisees. Many franchisors also choose to visit potential franchisees at their homes to assess the level of support given by their spouses and family members in their franchise venture. As well, potential franchisees who keep their homes neat and tidy tend to be able to manage their businesses better and more systematically than people who are untidy (Mendelsohn 1999).

Next, *psychometric tests* can be used to assess the suitability of potential franchisees. For instance, aptitude tests and personality profiling questionnaires can be used as an aid to identify possible strengths and weaknesses against the desired competencies and qualities of a potential franchisee (Melamed and Jackson 1995). *Performance-simulation tests* can also be carried out. These tests are based on job analysis and have been proven to be valid predictors of job performance. For instance, franchisors can request potential franchisees to work a full-day at an existing outlet to see how they cope with the duties required. Finally, a *physical examination* may also be carried out to ascertain that the candidate fit for the job if it requires physical effort.

Guidelines for Selection of Franchisor

Compatible partners should be selected for any long-term positive relationship, and this is the responsibility of both partners. As such, franchisees should also do their part in selecting franchise systems and franchisors that are suitable. For instance, franchisees should conduct in-depth research into the franchise prior to investment. Franchisees should also contact existing franchisees within the system to gather information on the work ethic, management style and communication ability of the franchisor. Franchisees should look at other alternatives, for instance, investigate the possibility of independent business ownership, or compare the various franchise systems available in the market. Most importantly, franchisees should note their own personal suitability for their choice of franchise investment (Frazer 2002). For instance, introverts should not consider investing in a retail franchise which requires them to have a cheerful, outgoing personality as interactions with customers and selling skills are usually strong assets.

The first thing potential franchisees can do is to scan through franchising advertisements and sales brochures, seeking ones that appear regularly in the media as opposed to 'fly by nighters' (Major 1984). Next, research the franchise systems that are of interest. There are a few criteria to examine (Zwisler and Carl 2002):

- History of the franchisor – experience in the industry and in franchising, maturity (age, size and distribution) of franchise network.
- The type and level of support and training provided by the franchisor. Apart from what the franchisor claims to do, existing franchisees are able to provide information relating to the actual quality of support provided by franchisors. In addition, a

mandatory Franchising Code of Conduct was introduced in 1998, requiring franchisors to provide a standard disclosure document to prospective franchisees prior to signing a franchise agreement so that the franchisees can clearly understand the franchise system, or ask for advice if they have any doubts or questions (Franchising Code of Conduct 1998).

- Level of franchisee satisfaction with the system. Contact existing and previous franchisees to determine their level of satisfaction or reason for exiting. Examine the franchisor's track record in terms of dispute resolution, termination and renewal of franchise agreements.

In brief, franchisees can assess franchisors via the reputation and history of the franchise system, studying franchise contracts and obtaining advice from experts such as franchise consultants as well as current and past franchisees. As well, franchisees can assess the personality and management style of franchisors through interviews and various forms of interactions with franchisors throughout the interview and selection process. Franchisee-franchisor selection is a two-way process.

Conclusion

In summary, franchising provides many benefits to aspiring business owners, thereby increasing their chances of success in having their own businesses. Essentially, franchisors should be competent in providing the relevant support services, training and advice to their franchisees. They should possess relevant management and business skills, as well as entrepreneurial spirit, interpersonal and communication skills, commitment, honesty, and a participative management style. Franchisees on the other hand, should also share similar goals and visions with their franchisors. They should ideally be financially sound, hardworking, able to commit time and attention to the business, have some management exposure, be ethical and trustworthy as well as being able to work independently although within set guidelines.

For the franchisor-franchisee relationship to be a success, compatible partners should be selected. This paper proposes a model of desired competencies and qualities required of a franchisor. Future research will attempt to confirm these factors as desirable traits and match franchisee and franchisor expectations.

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