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## **THE PSYCHOLOGY OF THE FRANCHISE RELATIONSHIP**

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## **I. INTRODUCTION**

The extent to which a franchisor company operates in harmony or in conflict with its franchisees, will depend on a range of factors outside of legal considerations, including its leadership style, commercial priorities and organizational culture.

Conflict is of course not unique to franchising. Any social system where people are working together – for instance families, associations, businesses, legal firms and communities - will face periods of internal conflict as the needs, expectations, interests or indeed the philosophies of the stakeholders play themselves out.

The paper broadens the stereotypical understanding of franchising as a legal and commercial relationship, to include a psychological dimension. It will be explained that the causes of much of the conflict in franchise systems, and the solutions to this conflict, will often be found by incorporating a psychological perspective. Indeed most human behavior is driven, not just by legal or economic considerations, but also by beliefs, emotions, values, unconscious habits and genetic programming.

In this paper we will explore how these psychological factors impact on the dynamic world of franchising, in particular, the relationship between franchisee and franchisor, and what franchisors in particular can do to reduce conflict and build powerful, constructive relationships with their franchisees.

## **II. BACKGROUND TO THE MATERIAL IN THIS PAPER**

The material for this paper has been drawn from research conducted by the Franchise Relationships Institute. The Institute views franchise networks as social systems with three key stakeholder groups:<sup>1</sup>

1. The shareholders of the franchisor company.
2. The management team of the franchisor company.
3. The franchisees.

Our work examines the relationships between these stakeholder groups, particularly the franchisor management team and its franchisees, and the factors that influence the nature of these relationships. The material for this paper has been drawn from research with over 200 franchise networks, ranging in size from small emerging systems to large established corporations with thousands of franchisees. The franchisees included in this research also range across the full “mad, sad, glad” spectrum. In some companies franchisee satisfaction and performance have been high, whereas in others, there have been vast numbers of franchisees who have been angry, confused or demoralized. We are thus drawing from a balanced and valid cross section of the franchising sector.<sup>2</sup> Our research, conducted by organizational psychologists, uses the following three approaches.

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<sup>1</sup> In some franchise systems with multi-layered franchise arrangements, for instance master franchising or area development rights, the complexity of these stakeholder groups increases. Suppliers and customers are also important stakeholders, but they lie outside scope of this work.

<sup>2</sup> Franchisee satisfaction surveys have recently become a popular franchise marketing tool in the USA, with franchise systems who receive favorable ratings making their results available to potential franchisees. While these surveys do provide interesting data on the state of the franchise relationship, published results need to be interpreted with some caution as they tend to be biased toward franchise systems where satisfaction levels are relatively high. Systems with low levels of satisfaction tend to either not engage in these surveys or do not make the findings available.

### **A. Quantitative Research**

These methods use rating scales to measure the attitudes of franchisees and franchisor executives on a range of issues. These include how they feel about their franchise relationship and the relevance of specific personal attributes or franchise support strategies to their ultimate success.<sup>3</sup> Results are analyzed to identify significant trends and relationships within the data. Quantitative techniques are particularly useful for making comparisons between groups, identifying underlying trends within data sets, and measuring changes in attitudes over time.

### **B. Qualitative Research**

Qualitative approaches use open-ended questions to elicit the opinions of franchisors and franchisees on specific questions.<sup>4</sup> Responses are recorded and analyzed for emerging themes. Where interviews are used additional data can be elicited through probing. Qualitative techniques are useful for identifying more subtle issues which may be overlooked if people are not given the opportunity to express themselves openly.

### **C. Ethnographic Research**

The ethnographic approach, also known as participant observation, requires the researcher to spend time observing and talking with people in their place of work in a seemingly casual manner. Although historically used by anthropologists to study different social cultures, this approach is now popular for studying organizational cultures and is particularly suited to the study of franchise systems. For instance, in a recent study of a dog washing franchise system our research team initially spent time in the field with franchisees and then met together to compare notes, critically reflect on the data collected and discuss alternative explanations for incidents observed.<sup>5</sup>

In addition to this formal ethnographic research our consulting work over a 16 year period has required us to spend significant amounts of time mixing with franchisor executives and franchisees in their work place and in their meetings and conferences. This has enabled us to observe actual behavior, especially how people interact with each other, as opposed to measuring just their claims of what they say they do.

Participant observation is enlightening because much of the available literature on franchise relationship practices comes from franchise industry articles and conference speeches delivered by franchisor representatives who understandably tend to present an overly favorable impression of how their companies operate.

I am not suggesting that such differences between theory and practice are intentionally misleading. As will be explained below, we all tend to rationalize our behavior to conform to a perception of ourselves as well intentioned, moral and competent citizens, a process known in psychology as the “self-serving bias”. This is a form of unconscious mental gymnastics, designed to minimize cognitive dissonance – the uncomfortable feelings we have when the mind has to make sense of potentially conflicting ideas.

One of the most respected figures in ethnographic business research, Chris Argyris, explains this paradox as follows.

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<sup>3</sup> Success in this context relates to their profitability, their ability to build a customer base and their willingness to participate constructively in the franchise program.

<sup>4</sup> People respond to questions on paper or internet based surveys or asked by interviewers - face to face or over the phone.

<sup>5</sup> LORELLE FRAZER, BILL MERRILEES & GREG NATHAN, *THE CHALLENGE OF KEEPING EXPERIENCED FRANCHISEES MOTIVATED* In Ogunmokun, G. (ed), 2006 Academy of World Business Marketing and Management Development Conference, Paris, France.

Each of us has what I call an *espoused theory of action* based on principles and precepts that fit our intellectual backgrounds and commitments. But most of us have quite a different *theory-in-use* to which we resort in moments of stress. And very few of us are aware of the contradiction between the two. In short, most of us are consistently inconsistent in the way we act.<sup>6</sup>

#### **D. Relevance to the USA Market**

Most of this research has been conducted in Australia. Despite there being cultural similarities between Australia and the USA there are obviously differences in the two legal systems, as well as in style and approach to franchising between the continents. This should promote some useful learning for practitioners. These differences will be highlighted from time to time in this paper. However most of the psychological material in this paper is drawn from universal principles of human behavior as applied to franchise networks worldwide. Feedback from franchisors, franchisees and advisers in the USA clearly indicates the relevance of these principles to the USA franchising market.<sup>7</sup>

### **III. DIFFERENT PERSPECTIVES ON THE FRANCHISE RELATIONSHIP**

#### **A. The Franchise Relationship Beyond the Legal Boundaries**

While the global culture of franchising has been largely defined and shaped by legal frameworks, particularly in the USA, the relationship between a franchisor and its franchisees, commonly referred to as the franchise relationship, is influenced by a range of factors.

Human history is filled with conflict resulting from the way in which people interact with and treat each other. Conflict touches almost every aspect of our lives from mild tensions between family members or work colleagues, to emotionally charged commercial battles, to the bloody violence of the war on terror. Franchising is of course not immune from the tendency of people to fight with each other and, no doubt, much of the work of attorneys involved in the franchising sector involves the management of conflict between franchisors and franchisees<sup>8</sup>.

In simplistic terms conflict occurs when people do not get what they want or seek to blame others for their troubles. While the law can be a useful way to help resolve conflicts by clarifying people's rights, it does not explain why the conflict started in the first place. Nor is it always successful in finding a resolution that satisfies all parties because a purely legalistic approach seeks to define who is right and who is wrong, thus producing winners and losers. Of course lawyers do not always take a rigid legalistic approach and most disputes are resolved using more pragmatic approaches such as mediation, which focus on interests, not positions.

While acknowledging the merits of defining and managing aspects of the franchise relationship within a legalistic framework, this paper attempts to explain the franchise relationship in terms that extend beyond legal boundaries. It will be argued that, while the franchise relationship is partly defined by the legal contractual obligations of the franchisee and franchisor, the relationship extends into two other important dimensions – the commercial and the psychological – and that there are significant benefits to be gained in expanding one's view of the franchise relationship to

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<sup>6</sup> Chris Argyris, *Good Communication That Blocks Learning*, HARV. BUS. REV., July-Aug 1994, at 77-85.

<sup>7</sup> Several U.S. franchise attorneys who have reviewed our work, such as Rupert Barkoff and David Holmes, have publicly commented on its relevance to the U.S. franchising sector and over 30% of our publications are purchased by U.S.-based franchising companies.

<sup>8</sup> In an extensive paper by Paul Steinberg & Gerald Lescatre, *Beguiling Heresy: Regulating The Franchise Relationship*, 109 PENN ST. L. REV. 105 (2004), the authors attempt to broaden the debate on the influences impacting the franchise relationship beyond just legal issues.

include a broader perspective. These include greater franchisee commitment to company initiatives, more positive referrals to prospective franchisees, more constructive use of people's energies (franchisor management and franchisees), more effective sharing of resources, greater compliance and support for the brand, and ultimately a happier and more productive franchise system.

As an introduction to this discussion, three broad ways to view decisions impacting on the franchise relationship are briefly described below.

### **1. The Legal Perspective**

The legal perspective of the franchise relationship is concerned with protecting the rights of franchisors or franchisees and ensuring that decisions do not expose the parties to unnecessary risk. As the legal aspects of the franchise relationship will have been competently covered elsewhere, and the author has no formal legal training, this paper will mainly focus on the commercial and psychological perspectives.

### **2. The Commercial Perspective**

The commercial perspective focuses on whether decisions are going to provide a satisfactory return on time and investment. In other words, will the decision leave the parties better or worse off financially. This approach defines the interests of franchisors and franchisees in economic terms.

The attraction of the commercial perspective is that it simplifies decision making to an analytical numbers exercise. There are however several limitations to this approach. The first concerns time frames. For instance decisions made for short-term financial gains, perhaps to meet shareholder expectations, may result in significant damage to the company's relationship with its franchisees and undermine the longer-term viability of the franchise system. This will increasingly become a challenge given the growing trend for franchise systems to bring in external investors<sup>9</sup> and be run by professional managers whose remuneration is largely tied to the achievement of short-term targets.

Another limitation of taking a purely commercial perspective is that it is amoral and, if overemphasized, can lead to decisions that are illegal, socially destructive<sup>10</sup> and which can thus undermine trust between people. A third limitation is that it ignores the influence of emotions on human behavior. This is why the psychological perspective can add significant value to the management of the franchise relationship.

### **3. The Psychological Perspective**

The psychological perspective on the franchise relationship considers how a decision by the franchisor will impact on trust levels and franchisee commitment. Do franchisees trust the decision? Do they feel it is fair? Will they support it?

This approach taps into the world of emotions, perceptions and feelings. While emotions have traditionally been regarded in business circles as "soft" and difficult to quantify, their impact in the world of franchising is hard to ignore. Consider the following:

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<sup>9</sup> See Jerry Wilkerson, *2005 Franchise Business Development and Industry Trends Analysis*, "Equity and investment firms will boost heightened levels of interest in franchising as the perfect model for investors because of solid management, high positive cash flows for franchisors, and clean, straightforward balance sheets. Private equity firms have found franchising to be their new golden goose, a discovery that has fostered more interest than available deals." at [www.franchise-chat.com/resources/2005\\_survey\\_wilkerson.htm](http://www.franchise-chat.com/resources/2005_survey_wilkerson.htm) for full article.

<sup>10</sup> This concern has led to schools of thought that promote socially responsible management practices such as "The Triple Bottom Line". See, e.g., ANDREW SAVITZ & KARL WEBER. *THE TRIPLE BOTTOM LINE: HOW TODAY'S BEST-RUN COMPANIES ARE ACHIEVING ECONOMIC, SOCIAL AND ENVIRONMENTAL SUCCESS*. (Wiley Publishers, 2006).

- Psychological factors, such as emotions and values play a significant role in the creation and resolution of most legal disputes. The increased use of alternative approaches to dispute resolution, such as mediation, indicates a growing appreciation that incorporating psychological approaches is not only cost effective, but also has other intrinsic emotional benefits such as the preservation of the long-term relationships and the self respect of participants.
- The discipline of marketing, one of the cornerstones of business and central to most franchise systems, is based on understanding the psychology of consumers. Building brand loyalty, creating advertisements that sell products or services, spreading messages that create a positive impression of a company's activities – these are all about the psychology of influence and understanding the social changes that impact on customer values and expectations.
- Concepts such as culture management, people skills development and team building have recently become a core part of management strategy in most organizations. This is because a significant amount of research conducted in the 1990s, one of the most dynamic periods of change in recent corporate history, found that 70% of new management initiatives failed to achieve their goals. This was not because the strategies were at fault but because of psychological factors such as a lack of commitment by the employees, exacerbated by poor interpersonal and communication skills by top leadership.<sup>11</sup> Each new generation that has joined the workforce over the past 30 years has also brought new attitudes and expectations in how they will be managed.<sup>12</sup> Organizations wanting to attract and retain a motivated workforce have had to respond to the changing needs of their managers, employees and indeed franchisees, by introducing greater informality, autonomy, flexibility and empowerment into their work practices.
- Franchise systems are complex social networks that today operate as much through influence as through formal power. This has partly been a response to the social changes mentioned above and partly as a reaction to poorly managed market expansion and change programs that impacted on the profitability of franchisees. Franchisors today that try to manage their franchisees using an autocratic, power based approach will eventually face stiff resistance by franchisee associations established to protect the interests of franchisees. At the 2006 IFA convention in Palm Springs, Ralph Alvarez, President of McDonald's North America, publicly spoke of his company's commitment to do business "in partnership" with its franchisees, and the importance of setting rules of collaboration. On the same platform, the President of McDonald's franchisee association (now called the Operator Leadership Council) said, "I have one message for franchisors – command and control does not work anywhere near as well as collaboration and assignment."<sup>13</sup> Other large franchisors such as Subway and Allied Domecq appear to have also seen the commercial benefits of developing more transparent and conciliatory relationships with their franchisees.<sup>14</sup>
- Our own research has shown that franchisee satisfaction is influenced just as much by psychological factors such as trust in the franchisor, as commercial factors such as sales or return on investment figures. These psychological factors include the perceived concern of the franchisor for the franchisee's success and the franchisee's confidence in franchisor leadership. The importance of these psychological factors seem to mainly "kick in" once the franchisee's

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<sup>11</sup> See, e.g., Michael Beer and Nitin Nohria, *Cracking The Code Of Change*, HARV. BUS. REV., June-July 2000, at 133-141.

<sup>12</sup> Commonly referred to as Baby Boomers (born 1946 to 1965), Generation X (born 1965 to 1977) and Generation Y (born 1977 to 1994).

<sup>13</sup> Stephen Giles, quoted in *Franchising Focus Newsletter*. Deacons. March 2006. (Available at <http://www.deacons.com.au/NewsUpdates/Newsroom/Newsletters.cfm?objid=5506>).

<sup>14</sup> Steinberg, *supra*, note 8, at 136.

business moves into profitability. Not surprisingly, our research also indicates that where a franchisee is losing money, his or her financial anxieties will have a negative impact on their overall satisfaction. These findings are consistent with a considerable body of research showing that, once a certain level of financial security is achieved, happiness levels are influenced far more by psychological factors than by economic factors. In order of importance these are family relationships, meaningful work, community and friends, health, personal freedom and one's philosophy of life.<sup>15</sup>

The above factors and trends suggest that franchisors and their advisers would be wise to include a psychological perspective in their approach to managing the franchise relationship.

### **B. A Note on the Psychology of Perception**

Before further exploring the impact of psychological factors on the franchise relationship, a brief discussion on the nature of reality will be useful. While this may seem out of place in a legal forum, the implications of this to the topic of understanding and managing the franchise relationship will become apparent.

While men and women have for thousands of years sought to understand and explain the nature of reality there are many eminent thinkers today who believe that we are no nearer to this goal than we were two thousand years ago. Perhaps this is easy to accept in the so called "soft" sciences such as philosophy and sociology, however there are many scientists working in the fields of physics and chemistry who argue that the more we know, the more we realize we do not know.

The reason for this paradox stems from the limitations of the human brain in how it gathers, analyzes and interprets information. Nobel laureate in chemistry, Ilya Prigogine, expressed the difficulty in gaining an accurate picture of reality by saying "Whatever we call reality, it is revealed to us only through an active construction in which we participate."<sup>16</sup> What he is suggesting is that reality is a construct that we formulate based on the information available to us at the time. Also that this construction will always be influenced by the position in which we sit at the time of gathering and collating this information. In other words, what we regard as reality is really just our brain processing information in a particular way. This occurs at all levels of human existence - spiritual, intellectual, emotional and even the physical.

Consider that more wars have been fought over differing beliefs of God than any other cause, scientific journals are filled with articles arguing over different interpretations of so-called objective data, and at the emotional level the counseling industry is booming with couples who say their partner doesn't understand them.

What people notice is always a filtered approximation of reality. The reason for this is that the human brain has evolved over thousands of years to give us the best chance of survival. One of its strategies is to subconsciously filter and organize information in what it thinks is the most efficient manner. If our brains did not do this we would become overwhelmed with input and thus be unable to make quick decisions, probably resulting in our death.

This is in many ways just as relevant today as it was 10,000 years ago. Imagine crossing a busy road if the taste and smell of the donut in your hand and the hat worn by a bus driver held just as much interest and importance as the bus bearing down on you.

This filtering and organizing process enables us to quickly make sense of information and

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<sup>15</sup> For a summary of this happiness research, RICHARD LAYARD, *HAPPINESS – LESSONS FROM A NEW SCIENCE* (Allen & Lane 2005); MARTIN SELIGMAN, *AUTHENTIC HAPPINESS* (Random House 2002). Layard is an economist and Seligman's book has a chapter especially written for lawyers.

<sup>16</sup> Mihaly Csikszentmihalya. *The Evolving Self – A Psychology For The Third Millennium*. 61 (HarperCollins 1993).

form a view of what is going on at any point in time. While it is a useful survival mechanism it also comes at a price because it forces us to make assumptions and take a lot of things for granted. For instance, providing we notice the bus and do not stand directly in its path; we can probably continue to enjoy our donut. But what if the bus driver was the ex-franchisee you successfully sued and sent into bankruptcy and who on the courtroom steps vowed to get even with you. You then may want to review your priorities and start running! Slightly ridiculous perhaps, but assumptions can get us into trouble.

#### **IV. PROFESSIONAL PARADIGMS**

The psychologist, Abraham Maslow said, “He that is good with a hammer tends to think everything is a nail.”

In other words we all operate from assumptions or prevailing views - what may be called “paradigms”. The concept of paradigms suggests that when professionals are confronted with complex or unfamiliar information they tend to respond to the situation through the prism of their own expertise.

While paradigms are useful in that they save us from having to second-guess every piece of information that crosses our path, they can also create blind spots and blocks to progress and innovation. Indeed the business community has in recent years integrated a number of mental techniques such as brain storming and the six thinking hats<sup>17</sup> into its planning processes to prevent managers from making poor decisions based on “paradigm blindness”.<sup>18</sup>

The concept of paradigms has direct relevance to the stakeholders in the franchising sector and is a major cause in creating or exacerbating franchise disputes. There are a number of paradigms that people who work in the franchising sector tend to adopt and which color their approach to the franchise relationship. Before examining these, the following case of a professional paradigm might be instructive.

##### **A. The Case of Ignaz Semmelweis<sup>19</sup>**

Ignaz Semmelweis was a physician in charge of the Vienna General Hospital in the mid-1840s. In the hospital there were two maternity clinics. The mortality rate of women giving birth at the clinic that Semmelweis operated with his medical team was more than six times that of the other clinic in the same hospital, operated by midwives. This was despite the same techniques being used in both clinics.

In his clinic, Semmelweis experimented with the physical environment seeking an explanation as to why more women were dying compared with the midwife clinic, but to no avail. Semmelweis was limited by the paradigm that the problem was something to do with the physical environment.

When he temporarily left his clinic to attend a conference the mortality rates decreased significantly. Then a doctor colleague died from an infection contracted after his finger was

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<sup>17</sup> In his book, *The Six Thinking Hats*, Edward DeBono (MICA 1999, Management Resources) encourages managers to look at problems from different perspectives by wearing the following imaginary hats. The white hat is for gathering all the facts, the red hat is for drawing out how people feel, the yellow hat is for examining the upsides, the black hat is for examining the downsides, the green hat is for exploring creative options, and the blue hat is for managing the discussion.

<sup>18</sup> See Barker, J. *Paradigms: Business Of Discovering The Future* (1999 HarperBusiness), for some informative illustrations of how paradigms can be used in business to Enhance innovation.

<sup>19</sup> The story of Semmelweis can be found in most medical history books. I first came across it in *Leadership and Self-Deception: Getting Out Of The Box* by The Arbinger Institute, (Arbinger Institute 2004) a fascinating book I regularly recommend to franchisor leaders.

accidentally punctured with a knife while performing an examination on a cadaver in the mortuary. The doctor's symptoms were similar to that of the women who were dying.

Semmelweis stopped looking at the physical environment of the clinic and start looking for a connection between the teaching work he and his students were doing on cadavers and the deaths of the women. When he reexamined his daily work routines he realized that the women were being examined after he and his students had completed their teaching sessions in the mortuary.

He immediately instituted a policy of rigorous hand washing and scrubbing in disinfectant between autopsy work and the examination of the pregnant women. The mortality rate dropped to that below the midwife's clinic. Semmelweis realized that it was he and his students who were causing the deaths of the women by carrying infecting particles on their hands foreshadowing the germ theory of disease.

There is another twist to this story that is relevant to our discussion on perceptions and paradigms. Semmelweis's observations went against the scientific paradigms of the time, which blamed diseases on an imbalance of the four humors in the body. It was also argued that scrubbing one's hands each time before treating a pregnant woman would be too much work. Nor were doctors eager to admit that they had caused so many deaths, which would run counter to the first precept of medicine, "First do no harm."

It was not until some decades later when Pasteur and Lister developed their germ theory of disease that the concept became accepted. Meanwhile Semmelweis, racked with guilt and frustration, went insane and committed suicide.

The lesson here for all professionals is that we must be careful not to let our conditioned assumptions blind us to better ways of assisting our clients. We also must be careful that we are not inadvertently creating more problems than we are resolving by only looking for nails that we can bang with our hammers!

## **B. Seven Paradigms of the Franchise Relationship**

The following seven paradigms are introduced here as a way of explaining how the franchise relationship can be viewed in different ways and how the unique contributions of different professions and advisers will impact on the culture of franchising, depending on their relative number and influence. This section has been included to encourage the reader to think as broadly as possible about why franchise disputes arise and how they might be resolved.

Each paradigm is not totally exclusive and people may, and indeed should, be encouraged to adopt an eclectic approach. As will be see, each paradigm has a "dark side" which can exacerbate existing difficulties in a franchise relationship, as well as having a useful contribution to make by highlighting an aspect of the relationship that might otherwise be ignored.

### **1. The Legal Paradigm – It's About the Contract**

The legal paradigm views the franchise relationship primarily in terms of the contractual obligations of the franchisor and franchisee as defined in the franchise agreement, as well as the relevant common and statutory law.

When a franchise relationship comes under strain attorneys are usually engaged to protect the rights of their clients using the franchise agreement and relevant law as their main point of reference. As franchise agreements are developed by franchisor attorneys and thus worded in favor the franchisor, every possible problem and contingency will typically be referred to in the agreement.

Using a legal paradigm, problems in the franchise relationship are best resolved by either going back to the franchise agreement or referring to the franchisee's rights under the relevant law. The problem with the legal paradigm is that it encourages the parties to take a defensive stance and to prove their position is right, which of course makes the other party wrong.

## **2. The Financial Paradigm – It's About Risk and Return on Investment**

Accountants and financial advisers are engaged to protect the financial interests of their clients and naturally tend to view the franchise relationship in terms of minimizing commercial risks while maximizing expected returns. Franchisors and franchisees enter into a franchise relationship with the hope of making money, and if this does not eventuate the relationship is likely to break down.

Using a financial paradigm, problems in the franchise relationship are best resolved by focusing on the figures and negotiating a decision that protects people's financial interests. The problem with the financial paradigm is that it assumes that problems in the franchise relationship will always be resolved if the parties are making money. This is not necessarily true and there are many cases where though financially successful, franchisees or franchisors will become dissatisfied and take legal action against each other.

## **3. The Broker Paradigm – It's About the Commission**

Franchisors often use the services of professional franchise sales brokers, usually paid on a commission basis. To the franchise sales broker the franchise relationship is primarily a sales transaction.

Because franchise brokers are often the first point of contact for prospective franchisees they can have considerable influence over the franchisee's perceptions of the franchise relationship. A shrewd broker will be tuned into the hopes and dreams of a prospective franchisee and, as the broker's livelihood is contingent on the franchisee signing a franchise agreement, they will focus on creating as favorable an impression of a franchise opportunity as possible.

The broker's paradigm is often based on creating an emotional environment conducive to the potential franchisee signing up. Once this has occurred the broker moves on to the next prospect.

Not surprisingly, strains in the franchise relationship can later occur if there is a significant mismatch between the dream that the broker and the prospective franchisee conjured up together and the reality that the franchisee faces in later running the business.

From this point of view, problems in the franchise relationship may only be resolved using a preventative approach. Brokers must be trained and briefed not to over sell the franchise opportunity. There should be checks and balances, perhaps even linked to their compensation, to ensure this does not happen. While a franchisee's longer-term success may be out of a broker's control, their expectations and readiness to proceed with the franchise are not.

We will return to the contribution that poor selection practices make to franchisee failure and disputation later in this paper.

## **4. The Marketing Paradigm – It's About Building the Brand**

It could be argued that the brand is the most powerful unifying factor in a franchise relationship as it is clearly in both the franchisor and franchisees' interests to protect and enhance positive customer perceptions of the brand. Strong brands protect profit margins by enabling higher prices to be charged, promote customer retention and boost the effectiveness of marketing programs.<sup>20</sup>

I have also argued elsewhere that the value of franchising for all parties largely comes from the competitive edge gained through the sharing of knowledge and resources, and that the brand is often the most valuable of the resources being shared, particularly in more mature franchise

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<sup>20</sup> See Connie Mason, *A Fresh Approach To Compliance*, AUSTL.FRANCHISE REV., 2005.

systems.<sup>21</sup>

From a marketing or brand perspective then, a healthy franchise relationship is one in which all parties respect the values of the brand and support these through their attitudes and behavior. It also follows that if one party behaves in a way that undermines the values of the brand or brings the brand into disrepute this will fundamentally damage the relationship and result in conflict.

Using a marketing paradigm, problems in the franchise relationship are best resolved by referring to issues of brand protection, reputation and customer satisfaction. The problem with the marketing paradigm is that marketing professionals can become so obsessed with brand building they fail to provide adequate sales building activities. Our research clearly shows that marketing that does not drive sales is one of the most common causes of franchisee dissatisfaction.

#### **5. The Franchisor Paradigm – It’s About Maximizing Market Share**

In addition to creating and maintaining strong, healthy brands, franchisors are primarily driven to expand and maximize their market share. They want their franchisees to work hard at building market share either through opening an agreed number of units, or building local sales in their territories. From this perspective, strains in the relationship will occur if franchisees are seen as hampering the franchisor’s growth of market share. In such cases the franchisor will either seek to put more units into a territory or to remove the territory rights from what it perceives as an under-performing franchisee.

Using a franchisor paradigm, problems in the franchise relationship are best resolved by convincing franchisees to accept that maximizing market share in a territory is in everyone’s interests. The problem with this paradigm is that it assumes overall market dominance is in everyone’s interests. While extra units in a territory may result in overall increases in market share, the sales figures of individual franchised units in the same territory can drop causing these units to become unprofitable. Claims of encroachment may follow.

#### **6. The Franchisee Paradigm – It’s About Support and Success**

Franchisees usually join a franchise system because they believe it will help them to achieve their goals with less risk than running an independent business. They are looking to the franchisor to deliver on the promise of being in business for themselves but not by themselves.

A franchisee may be motivated to buy a franchise for highly personal or emotional reasons; for instance to prove to themselves or others that they can be successful; to provide security for their family; to be free of office politics; to have more flexibility in their weekly schedule; and so on.

From a franchisee’s perspective, strains in the relationship will occur if the franchisor is not seen to deliver on its promises of relevant support or if the benefits of being in the system do not enable them to achieve the success they had envisaged.

From this perspective, problems in the franchise relationship are best resolved if the franchisor can meet the franchisee’s expectations for success, either by improving support or counseling the franchisee to lower their expectations. The problem is that success means different things to different people so unless the franchisee and franchisor have initially agreed on specific financial goals (which is unlikely given the legal risks involved for the franchisor) feelings of failure, disappointment and even betrayal can cause strains in the relationship. The Franchise E-Factor model,<sup>22</sup> explained below, also predicts that as a franchisee’s confidence and competence grows, their needs become increasingly more difficult to satisfy.

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<sup>21</sup> See GREG NATHAN. PROFITABLE PARTNERSHIPS: IMPROVE YOUR FRANCHISE RELATIONSHIPS AND CHANGE YOUR LIFE. (5th ed. 2002, Franchise Relationships Institute).

<sup>22</sup> See *supra*, note 21.

## **7. The Psychologist Paradigm – It’s About People Working Together**

People’s thoughts, attitudes and feelings about each other and about their work will always have a direct impact on their behavior and thus their performance. With this in mind psychologists are engaged to improve business performance by facilitating better working relationships and raising people’s commitment to their work and to goals that are consistent with the organization’s success.

Franchise systems provide psychologists with a rich source of material to work with because of the interdependence of the key stakeholders - franchisees and franchisor executives – for each other’s success. Some writers and commentators, including myself, have likened the franchise relationship to a marriage because of the interdependence of the parties.<sup>23</sup>

Take these examples of interdependence in the franchise relationship.

- In most franchise systems, the franchisor’s revenues are largely contingent on the revenues of its franchisees.
- The support franchisees believe they are receiving is contingent on franchisor management understanding these needs from the franchisee’s perspective.
- A franchisee or a franchisor executive, who is happy and performing at his or her peak, will have a positive impact on the others in the franchise system with whom they interact.
- The protection and reputation of the brand is contingent on all franchisees and franchisor executives sharing the same attitudes and commitment to the brand’s values. Every time a customer has a good or bad experience of a brand, all stakeholders win or lose by association.

Using a psychology paradigm, the franchise relationship functions most effectively when all parties are reminded of these inter-dependencies. Similarly strains in the relationship are addressed by understanding, and where necessary, realigning the needs and interests of the stakeholders.

However this approach in isolation can also create difficulties as it can lead to too great an emphasis on emotions and process at the expense of logic and results. Also terms such as “partnership” and “equality,” commonly used in the psychological paradigm, can create confusion if they are not clearly explained or if they are used out of context. For instance the use of the word partnership in franchising has been raised as a concern by some consultants who believe it raises unrealistic expectations from franchisees in the amount of power they have.<sup>24</sup> Similarly while in our work we encourage franchisors to communicate with franchisees in a spirit of respect and equal status, most franchise agreements clearly give the franchisor more power, so in the legal sense it is not an equal relationship.

The psychological approach must be used in a balanced way to complement rather than replace the legal and commercial realities of the franchise relationship.

## **V. COMMERCIAL IMPLICATIONS OF THE FRANCHISE RELATIONSHIP**

### **A. What is a Relationship?**

In the psychological sense a relationship could be defined as a feeling of connectedness that influences people’s behavior. This does not have to be positive and it does not have to be two-way. If a person believes they have a relationship with someone, then this belief is going to influence their

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<sup>23</sup> See, e.g., Stewart Germann. *A Special Relationship*, 35 FRANCHISING WORLD (2003).

<sup>24</sup> We use the term “profitable partnerships” to describe the ideal franchise relationship.. See *supra*, note 21. Other writers such as Paul Steinberg are more skeptical of the motives and behavior of franchisors and see this terminology as legally incorrect and psychologically inaccurate when applied to the franchise relationship. See *supra*, note 8 at 133.

behavior. In fact businesses actively encourage people to have such feelings of connectedness with their brands, their products or the actors and celebrities that appear in their advertisements as this impacts on their buying behavior.

## **B. How Important Are Constructive Relationships?**

We sometimes ask franchisors to rate on a five-point scale, how important they believe constructive relationships with their franchisees are to the success of their franchise systems.

While around 90% of franchisors typically rate constructive franchise relationships as very important or essential, when asked why they responded as they did, most people have difficulty articulating their reasons except to say that it is more satisfying and enjoyable to work cooperatively with other people. This is of course true, however there are a number of significant commercial reasons why franchisors, franchisees and their advisers need to take seriously the creation of constructive franchise relationships. Some of these are outlined below.

### **1. Communication**

The commercial power of franchising lies in the effective sharing of knowledge and resources, not only between franchisor and franchisee, but also the sharing between franchisees. In our surveys franchisees frequently rate the communication that occurs between them as equally important and useful to their business success as the communication that occurs with their franchisor. This is an important finding as it suggests that part of a franchisor's role should be to facilitate good communication as well as to be a participant in the communication. This distinction is subtle but significant and the best franchise companies build facilitative processes into their franchisee support services. These processes include:

- Intranet discussion forums. It is better to have the franchisees discussing issues, even contentious issues, within a transparent framework with agreed boundaries, than have them setting up secret chat rooms and anonymous "ourbrandsucks.com" web sites.<sup>25</sup>
- Open forums at meetings. Again it is better to have franchisees asking questions and discussing issues together with their franchisor, than have them meeting secretly in a hotel room with an attorney. These forums however must be competently facilitated using robust processes. This issue is covered in a later section.
- Best practice workshops where franchisees share not only the financial and marketing results, but the methods by which they have been attaining these results.
- Consultative committees to discuss a full range of issues impacting on the performance of the franchise system.

It is through such open sharing of information that franchise systems gain and maintain their competitive advantage.

On the other hand when relationships become strained people often withdraw their energy as a form of defense. Communication subsequently closes down. The most common symptoms of communication withdrawal are people not returning phone calls or emails, or a lack of physical or emotional participation in meetings. Someone may physically attend a meeting but be emotionally disengaged. People may also deliberately withhold information in the hope that this will make life difficult for the other party! Inevitably business performance will be affected.

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<sup>25</sup> The Internet has unleashed a whole new world of forums for franchisees to vent their frustrations. Because these forums are outside a franchisor's control and can fuel unsubstantiated rumors, they are becoming an increasingly powerful public relations threat to franchise systems that have a substantial number of disgruntled franchisees.

## **2. Commitment**

When people stop communicating a drop in commitment is likely to follow. This may show up as suspicion over new initiatives and a tendency to focus on the negative in discussions or meetings. We have found that if meetings become dominated by a few disenfranchised franchisees, franchisor executives will become defensive and authoritarian, and other franchisees will stop attending the meetings. This is a vicious cycle that further erodes commitment and morale.

Because franchisees are to a large extent operating their businesses autonomously, engaging commitment to new initiatives is essential. While staff and managers of corporate units can be instructed to implement changes, and will do so even if they secretly disagree with them, franchisees are likely to resist openly initiatives they do not believe in.

To build commitment to innovation or change franchisors need to create forums for openly sharing of information. Franchisees must be able to ask questions and express concerns without fear of retribution. Clearly this can only take place where there is a robust relationship of trust and good communication.

When people have the opportunity to participate in well run discussions, they will identify more strongly with the group and its goals. In most cases their commitment to the group and its goals will increase significantly.

The speed of social and commercial change today means that franchise systems must continuously evolve and innovate if they are to succeed. In such an environment the value of high levels of commitment created through interactive forums should not be underrated and can provide a franchise system with its competitive edge.

## **3. Group Psychology**

Misery loves company and unhappy franchisees who are unable to resolve significant differences with their franchisor will tend to seek out other franchisees to talk with, either over the phone, over the internet or in face to face meetings. If franchisees vent their frustrations in a sympathetic group they will tend to inflate their problems and an "us versus them" mindset will quickly develop. The tendency of likeminded people, who feel under threat, to close ranks against outsiders is the root cause of most feuds.

Group psychology is a two edged sword. People in a constructive mindset with a goal to achieve something meaningful will tend to motivate each other to greater commitment and performance, as in sports teams. Such groups are characterized by enhanced levels of creativity, concentration, energy and positive emotions.

On the other hand if people who feel like victims come together, they can develop a mindset and commitment to a destructive agenda. This is common in situations where a franchisor refuses to talk with franchisees on issues they are unhappy about. Franchisees may then develop a mob mentality and shut down their ability to think creatively and independently. Often the group ends up adopting a position in line with the thinking of its most frustrated member or members who take on the role of spokesperson for the group. A power struggle inevitably ensues with the franchisor where the focus shifts from running a successful business to issues of how to control and win the fight.

As the fight escalates, a team of attorneys are appointed and, with their paradigm of protecting their client's rights, everyone's energies are diverted into a battle of wits and resources.

## **4. Brand Damage**

While such confrontations are stressful for all parties, they also carry serious commercial implications and risks. For instance, a drop in customer satisfaction in the business of disaffected franchisees is common because stress and frustrations of franchisees tend to extend into their

relationships with their staff and customers.

Furthermore, groups of unhappy franchisees can develop an uneasy alliance with the media, who know that such stories attract the attention of their readers and viewers. This can quickly result in damage not only to their businesses, but the brand and the businesses of other franchisees not involved with the disaffected group.

## **5. Management Distraction and Stress**

When a franchise relationship breaks down and attorneys become involved the associated costs can, of course, be significant. However, the indirect costs in terms of management distraction and lowered morale can be even more commercially damaging. For instance, in cases where senior management have been embroiled in long standing disputes with franchisees there is likely to be a significant drop in productivity and innovation and an increase in sick leave and management turnover.<sup>26</sup>

When the morale of the franchisor leadership group drops, there will also follow a drop in the morale of franchisees. In one case the franchisor team had been fighting two significant legal actions by a relatively small number of franchisees for several years. The lack of energy in the head office management team was palpable. The CEO privately commented, "We all feel so jaded it's hard to get enthusiastic about anything."

When the people at the top of an organization feel like this, their feelings of stress and despondency cannot fail to be transmitted down the line. Not surprisingly, a subsequent franchisee satisfaction survey of this system showed some of the lowest results we have seen, particularly in the area of franchisee confidence in leadership and optimism about the future.

## **6. Franchisee Validation and Referrals**

Our research across a range of franchise groups in both Australia and the USA indicates that around 70% of franchisees will feel comfortable recommending their franchise system to prospective franchisees.<sup>27</sup> However these figures differ significantly from one franchise system to another, some averaging as low as 30% and others as high as 95%.

Franchisee advocates are of course an invaluable source of growth for a franchise system so we have examined the factors that are likely to turn franchisees into advocates for their franchise system.

To do this we took the statement, "I could honestly recommend this franchise to a prospective franchisee," from one of our questionnaires and ran a multiple regression analysis<sup>28</sup> on the data using over 5,000 franchisee responses. The best predictor of a franchisee's tendency to advocate for their franchise system turned out to be whether or not the franchisees felt their franchisor was genuinely concerned about their success.

Three other factors that emerged from this study as predictors of franchisee validation were:

1. How optimistic the franchisee feels about their future in the franchise.
2. How satisfied they are with the return on their investment.
3. The extent to which the franchisee has confidence in the top leadership of the franchise system.

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<sup>26</sup> Franchisor stress is common because franchisor managers are often under ongoing performance pressure in relation to their decisions from both their shareholders and their franchisees.

<sup>27</sup> We are grateful to Jeff Johnson from the Franchise Research Institute for sharing 2006 compiled USA franchisee satisfaction data from the FranSurvey.

<sup>28</sup> This is a statistical technique used to identify cause and effect relationships.

These findings indicate that, contrary to the common wisdom that franchisees who are making money will be happy, perceptions of the motives and competence of franchisor leadership can be more important. Interestingly, a recently released IFA publication on franchise relations also makes the observation that “there have been instances in which the franchisor and the franchisee were operating profitably and significant disputes still existed. Therefore the idea that lack of profitability is at the heart of all franchising disputes isn’t correct.”<sup>29</sup>

Indeed, we find in most of our studies that overall franchisee satisfaction is significantly correlated to the perceived motives of top leadership, especially whether or not they believe the franchisor can be trusted to look after their interests.

## **VI. THE CHALLENGE OF EFFECTIVE COMMUNICATION**

There is a substantial body of evidence showing that effective communication, one of the fundamental building blocks of good relationships, is easier to talk about than to put into practice. One reason for this is the problem of paradigms discussed earlier. Another is that we have difficulty in viewing our own behavior (because our eyes are pointing outwards). If you have ever seen yourself on a video replay you were probably surprised, even shocked, to see how you look from the point of view of other people.

An interesting feature of the human body is that our brains are located safely inside our heads, wired internally to glands that secrete thousands of chemicals that constantly influence our moods and feelings. Given the incessant barrage of thoughts, feelings and dreams each of us experiences day and night consider how frightening it would be if we could also hear, feel and see the thoughts, feelings and dreams of other people! While nature has spared us from this, it means that we each have to make an effort to accurately communicate to others what we are thinking and feeling.

Most of us will have had the experience of assuming that because we have had an insight, seen or read something, or feel strongly about an issue, that others somehow automatically have shared our insight (and obviously agree with us). We become surprised, irritated and even hostile when they look at us blankly and say something like “What are you talking about?” While some people are more perceptive at reading body language than others, no one is a mind reader.

The point is that what we think we have communicated is often different from what other people have seen, heard or experienced. As social psychologist, Hugh Mackay, points out, “It’s not what our message does to the listener but what the listener does with our message that determines our success as communicators.”<sup>30</sup>

### **A. Lessons From Marriage Research**

Many writers have drawn a similarity between franchising and other interdependent relationships such as marriage, where two parties depend on each other for mutual satisfaction and support. Indeed the feelings of excitement and hope in the early stages of the franchise relationship are not dissimilar to those experienced by people embarking on a partnership at the personal level.

A review of the research literature on interdependent relationships, such as marriage, reveals some potentially useful lessons for the franchising sector. Professor Kim Halford,<sup>31</sup> analyzed hundreds of studies on marriage and partnership breakdowns to identify consistent principles or

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<sup>29</sup> Bruce V. Bloom and David E. Holmes, *Resolving Disagreements By Working Together: A Dispute Resolution Handbook For Franchisors And Franchisees* (International Franchise Association 2004) (available at: <http://www.franchise.org/files/FRC%20Dispute%20HandbookX1.pdf>).

<sup>30</sup> HUGH MACKAY. *THE GOOD LISTENER* (Pan MacMillan 1997).

<sup>31</sup> W. KIM HALFORD. DEPARTMENT OF FAMILY AND COMMUNITY SERVICES *AUSTRALIAN COUPLES IN MILLENNIUM THREE: A RESEARCH AND DEVELOPMENT AGENDA FOR MARRIAGE AND RELATIONSHIPS EDUCATION*. (Canberra 2000).

trends. He found that during the first year, half of all married people have some doubts about their decision and wonder whether the relationship is going to work. Of this half, 20% experience relationship problems. In other words, 10% of legally committed relationships develop problems reasonably quickly.

The most fascinating aspect of the marriage research is that the couples that went on to experience serious problems could be predicted in advance with 91% accuracy, using the following four predictive indicators:

- An inability to deal with conflict
- Poor communication skills
- Unrealistic expectations
- A lack of supportive networks

These have great relevance to franchising.

### **1. An Inability to Deal With Conflict**

The single best predictor of partnership breakdowns is the poor management of conflict. The most important skill in managing conflict is the ability of each party to listen and show interest and respect for the other's point of view. Another important skill is simply talking about the problem. Numerous studies show that partners who avoid talking about topics that they are in conflict over inevitably suffer from relationship problems. At the other extreme, attacking the other party is just as bad. This actually leads to an escalation of hostility. In franchising we frequently see this escalation of hostility played out through litigation battles.

### **2. Poor Communication Skills**

A recent survey by the IFA Franchise Relations Committee asked franchisees and franchisors to rate the importance and effectiveness of different types of communication.<sup>32</sup> In this survey franchisors rated their communication as twice as effective as did franchisees. The reasons why communication is an ongoing challenge have been discussed earlier. What we say is not as important as what other people hear.

Emotions also tend to interfere with good communication. Franchisees will frequently become emotional as they have a lot personally at stake in their businesses. This will be discussed in the next section.

### **3. Unrealistic Expectations**

Unrealistic expectations at the start of a relationship are highly correlated with feelings of subsequent disappointment and betrayal. The franchise sales and qualification period is absolutely the best time for clarifying the expectations of both parties.

### **4. A Lack of Supportive Networks**

The fourth predictor of partnership breakdowns is concerned with the level of outside support the parties receive. This means that when problems occur, it helps to have someone constructive to talk to who can break the vicious cycle.

This principle is very appropriate to franchising and can be creatively applied to both franchisors and franchisees. Many franchisors report that they gain great support and

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<sup>32</sup> Bruce V. Bloom and Steve Nelson, *Improved Communication Means Improved Franchise Relations*. (International Franchise Association Franchise Relations Committee) available at <http://www.franchise.org/files/FRC%20HandbookX.pdf>.

encouragement from networking with their peers over problems that arise in their networks.

Franchisees may also find it useful to provide mutual support for each other when facing conflict with their franchisor. However, we strongly recommend that these groups engage an objective but supportive facilitator so their meetings do not deteriorate into the mob mentality referred to earlier.

The most important principle here is that an outside support person should have honorable intentions, be seen as a neutral with respect to any substantive issues between the franchisor and its franchisees, have an emotional investment only in a good relationship between the parties, rather than any particular outcome on an issue, and be favorably disposed to franchising and the existing relationship. Franchisees and franchisors must be wary of seeking advice from attorneys or consultants with a vested interest in intensifying the conflict or undermining the relationship. We have seen the promoters of some independent franchisee associations take such an inappropriate approach.

## **B. Lessons From These Four Factors**

Franchisees and franchisors need to have sound conflict resolution skills, or to engage people who have such skills to assist them. We recommend some sort of assessment of a person's ability to resolve conflict be part of selecting both franchisor staff and franchisees.

Franchisees and franchisors must be taught the value of listening. Action oriented and task focused people, as many franchisors and franchisees are, may believe that taking the time to understand another person's thoughts and feelings is a distraction from 'getting on with things'. This attitude can be an excuse for avoiding issues, or a way of protecting one's own pet ideas. After all, not listening to others means we don't have to accommodate their thoughts into our plans, they can't criticize us and we can continue to work in the way that gives *us* the most satisfaction.

Franchisees and franchisors should systematically verify each other's expectations through the use of checklists and discussions. Both parties need to spell out their understanding of what the other has previously communicated in key areas.

Franchisees and franchisors should seek out peers, mentors and advisers who are supportive of the franchise relationship and who can act as an objective sounding board on issues that the parties may not yet be ready to discuss with each other. They should be wary of people who make money from the creation of conflict.

## **VII. THE IMPACT OF A FRANCHISE LEADER'S INTERPERSONAL SKILLS**

### **A. The Three Basic Emotional Needs**

All human behavior has a purpose. Assuming that people's basic physical needs for food and shelter are met, emotional needs become the fundamental drivers of people's behavior. These emotional needs are threefold:

**Respect** - to be treated with respect and to be taken seriously. This is a particularly powerful need that can be undermined by a careless word or an angry outburst.

**Belonging** - to feel connected to and accepted by others. This drive to belong is behind the creation of tribes, villages, clubs, communities, societies and entire civilizations. And it is why many people join a franchise network.

**Purpose** - to have a sense of purpose with meaningful goals to work toward. Again many franchisees buy their franchise to engage in something challenging and meaningful that they can succeed in.

These needs are fundamental to human well-being and when they are met people are most

likely to work at their creative best. However if they are undermined, people are likely to feel hurt or to behave at their worst. Attention seeking, withdrawing communication, power plays, cynicism and seeking revenge are just some of the ways people respond if they feel these basic emotional needs have been thwarted.

## **B. Why Patients Sue Their Doctors**

The emotional vulnerability that many franchisees feel, especially if they believe their business is at risk, can make them particularly volatile. Indeed our interviews with many franchisees who have been in dispute with their franchisors show that their threats are often driven by emotional factors.

There are some pertinent lessons for franchisor leaders from the research into why patients sue their doctors. Analyses of malpractice lawsuits show that there is not a simple statistical relationship between a doctor being sued and the medical mistakes they make. In his book, "Blink", Malcolm Gladwell explains:

Analyses of malpractice law suits show that there are highly skilled doctors who get sued a lot and doctors who make a lot of mistakes who never get sued. At the same time, the overwhelming numbers of people who suffer an injury due to the negligence of a doctor never file a malpractice suit at all. In other words, patients don't file lawsuits because they've been harmed by shoddy medical care. Patients file lawsuits because they've been harmed by shoddy medical care and *something else* happens to them. What is this something else? It's how they were treated, on a personal level, by their doctor. What comes up again and again in malpractice cases is that patients say there were rushed or ignored or treated poorly.<sup>33</sup>

Gladwell goes on to explain the follow up research by psychologists who were able to identify subtle but significant differences in the behaviors of doctors who had never been sued compared with doctors who had been sued at least twice. These can be summarized as follows:

1. The doctors who had never been sued spent more than three minutes longer with each patient.
2. They were more likely to involve the patient in the consultation by explaining the process up front such as what the visit was supposed to accomplish and when the patient should ask questions.
3. They were more likely to demonstrate active listening skills such as paying attention and asking clarifying questions.
4. They were more likely to build rapport with the patient and laugh during the consultation.
5. Their tone of voice was less dominant and more concerned than the sued group.

This last point is especially significant because independent judges in one of the studies could predict which doctors would be sued just by the tone of their voice. The sued group had a dominant tone that indicated the doctor was not listening, talking down to the patient or not treating them with respect.<sup>34</sup>

## **C. Implications For Field Consultants**

The above research is supported by extensive studies into the effectiveness of different psychological techniques for producing behavioral change. As you may expect there are a wide

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<sup>33</sup> MALCOLM GLADWELL. BLINK. (Little, Brown and Company 2005).

<sup>34</sup> NALINI AMBADY, et al., *Surgeon's Tone Of Voice: A Clue To Malpractice History*, quoted in Gladwell, *supra*, note 33.

range of techniques and tools that counseling and coaching professionals use with their clients. Despite claims that one technique or system is better than another, the specific technique used has been shown to be relatively unimportant. The best predictor of successful outcomes is the quality of the relationship between counselor and client, what is known as the “therapeutic alliance”. An effective therapeutic alliance has two characteristics:

- The client sees the counselor as someone helpful and supportive.
- The relationship is focused on working together to achieve the client’s goals - what I would call a profitable partnership.

While the role of a franchisor is not to conduct therapy on its franchisees, field consultants are engaged as change agents to motivate franchisees to be the best they can be. Consistent with the above research we have found that a field consultant’s success in influencing franchisee attitudes and behavior will largely come from the ability to build a relationship of trust with their franchisees.

Field consultants can also have a significant impact on franchisee satisfaction and their intention to stay in or leave the system. While long-standing franchisees are more likely to want to sell their business, analysis of data collected across many different franchise systems reveals that a franchisee’s intention to sell is significantly related to their satisfaction with the support they receive from their field consultant.<sup>35</sup>

In one study, the morale of franchisees across the country was shown to be quite positive except for a particular region where franchisees were feeling ambivalent toward their business and the franchisor. The field consultant for this region was replaced and a survey of the same franchisees twelve months later showed their overall satisfaction was above the national average. On the specific scale which measures the extent to which franchisees feel their opinions are valued and listened to, franchisee satisfaction in this region had increased by 39%.

We subsequently interviewed the new regional manager asking him what he had been focusing on. He said he had made an effort to encourage franchisees to attend regional meetings and provided the opportunity for constructive open discussion on issues of interest to them. We also observed him for two days as he interacted with franchisees. Several aspects of his behavior stood out:

- He was clearly interested in the performance of his franchisees and asked specific questions to quickly gain relevant information about their business. He never reacted to whatever was said. He just listened.
- He kept conversations focused on positive outcomes. If a franchisee complained about something, the consultant was not defensive. He would first listen and then draw out their thoughts on how it could be improved.
- If he disagreed with a point of view he would say so but he always explained why, giving facts or examples where possible. His comments were thus never taken as a personal disagreement – just an alternative point of view, backed with facts where possible.
- His body language indicated a keen interest in the person he was talking to. Every conversation was treated as though it were the most important thing happening at the time.
- He was consistently enthusiastic about the business. Not a false enthusiasm, more the natural enthusiasm that comes from someone who wants to be the best they can at their job.
- Finally, he didn’t take himself too seriously. He was happy for others to have a joke at his

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<sup>35</sup> Nathan, G. *The Franchisor’s Guide To Effective Field Visits*. (2d ed.2004, Franchise Relationships Institute).

expense and every meeting, no matter how serious, had a moment of levity.

#### **D. Dangers of Ignoring the Personal Dimension**

The need to be treated with respect is particularly powerful in the franchising context. A franchisor who embarrasses a franchisee, or treats a franchisee with a lack of care or respect can pay a high price. The following case studies are provided to show, from the franchisee's perspective, how personal the franchise relationship can be, and the legal and commercial implications if the psychological dimension is ignored, even unintentionally.

##### **1. George – It's not Personal?**

Early in my consulting career I was approached by a franchisor CEO (we will call him George) for advice about a franchisee who was threatening to sue his company for misrepresentation. The franchisee's business had never reached break even and after two years of trading losses and royalty payments not being made, the franchisor had decided to terminate the franchise agreement. George told me his company had done everything they could for the franchisee and he could not understand why this person was threatening to sue them.

I phoned the franchisee, explained that George had told me about his predicament and that I was interested to know what had gone wrong and how he was coping. Toward the end of the conversation he said to me, "You know Greg, I really appreciate you calling and talking with me about this. The thing that has really upset me and my family about this whole situation is that George has not even called or spoken to us to say he is sorry about us losing the business."

I recounted these comments to George. His response surprised me. He said, "It's not as if it's personal".

One important principle in franchising is that to a franchisee who invests his money, his personal pride and his sense of purpose into a franchise, it is extremely personal. This franchisee wanted George to show some empathy and acknowledgment of the suffering he and his family were going through. The legal posturing was primarily a way to bring this sense of hurt to the attention of the company.

##### **2. Interflora**

One very public case in the UK, which was subsequently made into a documentary,<sup>36</sup> involved a group of Interflora franchisees who succeeded in having a newly appointed CEO and leadership team removed from office. The CEO was driving a number of new initiatives designed to improve the competitive position of the group. Interviews with the protagonists revealed that the spark which set off the dispute occurred at a regional meeting where the CEO publicly humiliated a franchisee named Bev.

Bev had been a long standing franchisee who was very attached to what she saw as Interflora's culture of people looking after each other. She felt that the new reforms would "rip the heart out of the organization" and had asked a challenging question of the CEO at the meeting. Instead of listening respectfully and responding in a non-defensive way, he retaliated with a sarcastic comment. One franchisee who was at the meeting recalled, "It was a disgrace. Bev was put down in front of everyone like a naughty child."

The CEO's interpretation of events is interesting. He took no responsibility for the altercation and said Bev had acted like a mad woman and her question was ridiculous. All he had done was respond to a stupid question in an intelligent manner! Whatever the CEO had said it was the tone of his response that had the biggest impact. In effect he had said to the franchisees: "I don't care what

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<sup>36</sup> *Blood on the Carpet, Guns "N" Posies*, BBC Worldwide Videos for Learning (1999).

you think – you are all stupid.”

Bev, who subsequently became the ring leader of what became known as the rebel group, recollected, clearly with some satisfaction: “He thought he could just flick me off like a piece of fluff – well I showed him!” Now it was highly personal. When asked about her relationship with the CEO, she responded, “I feel like a cat. I just want to claw his eyes out”.

After several months she had the backing of over a thousand franchisees. The dispute came to a head at the company’s Annual General Meeting with a debate over meeting protocols. Of course this had nothing to do with the real issues which were about a perception by franchisees that the CEO and Board were arrogant, self-serving and out of touch with their needs.

As it turned out the CEO’s business strategy for change was a good one and the new leadership team adopted most of it immediately. What was missing was an appreciation that the emotional needs of franchisees, especially to be listened to with respect, should have been given the same level of attention as the strategic needs of the business.

### **3. Cut Price Deli**

Frank Rechichi, the Founder of the failed Cut Price Deli chain, spent decades building a large and impressive retail franchising empire. It all crumbled in the early 1990’s as a result of a series of bad press articles and a three-year legal battle with several franchisees, which cost the parties several million dollars.

Frank believes that an incident in which one of the franchisees took offense to what was interpreted as a critical and insensitive comment from a field consultant triggered a series of arguments that escalated into the legal action. In an interview on what he had learned from the experience Frank recounted the following:

Be very careful if you are going to say something that could damage the pride or ego of another person. Franchisees put themselves on the line, financially and emotionally, and you can mortally wound someone with an insensitive comment. What you may think is the right way to do something may not make sense from their point of view, so you need to take the time to really listen to them and not fall into the trap of becoming self-righteous or bombastic.<sup>37</sup>

It may be argued that the emotional issues in these cases were a smokescreen for more substantial legal or commercial issues. However the research into why patients sue their doctors shows that emotional issues in themselves will often drive people’s behavior.

### **E. The Power of Effective Leadership**

Research on culture change in organizations shows very clearly that culture is mostly influenced by the people in top leadership roles. The quickest way to change a culture is thus to change the CEO. In the next two case studies, franchisees were dispirited, perhaps for good reason, yet effective leadership resulted in a positive shift in the culture and the franchise relationship, with remarkable results. Coincidentally both involve ice cream franchises.

#### **1. Wendy’s Supa Sundaes**

In June 1994, Geoff Davis found himself facing every franchisor’s worst nightmare. Geoff was Co-Founder of Wendy’s Supa Sundaes, an Australian chain of over 250 soft serve ice cream stores.

His problem was that McDonald’s had moved into his market, selling soft serve cones for 30 cents. Geoff’s franchisees needed to price their product at \$1.80 to stay profitable. Naturally

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<sup>37</sup> Telephone Interview with Frank Rechichi, former Managing Director, Cut Price Deli, 1999.

franchisees were frustrated, scared and angry as their sales plummeted.

Geoff recounts the situation. “Franchisees in malls were beginning to lose 20% of their sales. There seemed to be no short term answer from anyone – not from us, our advertising partner, our Master Franchisees, nor our franchisees...They arrived en masse to our July 1994 National Conference in Bali looking for blood.”<sup>38</sup>

Wendy’s management subsequently invested heavily in research and development and Geoff’s team experimented with a number of initiatives to regain their competitive edge. Gradually the group developed a multi-pronged strategy involving a new store design, a new product range, an increased marketing fee and a repositioning of the brand to a new customer base. The strategy was sound and the group was slowly making headway, but was still struggling to get franchisee commitment to the new initiatives, especially as franchisees, at a time of declining profits, were being asked to invest \$75,000 each in new equipment and store upgrades, and to shift their focus to serving a different customer demographic. It was a huge undertaking in terms of gaining franchisee buy-in.

A significant turning point was the appointment of a new Chief Executive, Shane Radbone, who at the time was just 30 years old. Geoff recounts: “He had style, presence, enthusiasm, boundless energy and an insatiable curiosity concerning business and franchising... He was young and, although he had made mistakes in business, he would always stop, listen and learn, then move forward and change direction if necessary.”<sup>39</sup>

Shane admits that his introduction into the company was not easy and recounts his first meeting with the franchisee group as follows. “A franchisee at the back of the room stood up and slowly walked down the aisle toward me with a document in his hand until he stood face to face with me a few inches away. He then tore the document into pieces and, his voice shaking with emotion, said ‘That was my franchise agreement and that is what I think of my relationship with this company’ He then turned and left the room. I was dumbfounded.”<sup>40</sup>

Over the coming years Shane not only focused on implementing Geoff’s business strategy but also introduced a number of initiatives designed to improve communication including regular franchisee forums and conferences and a revamped Franchisee Advisory Council (called the Business Unit for Development). This involved a franchisee and field consultant from every region, plus his senior management team – nearly 30 people – which he personally chaired.

Wendy’s subsequently not only managed to survive but in a recent trading year recorded a 25% increase in retail sales, store on store, and achieved some of the best franchisee satisfaction scores we have seen.

When I asked Shane what he believed was the most important factor in achieving such exceptional performance in such a difficult market he responded without a pause. He said it had been an uncompromising commitment that the management team embrace two values in all their dealings with franchisees - *listening* and *respect*. He said this provided the basis for a relationship with the franchisees where they could together face up to the unpalatable truth of what was happening in the market, explore options, investigate and trial new initiatives and ultimately roll out the strategy to successfully compete.

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<sup>38</sup> Excerpt from the book by GEOFF DAVIS. WENDY’S WENDY’S YUM, (Historical Consultants Pty Ltd, South Australia 2004).

<sup>39</sup> *Id.*

<sup>40</sup> Shane Radbone, CEO, Retail Brands Group, *People First Profits Second*, Franchise Council of Australia Conference, South Australia, March 26, 2004.

## **2. Carvel Ice Cream**

In the USA, another ice cream group, Carvel, has also been through its fair share of challenges. Carvel is the largest manufacturer of branded ice cream cakes in the U.S. and a leading retailer of ice cream shops.

In the early 1990's the company made a commercial decision to move its resources and focus away from its franchisees and into supplying supermarkets with its ice cream cakes. The company's relationship with its franchisees quickly deteriorated resulting in a string of lawsuits being filed by franchisees and ongoing store closures. Top leadership were clearly not interested in the morale of franchisees. Indeed in one of the trials a former Carvel sales director testified that Carvel's President once told him, after the director raised the issue of the supermarket program's impact on retail stores, that he "didn't give a f--k about the franchisees."<sup>41</sup>

When Carvel was purchased by Roark Capital in 2001, the number of stores had dropped from a peak of 850 in 1995 to 350. Franchisee morale was at an all time low as evidenced in a franchisee survey where only 17% indicated they agreed or strongly agreed with the statement "I trust Carvel".

Steve Romaniello, a young CEO with a background in hospitality and franchising, was appointed to lead a change management program that would return Carvel to a healthy state. Under his leadership Carvel invested heavily in corporate infrastructure – both assets and people - and brought the company's focus back to the neglected franchise system.

As Steve Romaniello observes:<sup>42</sup>

When we arrived it was not a happy place. Our first step was to invest in the franchise infrastructure to provide support for the existing franchisees and a foundation for growing the system. But exactly what we should do still needed to be determined. To figure this out we began actively seeking our franchisees' advice and input. We had a series of meetings and calls which quickly resulted in the re-establishment of the Carvel Franchisee Advisory Council (CFAC) as a formal way to coordinate and solicit input from the franchisee community. The previous management had disbanded CFAC. We also held numerous town hall meetings and I personally called at least 2 franchisees everyday for 90 days to hear firsthand what they needed.

This was not easy; many of the meetings were hostile and mean spirited. But we did not fight back, we just showed a positive mental attitude and a willingness to fix what was broken. And guess what, many of the ideas needed to fix the morale and physical presentation of the stores were already in the heads of our franchisees. All we had to do was ask the questions – and sometimes duck when things were thrown at us.

In collaboration with our franchisees, we developed a comprehensive solution, step by step, which became our 3 year plan.....Every idea and plan has been done in step by step collaboration with our franchisees.

Among a raft of initiatives, Carvel tripled the number of field visits the franchisees were receiving and aligned the field consultant's interests by making their compensation partly based on how the franchisees rated them in an annual franchisee satisfaction survey.

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<sup>41</sup> *Carvel Corp. v. Noonan*, 350 F.3d 6, 9 (2d Cir. 2003).

<sup>42</sup> Steve Romaniello, CEO, Focus Brands, Inc., e-mail to Greg Nathan, Managing Director, Franchise Relationships Institute, June 5, 2006, on file at Franchise Relationships Institute.

Two years later, after creating and implementing the plan with the input of franchisees, responses to the same survey question, “I trust Carvel” were 90%. Steve adds, “It would be disingenuous of me to not mention that franchisees were clearly comparing us to prior management, who really did not like or care for franchisees.”

Four years on, comparative store sales have increased two years running at an estimated rate of two times the category average. Instead of losing 30-50 stores a year, Carvel has opened 170 in 2004 and 2005, an additional 170 will be fully renovated by end of 2006. Financially, the company has exceeded its EBITDA targets and has used its excess capital to purchase the Cinnabon and Seattle’s Best Coffee brands.

While Steve Romaniello’s approach sounds simple, the patience and personal discipline required to seek out and actively listen to franchisee concerns without becoming defensive is considerable. Anyone who has met Steve Romaniello, or heard him speak, will observe a CEO who understands the importance of treating people with respect and listening non-defensively to his franchisees.

#### **F. Lessons for Leaders**

In these two cases and others we have seen where franchisees have faced considerable hardship and frustration, successful CEOs have managed to gain the trust of franchisees by listening to them in a non-defensive manner and placing a priority on good communication. Obviously, a sound business strategy is also essential. But without the trust and commitment of franchisees, even the best business strategy can fail, as demonstrated in the Interflora case study.

We have also observed a striking similarity between the interpersonal styles of high achieving franchisor CEOs, such as Shane Radbone and Steve Romaniello, and the interpersonal style of the doctors who did not get sued.

### **VIII. DECISION MAKING IN A FRANCHISE SYSTEM**

In our research we have found that while franchisees enjoy their work, generally have good relationships with their franchisor management team and are happy with the competence, drive and commitment of top leadership, they are far less happy about the extent to which they are listened to.

For instance, while 92% of franchisees say they enjoy their work and 86% agree with the statement, “Overall I have a good relationship with franchisor management”,<sup>43</sup> only 61% believe that franchisor management respects their opinions or that there are avenues in the franchise system to express their ideas and opinions.<sup>44</sup>

When decisions are taken which are going to impact on a franchise network, it makes sense to involve the franchisees. After all, they typically have a high emotional and financial interest in their business and will no doubt have strong views to express.

While franchisee involvement in decision-making can be a positive force in franchising, it

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<sup>43</sup> U.S. data shows similar findings. In the Franchise Business Review data 83% of franchisees agree with the statement “Overall my relationship with my franchisor is excellent and I have a high level of respect for the entire organization”. FRANCHISE BUSINESS REVIEW, INDUSTRY REPORT ON FRANCHISEE SATISFACTION (2006), available at <http://www.franchisebusinessreview.com/Resources/Reports/Industry-Overview.aspx>. Similarly, in the FranSurvey database, 80% of franchisees agree with the statement “My franchisor is a competent, skilful organization”, Jeff Johnson, President, FranSurvey, e-mail to Greg Nathan, Managing Director, Franchise Relationships Institute, June 1, 2006, on file at Franchise Relationships Institute.

<sup>44</sup> U.S. surveys do not tend to ask questions about the level of consultation so we do not have any comparative data. However we suspect the trends are similar to Australia, if not worse, as we have observed more of an autocratic style of leadership in the U.S.- franchising culture.

need be applied intelligently. There are pitfalls of trying to give everyone a say and for some issues this will be inappropriate.

### **A. Three Types of Decision Making**

There are broadly three types of decision-making which exist on a continuum - Participative decision making at one end, Directive at the other and Consultative in the middle.<sup>45</sup>

Franchisors need to decide which type of decision making they intend to use in a given situation and then make it clear to those involved. Difficulties most often arise because people were confused about the process that was being used. The most common confusion occurs between participative and consultative decision-making.

#### **1. Participative Decision Making**

This involves the widespread participation of franchisees in what should be done, usually through discussions and forums. The implicit promise is that once agreement has been reached, the franchisor will implement the group's decision.

This process can be very time consuming and result in inappropriate decisions. While people may have a high level of commitment to the outcome, the decision might not produce the desired results because of flawed assumptions or biased perspectives.

This approach is seldom appropriate for significant strategic decisions because both objectivity and broad information are required. Moreover, the time lag in reaching agreement may result in opportunities being missed or threats not being addressed in time to prevent major problems from occurring.

This style is generally best kept for decisions that are not significant to the future viability of the network, there is no urgency to arrive at a decision, or most people will probably agree with the outcome.

#### **2. Consultative Decision Making**

This involves consultation with franchisees on their thoughts and ideas. It usually has more to do with how a decision should be implemented rather than whether it should be implemented. In other words for tactical rather than strategic issues.

In this process franchisees may be invited to contribute their thoughts by mail, phone and email, or through face to face or internet forums. The franchisor should make it clear that it will ultimately make the final decision, although it will take into account the information gathered from franchisees. This arguably offers the most suitable form of franchisee/franchisor collaboration.

#### **3. Directive Decision Making**

Directive decision making is where the franchisor uses their authority to make decisions about the network's future and how this decision will be implemented.

It is best used when resistance or a slowing down of the decision making process could threaten organizational success. For instance a franchisor may be forced to take a non-negotiable decision on an issue that is important to the survival of the group.

While directive decision-making may be necessary or the most appropriate course to take, it can leave franchisees feeling alienated or cynical about whether they will be consulted in the future. We recommend that, out of respect for franchisees, they should be informed about why and how the decision was made, including the information that was taken into account.

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<sup>45</sup> A form of decision making known as "Sociocracy" is also becoming popular in some associations and may in the future find its way into franchise systems.

Another disadvantage to a franchisor using directive decision-making is that franchisees can be unforgiving of too many mistakes. As a general rule if a franchisor messes up once on a major decision, franchisees will accept this if there is a good reason; twice they will be relentless in their questioning; three times and the franchisor will have great difficulty re-establishing its credibility.

## **IX. WHAT FRANCHISEES WANT FROM A FRANCHISOR**

### **A. The Five Needs of Franchisees**

To better understand the needs of franchisees, in our surveys our research team always asks franchisees to describe the best and worst things about their particular franchise system. We also ask them to rate the importance of specific services provided by their franchisor.

Findings indicate that what franchisees want from a franchisor cluster into five areas:

1. Assistance to boost profitability
2. Positive interaction and harmony
3. Effective leadership
4. Effective marketing
5. Responsive support

The more effectively a franchisor meets these needs, the healthier the franchise relationship is likely to be. These five areas are examined in more detail below.

### **B. Assistance to Boost Profitability**

Franchisees want regular access to useful and relevant business information that will help them boost sales, control their costs and stay in control of their financial position. The more experienced a franchisee becomes in running his or her business, the more they value benchmarking information on key performance indicators and financial performance.

On average only half of the franchisees we have surveyed over the past 10 years believe their business is making a reasonable profit and just 58% believe they are making a satisfactory return on their investment. These figures appear similar to USA figures.<sup>46</sup>

Despite this relatively low level of satisfaction with the financial performance of their business franchisees tend to be an optimistic group with 75% believing their profits will grow and 83% believing their business will grow.

Franchisees also value ongoing training to improve their management skills, especially in the areas of people management, business planning and marketing. While 73% of franchisees say they were happy with the initial training they received, only 60% believe there are adequate ongoing opportunities for them to learn relevant knowledge and skills.<sup>47</sup>

As a priority, franchisees also want their franchisor to negotiate deals with suppliers that will

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<sup>46</sup> In a 2003 study by Jeff Johnson only 47% of franchisees agreed that they considered their franchise business a success in terms of financial returns. See JEFF JOHNSON. FRANCHISE RELATIONSHIPS: THE STATE OF THE NATION. (Johnson Franchising Consulting, Inc. 2003). The 2006 Franchise Business Review report was more optimistic with 56% saying the financial picture of the business was meeting or exceeding expectations and 63% agreeing with the statement "The total investment into my business, including both time and money, has been consistent with my expectations and any information provided to me by my franchisor." FRANCHISE BUSINESS REVIEW, INDUSTRY REPORT ON FRANCHISEE SATISFACTION (2006).

<sup>47</sup> In the USA the 2006 Franchise Business Review report indicates that 66% of franchisees believe their initial training was very good or excellent and 60% believe the ongoing training and support is very good or excellent. FRANCHISE BUSINESS REVIEW, INDUSTRY REPORT ON FRANCHISEE SATISFACTION (2006).

reduce their operating costs and to provide ideas and systems for enhancing productivity.

### **C. Positive Interaction**

Many franchisees refer to the sense of financial and emotional security they get from being part of a united, cohesive group. In particular they value the opportunity to interact with other franchisees at meetings and conferences. As mentioned previously, many rate the support they get from their colleagues as just as useful as the support they get from the franchisor.

A recurring theme in our studies is that franchisees want their regional meetings and conferences more interactive with the franchisor being more of a facilitator than a presenter. The following comment is typical: *“Our franchisor should create more opportunities for franchisees to have get-togethers and learn from each other.”*

Another recurring theme is that franchisees want the opportunity to have their ideas, questions and concerns heard by their franchisor through open forums and discussions. While they want to be included in important decisions, many feel the franchisor team does not take their ideas and suggestions seriously. For instance only 61% of franchisees feel their franchisor respects their opinions. The same number believes there are adequate opportunities to express their ideas and opinions. This suggests a significant number are not feeling heard.

The introduction of operational changes without adequate consultation is particularly frustrating and puzzling to franchisees who feel they have more insight about operational matters than their franchisor. The following comment is typical. *“Remember that we are partners in our work and our goals. The introduction of change without consultation is often insulting and degrading.”*

Of course sometimes consultation may be difficult or inappropriate because competitive conditions may require secrecy. In such cases the franchisor may still be able to involve franchisees in elements of the changes. Or at least to explain why franchisees were not involved. The question the franchisor needs to ask is, “Have we adequately considered how these changes will affect our franchisees and how they will feel about the decisions we are making?”

In summary we believe that franchisors as a group will have to improve their skills in the art and science of effective consultation if they are to gain franchisee commitment to change.

Despite a desire for more consultation and two-way communication, an average of 86% say they are proud to be associated with their respective brands.

### **D. A Desire for Harmony**

While most people dislike conflict, the reality of any interdependent relationship is that some conflict is inevitable. (The Franchise E-Factor model, which is explained below, predicts that there will be periods of conflict at specific stages of the relationship.)

Our research has identified a strong negative correlation between length of tenure and satisfaction levels, with “older” franchisees being more stressed, skeptical and dissatisfied. Furthermore we have found that at any given time there is an average of 17% of franchisees who are likely to feel they “have a serious current or impending disagreement with their franchisor.”

This does not mean these people are in litigation or formal disputation with their franchisor. However it does highlight the need for robust conflict resolution processes to be an integral part of every franchise system.<sup>48</sup>

Unresolved conflict has also emerged in our research as a major reason why people want to sell their franchise. If they feel they cannot resolve an ongoing dispute with their franchisor many

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<sup>48</sup> The USA 2003 data by Jeff Johnson showed that 15% of franchisees were “currently in a dispute with the franchisor”.

franchisees take the attitude, “life’s too short” and look to move on.

Recent USA research in this area is encouraging with 80% of franchisees believing their franchisor is able to resolve disagreements between itself and its franchisees.<sup>49</sup>

### **E. Effective Leadership**

Franchisees want and expect clear long-term direction from their franchisor. While franchisors may have goals, they often fail to adequately inform franchisees on where they fit into the overall picture, as the following franchisee comment suggests. *“I believe our franchisor is extremely focused on where they are going and far less focused on where the franchisees are going.”*

Consistent with other international research on what followers want from leaders is the finding that franchisees place a high value on the franchisor team being honest and fair in their business dealings.

Despite the bad press that franchisors sometimes receive they are rated by franchisees reasonably well on measures of integrity. For instance 72% of franchisees agree that their franchisor is trustworthy in its business dealings and 80% say their franchisor treats them fairly.<sup>50</sup>

However franchisees also expect that if they have supported the franchise system over a period of years this should be reciprocated. The following comment represents a frequent complaint we hear. *“They should show some loyalty to longer standing members instead of just buttering up new franchisees”*. Or as another franchisee eloquently stated, *“When I started in this business I was treated like royalty – now I am treated like royalties!”*

On a similar theme franchisees feel they deserve more appreciation with only 64% believing they receive recognition for good performance.

### **F. Effective Marketing**

Marketing always emerges as a hot topic in our studies. A strong brand is regarded as vital with many franchisees telling us that that they bought their franchise because of the strength of the brand. They also expect their franchisor to have a well-conceived marketing strategy that will give them an edge in their local market.

While franchisees are generally happy with the promotion of their brands, they are typically dissatisfied with the effectiveness of tactical marketing programs to attract more customers into their business. Only around a half of franchisees are satisfied with their sales figures and, not surprisingly, marketing is often blamed for this. Indeed franchisees usually rate marketing that drives sales as one of the most important services from their franchisor, but as one of the most poorly executed.

Franchisees want ongoing innovation into new products that will excite customer interest. Despite the public image of franchisors being entrepreneurial and creative, franchisees generally rate innovation relatively low with an average of 62% believing there is adequate innovation or encouragement to find new and better ways to build the business.<sup>51</sup>

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<sup>49</sup> USA FranSurvey database, 2006.

<sup>50</sup> In the USA the Franchise Business Review Survey data is even more positive with 91% of franchisees agreeing with the statement, “My franchisor encourages honesty and a high standard of business ethics throughout the organization”.

<sup>51</sup> USA figures are similar with 64% of franchisees describing “the creativity and openness of the franchisor to experiment with new ideas or improvements to current products/services/operations” as very good or excellent.

## **G. Responsive Support**

One finding worthy of comment is that 70% of franchisees believe their franchisor is genuinely concerned about their success, a moderately satisfactory result. As mentioned earlier the level of perceived franchisor concern is the best predictor a franchisee's tendency to advocate for a franchise system.

Quick response times to phone calls and emails are seen as vital. In ratings on the relative importance of services provided by the franchisor, "a prompt response to phone calls and emails" is usually rated near the top.

Some of the most powerful support a franchisee receives comes from their field consultant. Just as the performance of the franchise unit is significantly impacted on by the caliber of the franchisee, the performance of a whole region can be significantly affected by the caliber of the field consultant. For instance have seen unit on unit sales increases of 40% or more in a region over a 12 month period following the appointment of a new field consultant.

Field consultants also have a significant impact on franchisee satisfaction levels. A franchisee's intention to sell their franchise will often be significantly correlated with their satisfaction with the support they are receiving from their field consultant. Franchisors would thus be wise to invest in the recruitment, training and retention of quality field consultants.

Possibly the best measure of franchisee satisfaction is whether franchisees would buy the franchise again if they had their time over. In both the USA and Australia 63% of franchisees said they would be likely to do it again.<sup>52</sup>

## **X. THE PSYCHOLOGY OF THE FRANCHISEE**

In the previous section we saw that franchisee needs change over time and that support programs will be most effective if they cater to the competence and experience of their franchisees. This is an appropriate place to discuss the stages that franchisees go through in their relationship with their franchisor.

The Franchise E-Factor is a model I developed to help franchisees, franchisors and advisers better understand the psychology of the franchise relationship.<sup>53</sup> In particular why franchisee and franchisor dealings inevitably become strained and how the parties might reduce this tension to a level that, instead of undermining the relationship, it actually enhances it.

### **A. The Six Stages of the Franchise E-Factor**

The Franchise E-Factor has six stages.

**Glee** - The franchisee is somewhat nervous about their new venture but is also excited and optimistic about the future.

**Fee** - The franchisee starts to become sensitive and concerned about the value of the fees being paid to their franchisor or the costs of services or products received.

**Me** - The franchisee concludes that their success is due mainly to their own effort and plays down the contribution of the franchise system. Or if they are struggling they play down their own deficiencies.

**Free** – This stage is characterized by the franchisee's need to demonstrate his or her competence and assert their independence, thus testing the franchise system's boundaries.

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<sup>52</sup> FranSurvey 2006 database, *supra*, note 43. Note that this is significantly lower than an often-quoted 1997 Gallop Survey which found that 75% of franchisees would make the same decision again.

<sup>53</sup> See *supra*, note 29.

**See** - Through frank and open discussions the franchisee and franchisor better understand and respect each other's points of view.

**We** - The franchisee recognizes that success and satisfaction come more easily from working with, rather than against, the franchisor.

### **B. The Glee Stage**

In the lead up to buying a franchise and during the initial training and operation of the business franchisees are filled with glee. Along with the decision to buy a franchise comes the anticipation of whether things will work out and of course the hope of making lots of money.

The Glee stage covers the lead up period to buying into the franchise and will usually stay with a franchisee for between 3 and 12 months depending on their past business experience. Common feelings during this period are likely to include:

**Nervousness.** It is normal for there to be some fear about whether the new business will work out.

**Excitement.** The novelty of the business may create a sense of euphoria. Franchisees may run on adrenalin as they face the inevitable challenges associated with starting a new business. They are likely to also idealize franchisor staff and the value of their expertise.

**Optimism.** It is natural for a franchisee to have a sense of optimism about the business' future. After all they are embarking on a journey to live their dream of self-employment.

Members of the franchisor team will also tend to be enthusiastic in this early stage of the relationship. In other words, positive emotions will be running high on both sides. These emotions must be managed so they don't get out of hand.

### **C. The Fee Stage**

Franchisees are going to come into frequent contact with friends, relatives, business associates and advisers who are likely to make derogatory remarks about the fees and restrictions the franchise system places on the franchisee. For instance at dinner parties someone might say, "I can't believe you are paying all those royalties to a franchisor – what a rip off!"

Comments like this will naturally sow seeds of doubt. Also as the franchisee becomes increasingly focused on how royalty and advertising fees are taking the cream off their profits, their satisfaction will start to drop. They will subsequently move into the Fee stage where the following behaviors are likely to emerge:

**Questioning.** They might become more demanding or questioning about what they are getting for their royalty fees and the value of the franchisor's services. The most common question will be "What real value am I getting for all these fees I am paying?"

**Commercially minded.** As they become commercially astute they may request better training and support services. They may also complain about deficiencies in the competence or commitment of franchisor staff.

**Skeptical.** The relationship is moving from one of a grateful, starry-eyed student who was eager to learn, to someone who is realizing that their franchisor-teacher is not as infallible as they thought. In other words the franchisor is now ready to fall, or be pushed, off the pedestal.

### **D. The Me Stage**

As a franchisee's drive for independence starts to assert itself they will move into the Me stage. Because of their increased competence and confidence in running their business they will now tend to attribute their success to their own hard work and effort. Yet if things are not going so well they will blame the franchisor. Either way the franchisor will typically start to receive some

criticism. This natural tendency to take the credit for good results and blame others when things go wrong is known in psychology as the "Self-Serving Bias".

As franchisees now move into a more independent relationship with the franchisor their satisfaction will drop and they will increasingly experience the following emotions:

**Self-centered.** Failing to acknowledge the franchisor's contribution and becoming more demanding.

**Proud.** A heightened sense of pride and confidence to the extent that they may feel they know more than their franchisor and thus no longer need to listen to the franchisor's advice.

**Frustrated.** As franchisees feel they are catching up to or even passing their franchisor in their operational knowledge they can feel disappointed and critical.

### **E. The Free Stage**

As a franchisee's business confidence grows, their drive towards independence will increasingly assert itself. The Free stage is characterized by a need to break free of the restrictions and limitations of the franchise and test the system's boundaries. A franchisee might also test how tight the franchise agreement is and try to break free of their contractual obligations.

A franchisee in the Free stage may feel they have been treated unfairly and become resentful. They will also probably experience any or all of the following feelings:

**Cynicism.** Questioning the franchisor's motives and challenging the reasons behind innovations or changes in strategy. An "us and them" mentality may color interactions.

**Constrained.** The franchisee can develop a prisoner mentality, feeling resentful that the franchisor is inhibiting their creativity. For instance they may have developed what they believe is an innovative addition to the franchise concept, only to find that their field consultant has told them to stop this practice immediately.

**Combative.** They may feel the need to test out the franchisor's commitment to them. Discussions and interactions will likely be tense and peppered with conflict. Requests for compliance might be met with threats of "Make me!"

Obviously chances of conflict are greatest at this point. Franchisees in the Free stage may become a negative influence if not handled maturely and may also be exploited by people wanting to provoke trouble. The earlier case studies of Interflora and Cut Price Deli are example of how a franchise relationship that is poorly managed can get out of hand at this stage.

### **F. The See Stage**

Conflict in relationships seldom goes away by ignoring it. To move to the See stage there must be frank and open discussion where the franchisor and franchisee listen carefully to each other's point of view. As each party listens to the other's problems and perspectives greater tolerance and understanding will usually occur.

If a franchisor team has been managing the franchise system fairly and competently the franchisee will usually acknowledge the importance of consistency in systems and policies. It is this shift in perception that characterizes the See stage. As such the franchisee is likely to demonstrate the following behaviors:

**Inquisitive.** A willingness to listen to the bigger picture and ask questions about why certain decisions or approaches have been adopted.

**Open minded.** As they appreciate that they are part of a larger system in which everyone's individual needs cannot necessarily be met, they will be more inclined to let go of specific any

hobbyhorses.

**Empathic.** If the franchisor has genuinely listened to the franchisee's point of view, the franchisee will probably reciprocate.

### **G. The We Stage**

From the See stage there is a natural progression to the We stage — a move from independent to interdependent thinking. At this point the franchisee recognizes that success and satisfaction generally come more easily from working with, rather than against, their franchisor. Franchisees in the We stage will definitely hold the franchisor accountable, but will tend to do so without being overly unreasonable.

To reach the We stage a franchisee must be mature, objective and commercially minded. Most importantly, they must be profitable. It is also vital that the franchisor has delivered on its obligations and has been fair and consistent in its dealings.

Franchisees at the We stage tend to be:

**Cooperative.** Open to the mutual benefits in working with their franchisor. Ideas and opinions will likely be shared in a spirit of mutual trust and co-operation.

**Assertive.** While prepared to co-operate, they will also not be backward in stating their needs and views in a frank and direct manner. If they do not think an idea is in their or the network's interests they will generally speak their mind.

**Forward thinking.** They will usually have thought through their long term business and lifestyle goals. They will tend to have a business plan that extends for at least two years and will be working ON as well as IN their business.

### **H. Tips on Managing the Franchisee E-Factor**

The Franchise E-Factor is in fact based on the natural progression which many relationships move through — from dependence to independence to interdependence. The model is a useful reminder for franchise management about how franchisee needs and attitudes change over time and that the relationship is always "work in progress".<sup>54</sup>

While franchisees will need managing slightly differently at each stage, the following general management tips are useful to keep in mind, especially when if the relationship gets strained, as it will from time to time.

#### **1. Manage Expectations**

Over-promising and under-delivering is a sure way to create unhappy franchisees. Franchisors need to ensure that their franchise sales people do not unintentionally promise what the company cannot deliver. Some areas to beware include:

**Initial training and support.** Franchisees never forget if they fail to receive professional training, thorough induction and adequate initial support.

**Ongoing support.** Ensure the franchisee understands that *they* are expected to take responsibility for the performance of their business.

**Financial return on effort.** Profit is a vague term. If discussions are held on profitability or expenses, be sure that terms are clearly defined.

**Rebates and mark ups.** It is advisable to maintain transparency regarding all transactions

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<sup>54</sup> See *supra*, note 5.

relating to supplier rebates, marketing fund fees, and mark-ups for corporate supplies and services.

**Working capital and cash flow.** Be clear on how much working capital will be needed and what it will be needed for so that, if sales are initially slow, franchisees have enough money to support themselves.

**Small business lifestyle.** Franchisees who have not had direct family contact with running a small business may be naive about the reality of long hours and ongoing pressures. Ensure they have spoken to existing franchisees about the realities of running the business.

**Level of control and consultation.** Be sure they are clear that they will have to comply with marketing and product directives and that they will not necessarily have a high level of involvement in strategy setting or policy making.

**Sense of community.** The promise of “being in business for yourself but not by yourself” implies ongoing contact with other people. Ensure franchisees have a realistic idea of the number of forums and meetings they will have access to.

**Level of control and disclosure.** Be sure they understand that they will need to share their ongoing financial information with the franchisor.

## **2. Do Not Assume Continuity in the Relationship**

The franchise relationship is dynamic. Franchisor executives may need occasional reminding that because a franchisee is, or is not, satisfied at a particular point in time, does not mean this behavior will continue. What goes up must come down so franchisee gestures of appreciation in the early stages should be kept in perspective.

## **3. Do Not Get Defensive**

Listen to questions about the value of services or the competence of staff with an open mind. Do not try to prove that you are right as this makes the other person wrong.

Do not take it personally if a franchisee challenges the competence or the motives behind certain decisions. A question that does not receive a reasonable answer will continue to be asked. Do not debate, patronize or put down franchisees who ask what, in their own mind, are legitimate questions.

Set a good example and model the sort of behavior that is expected from franchisees. For instance treat them with respect, listen to their views and deal with differences maturely.

## **4. Do Not Knee Jerk React With Additional Services**

Do not mindlessly throw extra services at franchisees if they become more demanding or discerning about the support they are receiving for their fees. The motivation for providing extra services should be to provide value and meet the reasonable business needs of the franchisee. It is not about justification of franchise fees.

Check from time to time whether the franchise system is delivering value to franchisees over and above the fees they pay. If it is not, this could be a symptom of bigger problems.

## **5. Clarify Roles and Obligations**

Keep the relationship at a professional level and do not form friendships with franchisees. From time to time remind people of the different roles of franchisee and franchisor.

The franchisee’s role is:

- Running a profitable business
- Growing a base of happy customers
- Supporting the brand values and systems of the franchise

- Holding the franchisor accountable for delivering on its obligations

The franchisor's role is:

- Providing clear, positive leadership
- Helping franchisees achieve their goals
- Protecting the strategic position of the brand
- Monitoring and maintaining standards

#### **6. Keep People Challenged and Growing**

Promote a culture of continuous improvement and encourage franchisees to visit other businesses, attend courses and also participate in benchmarking meetings.

Do not become head office bound. Have franchisor executives spend regular time in the field to keep in touch with the customer end of the business.

Take time to understand what franchisees do well and offer them new challenges. For instance encourage them to mentor others and involve them in workshops where they can share their experiences with their peers.

#### **7. Do Not Become Intimidated By Angry Franchisees**

Be firm and explain the ground rules for the conversation. Get their agreement on this before proceeding. Maintain eye contact and speak calmly. Let them talk until they have said what they want to say. If their behavior becomes unruly or aggressive state firmly that you will not continue the conversation until they settle down.

If a franchisee is objecting to a policy do not try to prove them wrong or get into an argument. Just put forward the company's point of view with an explanation of why this policy or approach exists.

#### **8. Provide Outlets for Pent Up Frustration**

Give your complete attention with no interruptions unless it is to clarify something you don't understand. Write down their concerns so there is no confusion over what is being said.

Respond to questions, comments or accusations in an open and direct manner. Where possible give facts and specifics. Make sure all information you give is accurate.

If there is a group of frustrated or angry franchisees hold a group "gripe" session where issues are listed on butchers paper and discussed systematically. It may be better to use an external facilitator who is skilled in managing group processes.

Ensure franchisor executives understand how mediation works and ensure at least one member of the senior management team has undergone mediation training.

#### **9. Show Commitment to Profitability**

Remind franchisees at every opportunity of the company's commitment to their long-term profitability. Ensure support services focus on this goal.

Monitor franchisee performance and profitability. Identify and address problems early.

### **XI. THE PSYCHOLOGY OF FRANCHISEE RECRUITMENT**

Most franchise disputes have their roots in the recruitment stage of the franchise relationship. Something was inevitably said, done or missed that allowed unrealistic expectations to fester. A discussion of the recruitment process would thus appear appropriate at this point.

### **A. Why Franchisees Initially Join a Franchise System**

Research on why people purchased a particular franchise usually uncovers the following reasons.

- A strong brand.
- Proven business systems.
- Practical support and training from the franchisor.
- A personal attraction to the product or service.
- Being comfortable with people in the system - existing franchisees and franchisor staff.
- Being comfortable with the franchise sales person.
- Gaining assistance with marketing and sales.
- Easier access to finance.
- Reasonable ROI combined with the lower risks.
- Having more independence than being an employee.

These are mostly associated with reduced financial risk, the opportunity for faster growth and the comfort of being in business with people that can provide emotional and practical support. They would all appear legitimate reasons for buying a franchise. So why do franchisees fail?

### **B. The Dark Side of Franchisee Recruitment Practices**

In a recent study on the causes of franchisee failure, 30 franchisors and 30 of their ex-franchisees who had failed were interviewed for their insights into what went wrong.<sup>55</sup> While franchisees and franchisors held different perceptions on the importance of such things as support services, franchise fees and communication, there was agreement by all parties that inadequate franchisee selection procedures was a major factor behind the failures. The study found that franchisors often chose unsuitable franchisees due to a lack of selection criteria, but then tend to refine the recruitment process from the bitter experience of selecting unsuitable franchisees.

Another study of franchisor recruitment practices concluded that the screening process of a significant number of franchisors is not sufficiently developed with most relying on an interview and application form that does not adequately identify or address the attributes that candidates will need to succeed.<sup>56</sup>

Our own research into the area of franchisee recruitment also reveals that most franchisor companies do not have valid systems for assessing franchisee suitability. This includes both large and small companies.

### **C. Philosophies of Franchisee Recruitment and their Implications**

While franchisors and some franchising trade associations around the world promote franchising as a comparatively safe method for entry into business, the academic community has been unable to corroborate these claims.<sup>57</sup> While this is a controversial issue, the fact remains that

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<sup>55</sup> Lynn Frazer, Dimensions of Franchisee Failure: Insights From Franchisors and Franchisees, paper presented at International Services Marketing Conference (Brisbane 2002).

<sup>56</sup> Angus MacMillon. *Aspects of Franchisee Recruitment*. International Franchise Research Centre, University of Westminster (1996), available at: [http://www.wmin.ac.uk/IFRC/08\\_paper.PDF](http://www.wmin.ac.uk/IFRC/08_paper.PDF).

<sup>57</sup> See, e.g., Timothy Bates *Analysis Of Survival Rates Among Franchise And Independent Small Business Startups*, 33

the overall success rate of franchisees is nowhere near what is publicly claimed. Last year the IFA urged its members to stop quoting outdated and uncorroborated research claims that the success rate of franchised establishments is much greater than that of independent small businesses.<sup>58</sup>

While there is not one cause that explains franchisee failure, a lack of rigor in franchisee recruitment practices is clearly at the forefront. The reason for this is easier to understand when one examines how most franchise brokers and franchise sales departments operate.

### **1. Selling the Dream**

If you ask seasoned franchise professionals the most important lesson they have learned, they will usually say something like, "Choose your franchisees carefully". Yet it is common for franchisors to allow brokers and franchise sales departments to not properly screen prospective franchisees for suitability. The reason is often the pressure to meet short-term market expansion targets.

While most franchise sales brokers today are careful to not legally misrepresent a franchise opportunity, they do tend to over sell the benefits. They also often use sophisticated sales and influencing strategies to feed the hopes of their prospects.

Franchisees tend to be driven by the following five values.

1. They place a high value on their family.
2. They value having some flexibility in their lifestyle.
3. They value having a sense of independence and control over their destiny.
4. They like to enjoy a sense of achievement.
5. They value financial security.

Franchise sales people are skilled at tapping into these values to excite the interest of the prospective franchisee. While there is of course nothing wrong with this – it is what good sales people do – a franchise is not a commodity that can be traded in, returned or stored away in the garage if the customer is not happy with their purchase.

### **2. Franchise Coaches?**

In an attempt to distance themselves from the salesperson stereotype, several broker groups in the USA promote themselves as "franchise coaches". This is controversial in some circles because, while it promotes an image of objectivity and professionalism, the first rule of business or life coaching is the client, not the coach, drives the agenda.<sup>59</sup>

To ensure objectivity, coaches are paid by their clients or their client's organization, not through commissions by third parties as is the case with "franchise coaches". In this latter case the agenda is more likely sales driven and influenced by the "coach" not the prospective franchisee. Steve Hockett, President of FranChoice, one of the large franchise broking firm describes the role most accurately when he says, "We're like real estate agents. Our service is free to the

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J. SMALL BUS. MGMT., 26 ( April 1995); Francine Lafontaine & Kathryn Shaw, *Franchising Growth and Franchisor Entry and Exit in the U.S. Market: Myth and Reality*, 13 J. BUS. VENTURING 95 (1998); John Stanworth & David Purdy, *Franchise Versus Conventional Small Business Failure Rates In The US and UK: More Similarities Than Differences*, 16 Int'l. Small Bus. J. 56, (1998); Shane A. Scott , *Hybrid Organizational Arrangements And Their Implications For Firm Growth And Survival: A Study Of New Franchisors*, 39 Acad. Mgmt. J. 216 (1996).

<sup>58</sup> Matthew Shay, President, IFA, open letter to IFA members, May 2, 2005.

<sup>59</sup> LAURA WHITWORTH, HENRY KIMSEY-HOUSE & PHIL SANDAHL, CO-ACTIVE COACHING. (Davies Black1998).

candidate.”<sup>60</sup>

### **3. An Obsession With Franchise Sales**

Assuming that a franchise system is based on a proven business concept with sound training and support systems, we estimate that around 40% of a franchisee’s success will come through the application of their own hard work and talents. This is a significant amount and a franchisee who does not have the attributes for success, as defined further below, is likely to fail.

Unfortunately the rigorous screening of franchisees for these attributes is the exception rather than the rule. While this is a global problem, I believe it to be especially so in North America when compared to Australia or New Zealand.<sup>61</sup> For instance when we ask Australian franchisor executives the question, “How are sales going in your network?” they inevitably interpret this as a question about year on year sales by their franchisees. North American franchisors have been far more likely to interpret the question in terms of how many franchises they are selling.

The two interpretations of this question expose two potentially different franchising cultures – a franchise support culture and a franchise sales culture. This difference between the Australian and USA franchising cultures has not gone unnoticed by Australian and North American commentators on their visits to both continents.

Take the following quote from Joe Mathews of the Franchise Performance Group. “Aussies may drive on the wrong side of the road, experience Spring when they are supposed to experience Fall, but they have their sales emphasis right. They are completely keyed into their franchisees profitability and performance. Many American franchisors are on the wrong side of the road on this issue.”<sup>62</sup>

One of our Australian clients, a master franchisee of a North American franchise system, recently commented, “Because of our focus on support, my American franchisor thinks we are holding the wrong end of the pineapple!”

At the risk of over-generalizing, the North American emphasis on franchise sales rather than franchise support may partly explain its relatively higher rate of franchise litigation<sup>63</sup> and the growing incidence of adversarial franchisee associations.<sup>64</sup>

## **XII. IMPROVING FRANCHISEE RECRUITMENT PROCESSES**

### **A. Defining a Successful Franchisee**

A common myth in franchising is that high sales performance by a franchisee is equivalent to success. This is not true. While great sales performers may generate higher franchisor royalties, they may also run a poor business, damage the reputation of the brand and be miserable and angry in the role of a franchisee.

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<sup>60</sup> Gene Koprowski, *Successful Franchisees Embrace The System* STARTUP JOURNAL 2006, available at <http://www.startupjournal.com/franchising/franchising/20040308-koprowski.html>.

<sup>61</sup> Greg Nathan, *An Observation Of The USA Franchising Scene* at 10-11, THE FRANCHISE REVIEW, Issue 5, Winter 2005.

<sup>62</sup> Joe Mathews, Dec. 16th *Performance Newsletter* FRANCHISE PERFORMANCE GROUP, 2005, available at: [http://www.franchisecoach.net/www/docs/12.94/lessons\\_from\\_down\\_under.html](http://www.franchisecoach.net/www/docs/12.94/lessons_from_down_under.html).

<sup>63</sup> The Griffith University Franchising Australia study indicates that 39% of franchisors report involvement in a substantial dispute, defined as referred to an external advisor for action. This equates to less than 2% of franchisees. Uncorroborated estimates from USA sources indicate the USA franchisee disputation rate is around 6%.

<sup>64</sup> While hundreds of independent franchisee associations have sprung up across the USA in the past 10 years these are still the exception in Australia where consultative FACs are more common.

For instance, most franchisors will describe two types of problem franchisees:

1. Those who lack adequate motivation and initiative, and
2. those who have so much drive and creativity that they are always breaking out of the confines of the franchise system.

These latter types are always on the look for opportunities they can exploit and although they often build exceptionally high sales figures, they frequently end up in financial difficulty due to a lack of controls in other critical areas of their businesses.

An extreme example of this was a retail franchisee we interviewed who was achieving annual sales figures 15 times greater than the average figures for the franchise system to which he belonged. His franchisor was benefiting handsomely from the royalties on these sales and had awarded the franchisee the coveted 'Franchisee of the Year Award'. The high sales were however being achieved through a wholesale network, which was outside the recommended guidelines of the franchise system. This resulted in significant erosion of the franchisee's gross profit. The franchisee also spent much of his time out of the store looking for more wholesale customers and was therefore not effectively managing the customer interface. Furthermore as the business's financial position became increasingly under pressure he became embroiled in an ongoing battle for royalty reductions and started a campaign to discredit the competence of the franchisor management team. Indeed the franchisee confided in us that his goal was to have the CEO removed from power so he could take over the role himself. Not surprisingly the relationship went from bad to worse and the franchisee's business went into liquidation due to sustained losses.

The point is that great sales performers do not always make great franchisees. In our work we thus define a successful franchisee as someone who meets the following three criteria:

1. **Maximizes the profit potential of their business.** Part of this requires building strong sales, but sales must be priced intelligently to maintain satisfactory profit margins, and a franchisee also needs to control their business costs. Without a profitable business the franchisee will of course fail.
2. **Ensures all customers have a great experience every time in their dealings with the brand.** The long-term profitability of a franchisee's business and the goodwill of the franchise brand both depend on building a base of loyal, satisfied customers.
3. **Is comfortable adopting the role of franchisee.** This means the person will participate constructively in the franchise program, attend meetings and engage with other franchisees and the franchisor team. It also means they are prepared to give up some of their freedom to enjoy the benefits of being part of a group. As in the above example a franchisee who competes with their franchisor for the leadership role will quickly become distracted by political confrontations.

#### **B. Factors Known to Predict Franchisee Success**

With this definition in mind, the factors that predict franchisee success are shown below. While franchise concepts may distribute different products and services, they are all small businesses. Our research shows that franchisees that have been successful in one type of franchise will typically make a relatively easy transition to other types of franchises, providing they have an interest in the industry. Similarly the causes of franchisee failure tend to be remarkably similar across different franchise systems.

Below are some of the factors known to impact on the success of franchisees<sup>65</sup> and we

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<sup>65</sup> Andrew Hunter. The development of a questionnaire to measure personality constructs associated with franchisee

therefore recommend franchisors should be screening their franchisees for these attributes.

1. Having adequate reserves of working capital should the business be slower to grow than anticipated.
2. Having an interest in finance and business affairs.
3. Having the emotional support of friends and family.
4. Being able to work independently.
5. Being able to get things done efficiently.
6. Being well organized and proud of one's personal presentation.
7. Having physical and emotional resilience.
8. Being comfortable selling to people.
9. Being able to organize and motivate others to get things done.
10. Having a belief that one will be successful through ones own efforts.
11. Group orientation - Working effectively as part of a group.
12. Openness to learning - Being attracted to continuous improvement.
13. Being trustworthy in giving accurate information.
14. Having a realistic understanding of the franchise relationship and the obligations of both parties.

Screening for these attributes can be achieved through a combination of structured interviews, background checks, on the job trials and behavioral profiling. Though this does take training and resources, it is not overly difficult. The real challenge is in the commitment of franchisors to recruit better quality candidates and perhaps sacrifice some initial speed in their expansion plans.

### **C. The Impact of Franchisee Recruitment Practices on Performance**

We asked 84 franchisors to consider our definition of a successful franchisee and categorize their franchisees into one of the four groups below. These results are based on more than 4,000 franchisees:

**Low Achievers** = 13%. Franchisees who have a high likelihood of failing or who are so difficult to deal with that they perhaps should not have been granted a franchise in the first place.

**Inconsistent Performers** = 23%. Franchisees who run "hot and cold" and require significant time and support from the franchisor to keep going.

**Steady Performers** = 40%. Franchisees who run quite a good business but who still have plenty of room for improvement.

**High Achievers** = 24%. Franchisees they would love to clone!

These results indicate that 13% of the franchisees in this survey should probably never have been selected. Ironically, franchisors also report that the franchisees in the bottom third of their systems (Low Achievers and Inconsistent Performers) take up two thirds of their time and resources, with little return for their effort. People in these two groups also tend to have the worst relationships with their franchisor.

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success: an aid to franchisee selection. Masters dissertation, (St. Lucia, University of Queensland, 2004). See also Greg Nathan, *The Right Stuff*, AUSTRALIAN FRANCHISING MAGAZINE, SEPT./OCT. 2002.

The financial implications of this are quite compelling. A franchisee who fails will cost the franchisor between approximately \$25,000 and \$250,000, depending on the nature and size of the franchise. This takes into account diverted franchisor resources, damage to the brand and disruption to the network. This does not include the often devastating financial and emotional costs to the franchisee and his or her family. It also does not include legal defense fees should the franchisee try to sue the franchisor.

As mentioned at the beginning of this section, most disputes are connected to the recruitment process and the emotional and financial costs are significant. There is clearly a case for franchisors to improve their recruitment practices.

### **XIII. THE PSYCHOLOGY OF THE FRANCHISOR**

#### **A. What Franchisors Want and How They Can Help Their Franchisees Deliver**

Just as franchisees need and expect certain things from their franchisor, franchisors expect and need certain things from their franchisees. Franchisees who fail to deliver in any of the five areas outlined below are likely to test the patience of their franchisor.

Franchisors can prevent strains in the franchise relationship by clearly communicating their expectations in these five areas, especially the reasons why franchisees need to do certain things. It is not uncommon for a franchisor to assume that franchisees will support their strategies when they have not provided adequate information or a sound rationale for franchisees to invest their time and resources into these areas. Again the importance of consultation and good communication cannot be underemphasized. Franchisors can also provide relevant training, tools and guidance to assist franchisees with their performance in these areas.

##### **1. Maximize Market Share**

Franchisors expect their franchisees to actively promote and expand their business or businesses in their local markets. This means franchisees need to do the following:

- Setting goals and staying focused on the day to running of the business. Franchisees can plateau in terms of their commitment to a business and the effort they are prepared to put into developing it further. Franchisors need to make it clear that continual development in sales is expected and provide franchisees with the tools to measure and grow their local market share.
- Investing in training and motivating their staff. Again while franchisees may need to invest time, energy and resources in staff training and development, the franchisor should facilitate access to good quality programs that are relevant to the franchisee's business.
- Actively promoting the business through local area marketing. The franchise system should have an up to date local area marketing kit and provide franchisees with the training and support in how to use it effectively.

##### **2. Show Loyalty and Support for Strategies**

Franchisors expect their franchisees to be loyal "franchise citizens", supporting its business strategies and the values of the brand. This means franchisees should do the following:

- Try new initiatives, providing of courses these have been piloted and are commercially sound. Franchisors should not expect franchisees to invest in half-baked ideas.

- Speak positively about the company to others, for instance people who are enquiring about buying a franchise, or potential customers or suppliers. This assumes the franchisee does not have good reasons to not speak well of the franchise system.
- Be prepared to take some short-term pain for long term gains, especially with regard to supporting products or services which may not be in high demand in the franchisee's own territory, but should be offered to customers in the interests of brand consistency.
- Make an effort to understand the rationale behind company strategies. Franchisees may complain they have not been consulted but then fail to read relevant materials or attend meetings where new initiatives are being discussed.

### **3. Comply with Policies and Systems**

Because franchising depends on consistency, franchisors expect their franchisees to maintain high standards in the presentation of their business and delivery of products and services. Franchisors can again do their part here by explaining the rationale behind compliance requirements.

One approach to getting franchisees to appreciate the value of compliance is to get them involved in a concept we call "brand alignment". This recognizes that a brand is more than a logo and includes all the elements and devices that trigger customers to think about a company – for instance specific colors, typefaces, slogans, uniforms, music, smells and even behaviors. Brand alignment means all these elements "line up" or fit together and are applied consistently both within and between franchise units. It is this consistency in application that builds the power, credibility and value of a brand.

Educating franchisees in the concept of brand alignment is an effective approach to encourage compliance because building a strong brand is something that franchisors and franchisees both aspire toward. Without a philosophy of brand alignment, the compliance process can be reduced to one where franchisees feel they are being punished for transgressions.

### **4. Share Accurate Financial Information**

Franchisors expect their franchisees to stay in control of their financial position, pay their franchise fees and suppliers on time and share accurate information on agreed Key Performance Indicators.

The extent to which the franchisor company involves itself with the financial performance of its franchisees differs between franchise systems. Some franchisors believe that too much information may make them liable for franchisee under-performance while others ensure they know as much as possible, as they believe that a franchisee in financial difficulty is bad for the brand and the system. This is an area where the culture and leadership philosophies of franchise systems vary greatly.

### **5. Participate Constructively**

Franchisors need their franchisees to work productively with their management team and other franchisees. This means participating constructively in meetings, engaging with support staff during field visits and sharing ideas and information with other franchisees.

Franchisor management can help here by setting an example with their own interpersonal skills, ensuring meetings are well run with agreed ground rules, and having internal conflict resolution systems should franchisees have significant differences of opinion which they have not been able to resolve informally.

## **B. The Impact of Corporate Evolution on the Franchise Relationship**

The next section will examine the stages that franchisor companies move through as they grow, and the impact of these transitions on the franchise relationship.

### **1. From Family Business to Corporation**

Franchisor companies often start as small enterprises with a founder and multi-skilled management team. If the concept is sound and franchisee profitability is satisfactory the network will grow, often rapidly. Along with this growth comes recognition by the business community and customers. The franchisor team naturally becomes proud of its success and a sense of invulnerability may develop. At this point in time the franchisor and franchisees are usually quite happy with the family culture that has developed. Most of the franchisees are also in the Glee Stage of the Franchise E-Factor.

However the initial entrepreneurial franchisor team will soon be stretched beyond its level of competence. Professional management and appropriate corporate structures will need introducing. This transition from a 'family' to a 'corporate' culture poses considerable change management problems and represents a significant threat to the company's survival for the following reasons:

**Sacred cows.** Rituals, sacred cows and habits of 'how we do things around here' may prevent new ideas from being adopted.

**Management stress.** Because changes usually have to be implemented on the run, leaders have to maintain stability and consistency on the one hand, while introducing new people and new ways of doing things on the other. This can be very stressful.

**Franchisee confusion.** Franchisees will inevitably be observing management changes from the sidelines. They may complain that they are confused about who is doing what and that they don't know who to talk to any more. There can be a fear that their friendly franchisor is turning into an impersonal corporation. As the level of franchisee anxiety increases, the quality of communication typically decreases creating a breeding ground for rumors, mistrust and even disputation.

**Internal politics.** Internal politics may also increase for a time as people find they are required to let go of old ways and give up their established power base. For instance long standing franchisees who once yielded considerable influence over their franchisor may now feel left out. If there are power struggles at senior management or board levels this can leave the organization particularly vulnerable.

**Leadership focus.** The founder often needs to hand over the day-to-day running of the business to an externally recruited CEO. This is seldom a smooth process. As the changeover occurs, the organization may lose focus, allowing competitors to gain a greater foothold.

**Loss of operational expertise.** As the company establishes its new corporate focus, strategic excellence can be elevated above operational excellence. The operational memory of the company may have become lost, usually because key people have moved on.

**Alienation.** New people will bring with them their own values and approaches. Company traditions may subsequently be swept aside or lost. The biggest challenge for the franchisor as it moves into this corporate phase is to retain the best things from its previous culture.

### **2. From Corporation to Bureaucracy**

As a franchisor company evolves into a corporation, the drive for learning, continuous improvement and effectiveness can be replaced by a tendency to predictability, orderliness and efficiency. For instance the company may have been sold by the founder and now be professionally managed on behalf of a private investment group. Executives may come and go and the culture can

become process driven and bureaucratic.

Large well-established franchise systems of this type can continue to prosper for years, especially if they are leaders in their market sector. However they will gradually become disengaged from the franchisees and the markets they serve. Poor strategic decisions and a lack of responsiveness to changing customer trends, competitive pressures and franchisee needs can result in disappointing financial performance of both franchisees and franchisor.

In such cases poor communication and strained relationships between the franchisor team and franchisees will be common. Franchise executives may deliberately leave their phones on voice mail so they do not have to take calls from assertive franchisees. Separate organizational cultures can even develop. Franchisees might cling on to the old customer focused family values of the organization they originally joined, while the franchisor prides itself on its professional culture and its organized and efficient systems. In such cases the language used by franchisees and head office personnel to describe each other can also become disrespectful and derogatory.

This will be a particularly frustrating time for franchisees. Franchisee associations are often created to bring commercial pressures onto a franchisor that has become so obsessed with its own return on investment goals it has forgotten where it makes its money.

If changes are not made to reinvigorate the business and unite the culture a major dispute will occur and the franchisor will find itself in financial difficulty or facing a forced sale.

### **C. Tips For Managing Corporate Transitions**

- Franchisors should review their values, strategy, structures and business processes every year, especially during periods of change.
- Quick and ruthless changes may be needed if the franchisor or franchise system is found to be out of step with the needs of franchisees or the market.
- Keep franchisees informed during periods of internal restructuring. Franchisee committees can serve a useful purpose here.
- Do not allow key people to leave the organization until their operational knowledge has been recorded, systematized or passed onto a suitable person.
- Hold regular briefing sessions and forums with franchisees to share information on changes and the potential implications for the business.
- Plan for some chaos and emotional turmoil during periods of change.

### **D. Franchisor Cultural Types and their Impact on the Franchise Relationship**

As previously mentioned the biggest influence over the culture of a company comes from the CEO. In his forthcoming book, *Street Smart Franchising*, Joe Mathews, describes five types of franchise cultures.<sup>66</sup> A summary of these is provided below. While these might be extreme examples, and no one company is likely to display all these elements, the insights are instructional, particularly for prospective advisers, franchisor employees and franchisees.

#### **1. Anarchy**

The CEO and leadership team are disorganized, do not enforce quality standards and have little credibility with franchisees. Because of their lack of discipline and systems they will have lost control of their brand and franchisees will probably be doing what they please. While there may not be a lot of conflict in this group, the franchisor and franchisee will perform poorly and will probably

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<sup>66</sup> Joe Mathews, et al. *STREET SMART FRANCHISING*. (Entrepreneur Press 2006).

fail or be bought by more skilled and better-organized competition.

## **2. Management by Committee**

The franchisor team is operating outside its level of competence, lacks a long term vision, and makes short-term compromises to try to please franchisees. Leadership will not make tough decisions for fear of making franchisees hostile. Because the franchise system has not been properly piloted or the franchisor is out of touch with the market, franchisees are left to fix or design the systems themselves. The franchisor has low levels of credibility and gives in to the demands of the more aggressive and vocal franchisees who tend to drive initiatives to suit their own interests. This type of franchising culture will not have a strong brand because of the inconsistencies of franchisees who are likely disengaged and happy to just do their own thing. If the franchisor tries to implement new initiatives, franchisees are likely to be divided or apathetic.

## **3. Benevolent Dictatorship**

The company is still headed by the founder, a charming, authoritarian and capable leader who has a clear and exciting vision and usually gets his or her own way. Because trust is valued over competence, the franchisor team often consists of family or loyal operations people who may have been promoted beyond their competence. Capable professional managers do not tend to survive, as the leader, while well meaning, dislikes being challenged. These companies have a high level of passion for the brand. Because the leader wants to grow, but can't let go, the company's development can be stunted. The Benevolent Dictatorship is the most common of all franchising cultures. In most cases the founder eventually realizes he or she needs to bring in strong and experienced senior leadership. However it may take two or even three attempts to find a suitable person who can work with the founder. In some cases the company will be sold. While franchisees will generally be happy because the group is performing well, they will probably say they would like to have more consultation and input into decision-making.

## **4. Dictatorship (Minus the "Benevolent" Part)**

These companies are headed by domineering, ego-driven leaders. While they project themselves as visionary leaders and may initially seem charming, they are primarily motivated by a fear of losing control and under pressure they will show their true colors. They consciously use intimidation tactics to bully and control employees and franchisees, and tend to be hypercritical, breaching franchisees for the most minor infractions. They surround themselves with fearful people who give an impression of being competent. Dictatorships lack integrity and the leaders will get away with whatever they can. Companies with this type of culture are continually fighting off threats of litigation and usually take an approach along the lines of "attack is the best form of defense". Franchisees are likely to feel angry or depressed. These are the organizations that often appear in the media stories that give franchising a bad name.

## **5. Empowered Leadership**

Franchisees and the franchisor team are clear on their roles and responsibilities and have the authority and resources to achieve their goals. When there are problems they work together to identify a solution, taking into consideration everyone's needs. There will be a cohesive top leadership team guided by a clear mission and an articulated set of corporate values. Leaders do not feel the need to always be right and where appropriate they solicit franchisee feedback. While franchisees may not agree with everything the franchisor is doing, they believe the franchisor is acting in their combined best interests. This type of franchising culture has the most satisfied franchisees and generally performs the best. Unfortunately it is not as common as it should be.

#### **XIV. THE ROLE OF FRANCHISEE ASSOCIATIONS AND CONSULTATIVE GROUPS**

##### **A. The Impact of Franchise Advisory Councils (FACs) on Franchise Relationships**

FACs are generally accepted by franchisors and franchisees as a desirable initiative to promote consultation and improved communication.<sup>67</sup>

###### **1. Best and Worst Practice**

Because FACs come in so many shapes and sizes, we see them more as a process than a structure. More specifically we define an FAC as follows:

*A planned meeting process involving franchisees and franchisor executives to improve the operations of the franchise system.*

Taking this definition a step further we would define best practice as:

*A well organized and competently chaired meeting involving equal participation of franchisee and franchisor representatives where issues of importance to the entire group are discussed with the aim of improving the competitiveness, productivity and profitability of franchisees and franchisor.<sup>68</sup>*

Agenda items for such meetings focus on innovation, business development, strategy, profitability, customer growth, communication, product development and systems.

On the other hand, worst practice could be defined as:

*A “gripe” session where franchisees meet privately to create a list of grievances, and then call in a small team of franchisor executives who are systematically attacked and criticized, after which the franchisees leave on a high, but the relationship has been further damaged and nothing productive achieved.*

Or another version of worst practice is:

*A group of compliant franchisees nominated by the franchisor to give the impression of consultation but who really just rubber-stamp the franchisor’s decisions.*

There are still many FACs that operate using one of the worst practice models, and not surprisingly, they are soon ignored or treated with disdain by the franchisor or franchisees, as the case may be.

###### **2. Predictors of Successful FACs**

While FACs vary in their formality and structure, our research indicates that the level of formality is not a measure of success and can indeed stifle relevant and meaningful discussion. The drivers of success would appear to be fourfold:

1. A competent chairperson who keeps discussions focused on relevant issues, and is able to encourage an open but constructive dialogue between people. Whether the chairperson is a franchisor manager or a franchisee is irrelevant to the meeting’s effectiveness, although for political reasons this may appear important.
2. Senior franchisor involvement with a genuine preparedness to listen and take action on legitimate issues discussed.

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<sup>67</sup> Nathan, G., *What Makes Franchise Advisory Councils Work*, Australian Franchising Magazine, JAN./FEB. 2002.

<sup>68</sup> Nathan, G., *Creating Effective Franchise Advisory Councils*. (Franchise Relationships Institute, 2006).

3. Franchisee involvement by mature, commercially minded people who respect the rights and responsibilities of the franchisor and are motivated to enhance the value of the brand.
4. Topics discussed being of interest to both parties with the goal of finding mutual benefits for all.

Not surprisingly, the reasons why FACs fail to gain traction in a franchise system or the support of franchisors and franchisees are the reverse:

1. Poorly chaired meetings that are allowed to degenerate into negative or distracted meanderings or where hidden agendas are allowed to fester.
2. Franchisors railroading or over-controlling meetings with their own agendas, or giving lip service to listening, but in reality being disengaged from the process.
3. Franchisees that are driven by personal or political agendas or a personal vendetta against their franchisor.
4. Topics discussed being of interest to only one party with an attitude of the winner takes all.

### **3. Limitations of FACs**

Despite the many potential benefits to franchisors and franchisees of a well run FAC there are costs and pitfalls involved, especially if the FAC fails to perform. Some of the pitfalls and drawbacks to franchisors and franchisees include the following.

- A slowing down of decision making while discussions and consultation occurs. This can be frustrating for all parties.
- Franchisees may feel disappointed or disillusioned by an apparent lack of tangible “wins” through the FAC. While improvements in communication, trust and commitment are worthwhile in themselves, it is difficult to articulate how these will result in more sales or less costs, the focus of most franchisees.
- Franchisors may feel despondent or disillusioned when hot topics are raised which involve them being criticized for their lack of performance. Franchisees have little tolerance for franchisor behavior which is seen as incompetent, unethical or self serving.
- The parties might come to a stalemate over rights or how much power the FAC has to make or influence decisions. For instance, one study highlighted different perceptions of franchisees and franchisors over the power and influence of the FAC. Franchisors tend to see FACs as advisory bodies with a focus on operational issues, while franchisee tend to see them as also having the power to make decisions on policy and strategy.<sup>69</sup> Such differences in perception are a recipe for conflict.
- The process can become overly political rather than commercial in focus with FAC members feeling that their prime responsibility is to represent the interests of their constituents rather than to influence sound commercial decision-making.
- Where FAC members are elected by franchisees, the franchisor may not work well with these people.
- Communication channels to the network can become confused, especially if

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<sup>69</sup> Colin McCosker, Lorelle Frazer & Di Pensiero (1995), *An Exploration of Franchise Advisory Councils: Expectations of Relationships*, Proceedings of Society of Franchising Conference, Honolulu.

franchisees feel it is their role to communicate with their peers. Often their messages will be inconsistent with the franchisor's messages.

#### **4. Areas of Confusion**

Our observations are that there is also a level of confusion over the following issues of process and purpose, which can lead franchisees who are not on the FAC to become suspicious of its intent and value.

**Roles.** Is it a *Franchisee* Advisory Council where franchisees have their say to the franchisor or is it a *Franchise* Advisory Council where both franchisors and franchisees discuss issues as equal participants?

**Communication.** Who is responsible for communicating with the franchisees that are not on the FAC? Are franchisees supposed to communicate with and represent the views of other franchisees or are they there to put their own views forward with the franchisor looking after communication with the wider franchisee group?

**Power.** Is it to advise on or create policy or strategy?

**Agenda.** What should be on and off the agenda? Is it okay to talk about changes to the contract? Is it okay to talk about individual franchisee grievances?

**Separate meetings.** Is it a good or a bad thing for franchisees to meet separately from the franchisor and if so, how this should take place?

Franchisors and franchisees should not only to address these questions during the establishment of an FAC but also review them annually. The FAC should be a dynamic body that adjusts to the evolving needs of the network. We have found there is no one right way to run these processes. Innovation should be encouraged.

#### **C. Why Independent Franchisee Associations Form**

In the USA, FACs appear to have developed a reputation as being toothless tigers that exist at the behest and pleasure of the franchisor.<sup>70</sup> This perception has led to the rise of independent associations, a phenomenon that is nowhere near as prevalent in Australia, at least to date.

Generally speaking the difference between an FAC and a franchisee association is that the former is established or at least fully endorsed by the franchisor, while the latter is usually organized without any franchisor involvement.

While FACs are focused more on the question, "How can we run a better business?" Associations tend to focus more on the question, "How can we protect our interests from the franchisor?"

Associations usually form because of prolonged frustration that a franchisor has not been listening or is unwilling to address specific franchisee concerns. Usually this involves some sort of perceived threat to the interests of franchisees which comes about by a franchisor that is seen as incompetent, unreasonable or self-serving in its intentions and actions.

Some specific examples of common franchisee concerns which if not addressed, can lead to the establishment of a franchisee association, are provided in Appendix A.

Independent Associations can be instigated due to inside or outside agitation or political forces. Some common examples include the following:

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<sup>70</sup> Rupert M. Spandorf and Rochelle B. Barkoff, *Close Encounters: Franchisee Association and Councils*. ABA Forum on Franchising, Program Materials at Tab LB 9 (2003).

- Franchisees may have a personal grievance against the franchisor and thus want to “bring down” the system. This can result from broken promises, loss of face, business failure or being jealous of the franchisor’s position and power. Feelings of betrayal can be especially powerful in motivating individuals to lead an action against a franchisor.
- Lawyers wanting to generate work for their firm can initiate unrest in a reasonably stable franchise system by extending their work with one discontented franchisee to others in the group. For instance by creating a class action that is supported by an outside Association.
- An outside franchisee association may want to attract members and use fear tactics through the media or directly with franchisees to create a perceived need for their services as a form of protection, not unlike how trade unions market themselves as the protectors of worker rights.

### 1. **Are They Good Or Bad For The Franchise Relationship?**

In most cases, the formation of an independent association creates initial conflict both within the franchisee group and between franchisor and franchisees. This is because they are usually created through what the franchisor sees as secret meetings, which undermines trust and communication. Also many franchisees are not comfortable with the idea of forming or belonging to an independent association as they see it as being counter to the partnership philosophy of franchising and more like a union. This can create rifts within the franchisee group.

Independent Associations are in themselves not a bad thing for a franchise system. However if they create or promote an adversarial approach to the franchise relationship they can prove a distraction to the business of serving customers and building the brand.

If an adversarial Association starts to form the franchisor probably needs to ask itself whether it is in some way complicit in the situation through its culture or its own actions or inactions.

### 2. **Transparency**

One way a franchisor can insure itself against a breakdown in the relationship, especially during times of change, is to develop a philosophy of transparency in its business dealings with franchisees.

For instance when discussing issues to do with individuals or groups of franchisees, franchisors might ask themselves, would we be prepared to broadcast this conversation to our franchisees?

Also when significant decisions are made, it is useful to put them through a filter that considers the interests of other groups over and above short-term franchisor profitability. For instance,

1. Is this decision contrary to the interests of our franchisees?
2. Is this decision contrary to the interests of our customers?
3. Will this decision damage our relationships with our franchisees?
4. Will this decision damage our brand?

Indications are that franchisors are going to have to become more transparent in how they manage their systems and to put far more effort into listening and responding to the needs of their franchisees. The evidence suggests that franchisors that do this will gain a competitive advantage through the more effective sharing of knowledge and resources and the creation of motivated and committed franchisees.

The question is whether franchisors will act first to make this happen or whether they will be dragged kicking and screaming by an angry and hostile franchisee Association.

## **XV. CONCLUSION**

This paper has drawn on research into franchisee satisfaction to better understand the factors that contribute to healthy franchise relationships. It has also sought to highlight the commercial implications of constructive relationships and the impact that the interpersonal skills of top leadership, particularly the ability to listen non-defensively, can have on a company's relationships with its franchisees.

It has been demonstrated that in addition to their financial hopes, franchisees are largely driven by emotional factors, such as a need for respect and belonging, and that many franchise disputes are exacerbated if not caused by franchisor ignorance of these factors. It has thus been argued that the franchise sector would benefit from broadening its conception of the franchise relationship to encompass psychological as well as legal and commercial factors.

The paper has also described what franchisees want from their franchisor and what franchisors can do to help their franchisees become better franchise citizens. It has shown how franchisees move through stages in their relationship with their franchisor and how there will be periods when franchisees are more likely to feel dissatisfied and vulnerable to being drawn in a dispute.

The area of franchisee recruitment, particularly an obsession with selling franchises without due regard for the suitability or ongoing support of candidates, has been identified as a weakness that is contributing to failure rates and litigation.

The stages that franchisor companies move through has also been discussed as have several different leadership styles and their implications to managing the franchise relationship.

While greater consultation has been identified as a desirable strategy for franchisors to adopt, there is still much to learn about setting up appropriate structures, systems and cultures that can balance the need for strong leadership with the benefits of listening to and harnessing the experience and creativity of franchisees. This will require franchisors to try new approaches, embrace a philosophy of responsible franchise citizenship and commit to a long term "profitable partnership" with their franchisees.

## **APPENDIX A – WHY INDEPENDENT ASSOCIATIONS FORM**

Some specific examples of common franchisee concerns, which can lead to the establishment of a franchisee association, are provided below. Where a company is operating in a relatively stable business environment and most franchisees are profitable, each of these may be relatively innocuous. However if a few of these concerns come together they can have cumulative impact on franchisee anxiety levels and result in a mild or more serious “revolution”.

- Concerns over failed product or marketing initiatives or a lack of clear marketing strategy and direction.
- Concerns over franchisors not sharing the benefits of purchasing programs with franchisees, especially if the franchisor is seen as benefiting from rebates from suppliers at the expense of franchisees. This can particularly be an issue if rebates are not transparent.
- Concerns over franchisors over-saturating markets and thus encroaching on the businesses of existing franchisees.
- Concerns over franchisor competence to run a growing company or provide adequate support to existing franchisees while this expansion is occurring.
- Concerns over franchise renewals particularly if franchise renewal fees are seen as excessive or unfair.
- Concerns over inappropriate franchisor use of discretionary funds such as marketing funds.
- Declining sales or margins which are not acknowledged or addressed by the franchisor.
- A change of franchisor ownership including mergers or acquisitions with or by competitors, which obviously creates concerns over territories or brands.
- Changes to the brand, leadership and culture of the company that undermine franchisee sense of identity.
- Concerns over the financial viability of the franchisor, for instance a franchisor that has gone into administration or receivership.
- The franchisor company going public, with fears of a subsequent drive for profit at the expense of franchisee profitability.
- Unilateral changes to franchisee contracts which are seen as unfairly disadvantaging franchisees.
- Unilateral changes to the franchise system or business, especially if these do not seem to have any clear benefit to franchisees.
- Franchisor leadership behaving indifferently or arrogantly to franchisees, or treating them as though they are employees.
- Franchisors deciding to convert from franchising back to company owned operations, leaving the future of existing franchisees in limbo.