FRANCHISEE/FRANCHISOR RELATIONS: 
A STUDY OF CHANNEL CONTRIBUTIONS

R. D. Nordstrom, Western Illinois University
Dave Schnicker (student), Western Illinois University
Henry Metzner, University of Missouri at Rolla

Abstract

Several authors discuss factors affecting Franchisee/ Franchisor relationships. This work evaluated the Franchisee's view of various factors in terms of importance of Franchisor's contribution to short-run profitability and contribution to operating practices.

Introduction

The franchising system was introduced in the American economy by the automobile and petroleum industries about 1900. Producing firms in these two industries contracted with independent businessmen to sell their output. In return the independent businessmen agreed to sell one brand exclusively.

Franchising began to flourish after World War II. Small investors saw it as an opportunity to become self-employed and do so with expert guidance. Food and ice cream stands were the primary businesses. Today, hundreds of companies market many products and services through franchised outlets. (8, p. 2)

Essentially, franchising is a plan of distribution under which an individually owned business is operated as though it were a part of a large chain. Services or products are standardized. Uniform trade marks, symbols, design, and equipment are used. A supplier (the franchiser) gives the individual dealer (the franchisee) the right to sell, distribute, or market the franchiser's product or services. Use of the franchiser's name, reputation, and selling techniques also accrue to the franchisee. The franchise agreement (or contract) usually gives the franchisee an exclusive right to sell, or otherwise represent, the franchiser in a specified area. In return for this exclusive right the franchisee agrees to pay either a sum of money (a franchise fee), a percentage of gross sales, or to buy equipment or supplies from the franchiser—or some combination of these considerations. (6, p. 43)

From the franchisee's point of view, the negotiation of a franchise contract represents a compromise between complete autonomy in return for a reduction in his risk of failure. The individual franchisee gives up certain elements of operational independence in return for specified forms of security, assistance, and information from the franchiser. A franchisee's gains may be very valuable contributions toward his success. However, sometimes benefits from being franchised are not readily apparent to the franchisee.

Franchising creates distinct opportunities for the prospective small business owner. Without franchising it is doubtful that thousands of small business investors would have ever embarked on an entrepreneurial venture.

Purpose of the Study

A necessary feature of any franchise is a continuing relationship between the franchisor and the franchisee. One basis for a good continuing relationship is a willingness of the parent company to do anything and everything to help make the franchisee a profitable operator. There exists a moral as well as a legal commitment to help franchisees. Franchisors provide various amounts of training, competent promotion, merchandising, suggestions, information releases, advertising ideas, record keeping systems, product-testing information, and troubleshooting assistance in many areas. Good solid relationships include a similar commitment on the part of the franchisee to accept continuing assistance in good faith. (3, p. 25.) In the broadest context, the continuing relationship refers to all the exchanges both economic and non-economic which take place between the franchisor and the franchisee. Although the franchisor is in business for himself, he does not function by himself. Franchisors and franchisees must develop mutual respect for respective business roles. Complete understanding of needed divisions of work permits the system to exploit strengths on either side of the union.

In this study only one-half of the union was examined: the extent to which the franchisee feels his franchiser carried out and developed a solid and continuing relationship. The purpose of this study was twofold: 1) to gather information on franchisee/franchisor relations with respect to operating practices, and 2) to identify and evaluate those factors which are deemed influential to short-run profitability by franchisees.

Background

Generally speaking, the principal advantage of franchising is that it enables an individual, as an investor, to obtain information quickly rather than via experience that might take a long time or via the hard way—through trial and error. The franchise granting or parent company uses its information and experience to help with business locations, management, advertising, publicity, product research and development, and so on to enable its franchisees to start and operate their outlets with optimum efficiency, maximum profitability, and minimum friction. (8, p. 2.)

Managerial and operating efficiency gained through a franchised system of distribution, however, is frequently contingent upon two assumptions. First, independent operators will be motivated to perform essential tasks more thoroughly and efficiently than will a manager for an absentee owner. Secondly, while individual franchisees have much to do with the ultimate success of a franchisor's total business, a franchisor's control, supervision, and guidance mechanisms are designed to stimulate individual franchisees, a standard of conduct which will be beneficial to the entire operation, and not just one segment of the franchise system. Thus, collective action of parties in a total franchised system ultimately determines success.

These assumptions stimulate several questions regarding
the theoretical basis of a sound franchise system. Does the franchisee feel all controls and recommendations set forth by the franchisor are beneficial to him? To what extent will the franchisee cooperate with the franchisor to promote a good working relationship which is essential to a smooth running organization? Since the profit motive acts as a force to stimulate the franchisee into effective action, how does the franchisee perceive monetary success through cooperation with his parent partner? What is the effect of franchisee maturity on the operational practices of the franchise system?

Scope of the Study

Problems under examination in this paper may vary in intensity from one franchising company to another. It was decided that an in-depth study of one franchising organization was preferable to a more superficial study of several systems. Thus, this study concentrated on franchisees in the system of Karmelkorn Shoppes, Inc.

Significance of the Study

Because this study pertained to the operations of only one franchising organization, it would be quite difficult to assume results of this survey apply to all franchising concerns, especially those with dissimilar product lines. However, there are a great many franchising organizations which employ similar strategies and tactics to create an environment of mutual dependency. If the franchisee does not develop an active recognition of both constraints and freedoms elicited by the franchising union, the franchise system may not function effectively and/or efficiently. Thus, while specific applications were somewhat limited, the findings developed considerable insight into factors affecting the continuous working relationship needed for a good franchising system.

Hypothesis

The hypothesis tested in this study was as follows:
the longer the franchisee is in business the more rigorously he will conform to the operational framework developed by the franchisor

Rationale

As they start, most franchisees make only a limited down payment of their franchised business. As the franchisee continues to make capital payments up to the point of a final pay-off, he has more to lose in terms of his total investment—that is, down payment plus payments—and likewise, he has more to gain in available take-home pay after he has completed payment. The longer the franchisee is in business the better he could understand the benefits of cooperation with the franchisor, that is, if in fact these benefits do exist. Thus, the conclusion is essentially that cooperation should be more in evidence with franchisees who have been in business the longest and therefore have realized benefits derived from cooperation.

Karmelkorn Shoppes

Karmelkorn Shoppes, Inc., a nationwide franchising organization, cooperated in compiling a mailing list of subjects for this paper. Karmelkorn Shoppes offer products such as popcorn, and other high-profit related products. Karmelkorn originated in Casper, Wyoming, in 1929. Today, Karmelkorn Shoppes, Inc., is a subsidiary of Franchise Growth Corporation in Rock Island, Illinois.

Franchisor Services

The parent company sets reasonable standards of quality, store appearance and prominence for trademark identification. Much effort is expended in attempting to convince all franchisees that the parent company's standards are best for overall maintenance of the operations. The company maintains an inventory of certain materials and supplies for sale to the franchisee. Franchisees may, at their option, purchase any of their supplies from sources other than the company, provided that such supplies meet quality standards. The franchiser also suggests pricing to conform to a standard profit margin. However, franchisees are free to establish their own prices. Other services are provided as follows:

a. Exercise its best efforts to find and/or review a proposed site for the shoppe.
b. Assist in lease negotiations.
c. Furnish plans and design for the Shoppe premises and for the equipment layout.
d. Cause such construction for the Shoppe premises to be done as may be necessary in accordance with plans and designs.
e. Assist franchisee in obtaining his original financing.
f. Furnish pre-opening training for Franchisee or such person designated by him. Such training shall be at a training shoppe designated by the Company for a period of a minimum of one week; however, the Company will provide a training supervisor at the Shoppe for one week at the Company's expense.
g. Provide a training supervisor for at least two days at the time of the opening of the Shoppe.
h. Furnish operating manual and recommend accounting procedures.
i. Aid in obtaining sources of supply.
j. Provide assistance in pre-opening promotion and advertising at the Company's expense.
k. Aid in establishing contacts for equipment service.
l. Furnish promotional material.
m. Serve as a source for equipment and supplies.
n. Suggest hours for operation.

In return for these services a franchisee pays a fee of $7500 plus 5% of gross sales. Normally, the franchisee will have an investment of $45,000 - $75,000 depending on variables such as area of country, size of mall, construction costs, etc.

Methodology

There are about 200+ Karmelkorn Shoppes. From the actual number of shoppes located in 34 states, shoppes less than one year old were excluded. Multiple ownership further reduced the total since this would have resulted in a bias in the study.

Pretest of the questionnaire included a review by executives at Karmelkorn's main office. The first part of the questionnaire, questions one through eight, were designed to secure information on franchisee operation, finances, and personal background data on the franchisee. They were also designed to secure supplementary information for the second part of the questionnaire on factors influential to the franchisee's business success.