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Entrepreneurial Opportunities and Performance in Franchising Firms

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1.0 INTRODUCTION

> For a field of social science to have usefulness, it must have a conceptual framework that explains and predicts a set of empirical phenomena not explained or predicted by conceptual frameworks already in existence in other fields (Shane 2000).

This study explored entrepreneurial opportunities within franchising. On the surface, franchising appears to create a system whose underpinnings are standardization, replication, and compliance with detailed long-term contracts--a seemingly unpromising environment in which to explore entrepreneurial opportunities. I argue that heterogeneity and organizational complexity exist among franchising firms, attributes overlooked in studies that characterized the phenomenon narrowly as a uniform, dyadic relationship between franchisors and franchisees.

This study found that contractual provisions, franchisee obligations, and organizational hierarchies varied among franchises, and that a relationship existed between the presence of these attributes and differential performance among franchising firms. As a contractual relationship between distinct entities, franchising is governed by a variety of disclosure, trade, and intellectual property laws. Its contractual provisions and formal disclosure documents define a formal context in which franchising is conducted. In addition to franchising's formal context, an operational realm also exists, one in which daily operations of franchised businesses take place. This study revealed that franchising's operational realm is not always contained within the defined limits of its formal agreements, suggesting greater franchisee discretion may exist than revealed in the agreement. As a result of organizational discontinuities in franchising's formal context, and franchisee discretion within its operational context, diverse opportunities for entrepreneurship exist within franchising beyond the birth of a franchisor's firm.

Some researchers have called for additional theoretical development in franchising, using more supple approaches that link strategies and performance. Consistent with that approach, this study pursued four primary objectives:

1. To explore franchising's formal context, examining the nature and extent of homogeneity in its disclosure and contractual provisions.
2. To examine relationships between firm characteristics, contractual provisions, growth, and strategies among firms engaged in franchising.
3. To test the ability of characteristics and contractual provisions found in franchising's formal context to predict measures of differential performance.
4. To examine relationships between franchising's formal context and its operational realm, exploring the role of disclosure and contractual agreements in franchise selection processes and daily operations of franchised businesses.

This study builds on previous research in franchising, revealing that entrepreneurial opportunities exist within franchise systems beyond the inception of a franchisor's original concept. It finds that organizational networks are formed within some franchise firms, and that they are positively associated with the growth of those firms. Support was also found for a view of franchising as a permanent organization form, not merely a temporary expansion strategy. Further, this work revealed distinctions between franchising's formal context and its operational realm.

Initially focused on franchising's formal context, this study examined relationships among firm attributes, contractual provisions, and firm performance using three measures of growth. Analysis revealed that some contractual provisions and firm attributes increased the probability of opportunity exploitation and growth through creation of new hierarchies and franchise networks within franchising firms. The ability of contractual provisions and firm attributes, typically associated with franchising's formal context, to explain comparative performance among franchising firms was then tested, using three measures of growth. Next, franchising's operational realm was examined through in-person, semi-structured interviews with present and former franchise owners, as well as representatives of a franchisor. In this portion of the study, the role of official disclosure documents and franchise agreements in both franchise selection processes and daily operations of franchised businesses were examined, in order to better understand differences between franchising's formal and informal contexts.

This chapter begins with a background to this research, including sections that introduce contributions from entrepreneurship, corporate entrepreneurship, and franchising research that helped to shape this study. Next, research justification is presented, including franchising's economic impact, discussion of the research gap, relative neglect of the methodology, and usefulness of this study. Methodologies used in this study are presented next, followed by a brief summary and outline of this thesis.

1.1 Background to the Research

This section provides background to this work, highlighting research that helped to shape this study. It begins with an introduction, and then presents a selected group of studies in entrepreneurship, corporate entrepreneurship, and franchising that have particular relevance to this study. A more comprehensive review of theoretical and empirical literature is provided in a review of selected literature in the next chapter.

1.1.1 Background to the Research- Introduction

Firm performance and its social and economic impacts have justified longstanding interest by practitioners and academics (Birch 1987); (Schumpeter 1934); (Storey

1987). Firm performance has been called "the ultimate dependent variable" (Covin and Slevin 1991, p. 9), and its relationship with entrepreneurial activity remains a fruitful area for further research (Zahra, Jennings et al. 1999). Determinants of firm performance have been linked to marketing (Chaston 1997), strategy (Covin, Slevin et al. 1994), individual leadership (Eggers, Leahy et al. 1996), training (Westhead and Storey 1996), and entrepreneurship (Birley and Westhead 1990). Still a comparatively young paradigm (Bygrave 1989), entrepreneurship theory could advance its body of knowledge into economic and business mainstreams through systematic explorations of entrepreneurial processes and firm performance (Clarkin and Rosa 2000).

Isolating determinants of firm performance, however, has proven complex and problematic (Jennings and Beaver 1997). Firms are a nexus of relationships and dynamic interactions among heterogeneous entities and individuals (Coase 1937). Matrices of interactions between individuals and firms, with their internal and external environments have been associated with entrepreneurial processes (Bouchikhi 1993); (Kao 1991), and are believed to significantly differentiate the more from the less successful (Solymossy 2000). One way to isolate determinants of performance is to reduce the levels of environmental complexity, holding constant some contextual factors that may affect firm performance.

An approach employed by Birley and Westhead identified eight different *types* of small firm growth strategies, characterized by their internal and external attributes (Birley and Westhead 1990). The authors concluded that firms within the small business sector changed over time, and that assumptions of homogeneity in their strategies were not supported when subjected to empirical analysis. Following a similar theme, Ucbasaran et al. built on previous work in entrepreneurial behaviours (e.g., (Gartner 1988); (Gartner 1990); (Lumpkin and Dess 1996)), proposing a system of entrepreneurial *types* categorized by organizational form (Ucbasaran, Westhead et al. 2000). The authors' approach recognized that research in entrepreneurial behaviour should consider contextual issues, and that entrepreneurial processes were more likely to be found in some contexts than others. A means to implement this approach was suggested by Gartner, who argued that before differentiating entrepreneurial types, the degree of homogeneity within each organizational context should be examined (Gartner 1985).

Another approach was employed by Kodithuwakku and Rosa, who suggested that environmental complexity may be reduced by examining entrepreneurial processes in highly unpromising environments (Kodithuwakku and Rosa 1999). In a seemingly uniform social and economic environment, with an apparent lack of opportunities and resources, entrepreneurship emerged as a major determinant of success among farmers in their study.[1] The authors found that entrepreneurial behaviour was more apparent in this constrained, relatively homogeneous context, concluding that greater environmental constraints improved the possibility of observing entrepreneurial processes. Kodithuwakku and Rosa posited "Just as the value of water is most apparent in a desert, so by analogy, it could be argued that the best way of observing the value of entrepreneurship is when opportunities and resources are at their most meagre" (p. 12).

[1] Kodithuwakku and Rosa (1999) examined why some Sri Lankan farmers were more successful than others in the same village, given the same allocation and availability of resources. Ten years prior to the field study, a group of families each received two and one-half acres of cleared land and a small monetary grant. In fieldwork, they found considerable economic and social differentiation among the pioneers, despite the parity of their initial resources and the uniformly scarce resources available to the farmers. Although entrepreneurship studies frequently use success as the dependent variable (e.g., (Birley and Westhead 1993); (Gray 1998); (Monroe, Price et al. 1996)), the "quasi-experimental" context of this study made it somewhat unique.

Both of the previously cited approaches sought to better observe entrepreneurial processes by reducing environmental complexity and contextual heterogeneity in their samples. The authors recognized a need for entrepreneurship research to go beyond simple descriptions of the phenomenon and the birth of small firms, considering both entrepreneurial contexts and processes (Low and MacMillan 1988). Additionally, these approaches recognized the mediating effects of context on opportunity recognition and exploitation, considered central tenets of entrepreneurship (Stevenson and Gumpert 1985). One aim of this study is to extend application of these previously described approaches by exploring opportunities for entrepreneurship within the apparently homogeneous and constrained context of franchising.

Although a high degree of uniformity is widely assumed among franchising firms, its nature and extent has not been systematically examined. It follows that if Kodithuwakku and Rosa's approach is to be developed beyond an agricultural setting, another highly unpromising, uniformly constrained context should be explored. Franchising potentially meets these criteria. Built on replication, standardization, and conformity, franchising appears to create another highly unpromising context for entrepreneurial opportunities. Innovation, adaptation, and other behaviours commonly associated with entrepreneurship are considered inherently illegitimate in highly formalized and structured organizations (Kirzner 1979), such as those found in franchising. To determine if franchising qualifies as a uniformly unpromising environment in which to examine entrepreneurial processes, the first section of this study systematically examined franchising's formal context

Dant and Nasr observed that a number of earlier studies of franchising viewed it as a simple dyadic relationship between franchisors and franchisees (Dant and Nasr 1998). Studies that focus exclusively on the contracting relationship of the parties or the principal and agent relationship created by a franchise are examples of this approach. Recent empirical studies have revealed, however, that organizational complexities are prevalent among firms engaged in franchising, including multi-unit ownership by franchisees and various forms of master franchising. In their study of the restaurant industry, Kalnins and Lafontaine found that only 11 percent of franchisees in their sample were single unit owners (Kalnins and Lafontaine 1996). In his field examination of five fast food chains, Bradach found that chain organizations rely heavily on multi-unit franchisees as "building blocks of their organizations" (Bradach 1995, p. 80). These and other empirical findings suggest that narrowly-focused studies may ignore complexities that exist in franchising, reducing their explanatory effectiveness.

Organizational complexity and a broader approach to theoretical development are potentially useful in understanding differential performance among firms in franchising. Positing that organizational differences among franchising firms had an impact on performance, Kaufmann and Kim found that firms engaged in various forms of master franchising grew faster than those that did not (Kaufmann and Kim 1995). These area developers and master franchisees introduced organizational layers between franchised outlet owners and franchisors, creating a hierarchical structure beyond that of a simple, dyadic governance system (Larson 1992). Hierarchies within firms create institutional settings where exploitation of opportunities may exist, both in terms of establishing new organizations and in pursuing new opportunities on behalf of their existing organization

(Shane 2000). In order to take this approach one step further, this study examined the prevalence of various forms of franchise networks, including area development, master franchising and passive ownership, and measured their relationship to franchise system growth.

On an aggregate basis, the success rate of firms engaged in franchising have been compared with non-franchised businesses (e.g., (Bates 1996); (Stanworth, Purdy et al. 1998)). Other comparisons have focused on franchising as a method of expansion, noting that economies of scale that accrued to franchised outlets provided competitive advantages (Stabell and Fjeldstad 1998). Although franchise failure has been a popular topic of debate among researchers (c.f. (Bates 1995); (Castrogiovanni, Justis et al. 1993)), and franchising has been found not to be a panacea for marginal small businesses (Pilling 1991), factors that contribute to differential performance among franchises remain a largely unexplored topic.[2] Consistent with previous entrepreneurship studies (e.g., (Davidsson 1989); (Zahra 1996)), this study focused on firm growth as a measure of relative performance, operationalized as a changes in the number of outlets within a given franchise system. Arguably, this approach and measurement is consistent with venturing, the birth of new businesses within existing organizations, a widely accepted measure of entrepreneurship employed in corporate entrepreneurship literature (Guth and Ginsberg 1990).

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[2] Castrogiovanni et al., found problems with methodology and generalizability of an earlier attempt to differentiate franchising firms by Carney and Gedajlovic, which found five franchisor types: (1) rapid growers; (2) expensive conservatives; (3) converters; (4) mature franchisors; and (5) unsuccessfuls (Castrogiovanni, Bennet et al. 1995)

This study of franchising was conducted in the United States. A contractual relationship between legally distinct entities (Stanworth and Kaufmann 1996), franchising in the U.S. operates in a highly regimented and formal context, defined by detailed disclosure requirements and contractual provisions. Arguably, U.S. franchise regulations are among the most comprehensive in the world, providing a robust setting for examinations of franchising's formal context. Frignani referred to disclosure requirements in the United States as "particularly dense and complex" (Frignani 1995, p. 10). Despite lengthy and regimented disclosure requirements, the extent to which these items explain differential performance among franchising firms has not yet been explored.

Although lengthy disclosure requirements and contractual provisions provided a robust source of information, franchising's formal context presents only a partial view of the phenomenon. Research conducted by the University of Westminster found differences among franchisees in their ability to control their operations, and differences between their perceived discretionary power and that specified in their agreements (Stanworth 1995). In other words, a large number of franchisees reported higher levels of autonomy and independence than were actually afforded by the terms of their agreement. This finding led Stanworth to argue "the formal contract was often a poor guide to the world of operational reality" (p. 161). Consistent with Stanworth's approach, this study used a combination of quantitative and qualitative methods to explore both formal and operational contexts of franchising in order to provide a more complete view of the phenomenon.

1.1.2 Background to the Research- Entrepreneurship

Entrepreneurship has been widely recognized as an engine that fuels most economies (Gorman, Hanlon et al. 1997). In broad terms, entrepreneurial processes and their ability to impact firm performance have been influenced by three factors: the external and internal environment, opportunity recognition, and opportunity exploitation. Although recognition of entrepreneurial opportunities is considered a subjective process, the opportunities themselves are an objective phenomena (Shane 2000).

Environmental factors have been found to mediate entrepreneurial processes (Kaufmann and Dant 1998). Restrictions on financing, capital scarcity (Evans and Leighton 1989), and liquidity constraints (Blanchflower and Oswald 1998) are most often cited as indicators of environmental constraint on entrepreneurship. An environment that fosters opportunity detection is an essential and necessary prerequisite to entrepreneurship, because without it no entrepreneurial processes will emerge (Stevenson and Jarillo 1990). Organizational context has also been found to affect entrepreneurial environments[3] (Kao 1991), exerting influence on a firm's ability to innovate (Mone, McKinley et al. 1998). Environmental factors affect an entrepreneur's ability to continually search out new opportunities that other firms cannot or choose not to pursue (Hudson and McArthur 1994). Irrespective of size, high performing firms were found to adopt more flexible organization structures, especially in environments characterized by intense and dynamic competitive pressures

[3] Kao (1991) defines the *organizational context* as "the immediate setting in which creative and entrepreneurial work takes place...organizational structure and systems, the definition of work rules, and group culture affect significantly the nature of the creative or entrepreneurial environment. Such factors may limit or facilitate creativity and entrepreneurship, and become an increasing factor to contend with as the organization evolves" (Kao 1991).

(Khandwalla, 1977 in (Covin and Slevin 1989)). These *organic* organizations were more adaptable, had more open communications, more consensual decision-making, and were more loosely controlled (Chell, Haworth et al. 1991).

Khandwalla found that, in general, high performing firms adopted more mechanistic organization structures only in environments with minimal competitive pressure (Covin and Slevin 1989). Mechanistic organizations worked well when tasks were straightforward, competitive environments were stable, when the goal was to produce the same product repeatedly, and when human "machines" merely complied with the rules as designed (Morgan 1997). These organizations tended to be highly centralized and formal, with high levels of vertical interaction and specialization (Lumpkin and Dess 1996). They were characterized as "much more traditional, more tightly controlled, and more hierarchical in (their) approach" (Chell, Haworth et al. 1991, p. 60). Mechanistic firms are believed to be ill suited for rapidly changing, highly competitive, and dynamic markets.

Second, an ability to recognize opportunities has been considered a prerequisite for entrepreneurship (Churchill 1997). Entrepreneurial opportunities are ones that create profit potential through creation of new businesses, or that significantly improve the position of an existing business (Hills, Lumpkin et al. 1997). Opportunity recognition has been an important factor when firms operate in highly competitive and dynamic market environments (Wright, Robbie et al. 1997), for both new venture creation (Cooper, Folta et al. 1995), and to enhance the position of existing businesses (Hills, Lumpkin et al. 1997). Kirzner suggested that opportunity recognition is a central role of an entrepreneur, defined as knowing or recognizing things that others did not (Kirzner 1979).

An ability to exploit opportunities is the third factor in entrepreneurship (Shane 2000). Opportunities are typically exploited in small firms through quick decision-making, simple administrative structures, and flexible operations (Baldwin 1995). These attributes enable rapid adaptation to changing market demands (Jennings and Beaver 1997). Miller concluded that rapid exploitation of opportunities for both small and large firms was the only effective means of coping with adversity in hostile environments (Miller 1983). Hostile environments were characterized by unstable industry settings, intense competition, and comparative lack of exploitable opportunities (Covin and Slevin 1989).

Thompson posited that strategic organizations are able to embrace innovation and entrepreneurship, finding and exploiting manageable opportunities (Thompson 1998). He concluded that visionary leadership at all management levels and organizational flexibility were essential aspects of entrepreneurial firms. Traditional organizational models structured with rigid hierarchies and clearly defined boundaries were found to be poorly suited for today's entrepreneurial corporations (Dess, Lumpkin et al. 1999). Increasingly, large firms engaged in highly competitive markets have attempted to emulate apparent successes by small firms through adoption of more flexible organization structures (Kanter 1996).

1.1.3 Background to the Research- Corporate Entrepreneurship

Once considered an oxymoron, entrepreneurship in various organizational contexts has received increased attention for its role as a determinant of firm survival, success, profitability, and growth (e.g., (Birkinshaw 1997); (Burgelman 1983); (Drucker 1985; Guth and Ginsberg 1990); (Miller 1983); (Pinchot III 1985); (Zahra 1996)). Stevenson and Jarillo argued that pursuing opportunity, whether through specific company structures or not, constitutes the core of both individual and corporate entrepreneurship (Stevenson and Jarillo 1990).

Thirty years ago, Peterson and Berger (1971) found that entrepreneurial processes could help firms to create new revenue streams through new business development (Zahra, Nielsen et al. 1999). Entrepreneurial processes, through development and deployment of unique resources were deemed necessary for organizational survival, profitability, growth (Penrose 1968), and strategic renewal (Zahra 1996). Recently, opportunities for entrepreneurship within corporate organizations have become a subject of discussion among both practitioners and academicians (Sharma and Chrisman 1999).

Guth and Ginsberg posited that corporate entrepreneurship encompasses two types of phenomena and the processes surrounding them: (1) venturing, the birth of new businesses within existing organizations; and (2) strategic renewal by the transformation of organizations through renewal of the key ideas (Guth and Ginsberg 1990, p. 5). Empirical evidence suggests that corporate entrepreneurship improved company performance by increasing a firm's proactiveness and willingness to assume risks, and by subsequent development of new products, processes, and services (Lumpkin and Dess 1996); (Zahra, Nielsen et al. 1999). Increasing creativity and innovation has not only been considered a determinant of increased performance, but has become a minimum requirement for many corporations simply to remain competitive (Herbert and Brazeal 1999). Over the past decade, there has been growing awareness of the impact of governance and ownership systems on corporate entrepreneurship (Zahra 1996). It is widely accepted that organizational structure, processes, and systems found among firms are associated with relative performance (Covin and Slevin 1989); (Eisenhardt 1989); (Slevin and Covin 1997).

Covin & Slevin argued that firm performance is a function of both organizational and individual-level behaviours (Covin and Slevin 1991). The authors argued that a firm-behaviour perspective of entrepreneurship has a number of advantages: First, entrepreneurial effectiveness can be measured in terms of firm performance. Second, behaviours rather than attributes give meaning to entrepreneurial processes-- an organization's actions make it entrepreneurial. Third, development of entrepreneurial process knowledge hinges on accurately differentiating between more or less entrepreneurial firms. Fourth, firm-level entrepreneurial behaviour is affected by and managed through organizational structures, strategies, systems, and cultures (p.8). Covin and Slevin's conceptual model of entrepreneurship as firm behaviour is presented in Figure A2 in Appendix A.

Because management values, economic realities, and strategic considerations all result in varying degrees of entrepreneurship within organizations (Herbert and Brazeal 1999), it became possible to array firms on a continuum of conservative-entrepreneurial (Covin and Slevin 1991). From the strategic management literature emerged methods, practices, and styles that categorized and distinguished firm-level entrepreneurial processes, called *Entrepreneurial Orientation* (EO) (Lumpkin and Dess 1996). The authors argued that a firm's level of autonomy, innovativeness, risk taking, proactiveness, and competitive aggressiveness served as indicators of its EO. They concluded that relationships existed between a firm's EO and firm performance. EO definitions and references to other work in Entrepreneurial Orientation are presented in Appendix B, Table B20.

1.1.4 Background to the Research- Franchise Systems

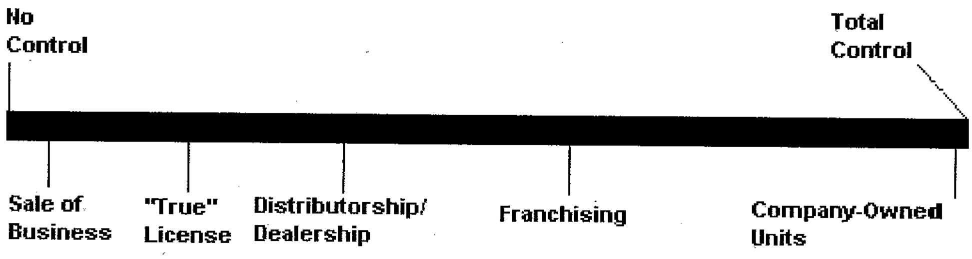
On the surface, franchising appears to create a uniformly regimented and theoretically unpromising environment for entrepreneurship, especially when contrasted with non-franchised businesses. Some have suggested, however, that franchising provides a unique and fertile setting for research in entrepreneurship (Kaufmann and Dant 1998), creating an organizational context that can either promote or constrain entrepreneurial processes (Falbe, Dandridge et al. 1998).

Franchising's environment presents a somewhat unique setting for entrepreneurship research, in that success within its context depends on cooperation by two distinct entities: franchisors and franchisees (Shane and Hoy 1996). Through cooperation, franchised outlets achieve economies of scale in marketing and production normally found only in large firms (Elango and Fried 1997). Unlike studies of non-franchised small businesses, where data scarcity and poor reliability are prevalent (Birley and Westhead 1990), detailed financial and operational data on franchises may be available to researchers. The contractual nature of a franchise and disclosure regulations found in some countries provides a rich source of legal and financial information, although this information is typically not made available to the public. This fertile setting for information is especially apparent in the United States, where federal and state laws require detailed disclosure of material facts related to each franchise (Emerson 1998); (Government 1986).

On one hand, franchising promotes entrepreneurial processes by delimiting financial constraints on growth (Spinelli and Birley 1996). From a franchisor's perspective, franchisees provide an efficient source of expansion capital (Caves and Murphy 1976); (Dant 1995). Franchising overcomes informational barriers by providing franchisees with management training, site selection assistance, and pricing guidance, as well as information on other aspects of business ownership (Curran and Stanworth 1983). Franchising also provides an alternative to employment for current or previous self-employed individuals (Stanworth and Kaufmann 1996).

Conversely, franchising's organizational context has also been found to constrain entrepreneurial processes. Unlike other businesses, franchised firms exist in an environment characterized by performance monitoring and control mechanisms, detailed contractual specifications, and financial reporting systems (Morrison 1997). For individuals and firms within franchise systems, the path to success is through efficient implementation of a proven system devised by others, rather than through independent entrepreneurial behaviours. Detailed covenants of behaviour are prevalent in franchising, leading some to conclude that franchisees more closely resemble employees than independent entrepreneurs (Baucus, Baucus et al. 1993). Kanouse suggested that from a legal perspective, a "control spectrum" existed, as depicted in Figure 1.1 below (Kanouse 1990).

Figure 1.1: Kanouse's Control Spectrum



Source: (Kanouse 1990)

Kanouse's spectrum positions franchising at a point where a governing firm has less control than found in corporate-owned outlets, but more control than through distributorships or licensing arrangements. Stanworth's study revealed, however, that franchisors and franchisees differ in their views of responsibility and control over operations of franchised outlets. A summary of this study is presented in Table 1.1.

Table 1.1: Views of Control Over Franchise Outlet Operations

		Percent in agreement	
Mainly or totally decision of:		Franchisee (n=215)	Franchisor (n=15)
Additions/Deletions of products or services	Franchisor	55.3	93.3
Pricing	Franchisor	62.8	80.0
Hrs. of operation	Franchisee	78.1	66.6
Staff employment	Franchisee	93.5	60.0
Staff wages	Franchisee	88.4	93.3
Quality of service	Franchisee	74.4	46.7
Bookkeeping	Franchisee	85.1	73.3
Local Advertising	Franchisee	91.6	33.3

Source: Stanworth, J. (1995) *The Franchise Relationship: Entrepreneurship or Dependence?* (p. 167)

As Table 1.1 illustrates, large discrepancies existed between franchisors and franchisees in responsibilities for control decisions in franchised outlets. Franchisors, responsible for crafting franchise agreements, consider control over pricing and product offerings to be largely their responsibility. This view, however, was not widely held by franchisees.

In the United States and several other jurisdictions, both franchisors and franchisees are embedded in laws and regulatory requirements that establish legal limits within which franchising must be conducted (Hudson and McArthur 1994). Franchise laws and regulations restrict levels of flexibility by both parties (Lewis 1990). Contractual provisions may also limit both parties' ability to evaluate the comparative value of other opportunities (Kirzner 1979). Non-compete clauses, prevalent in franchising, impose limitations both during and after the period covered by a franchise agreement. In his study of industrial relationships, Blois observed that preclusions from other opportunities may be perceived as a golden cage or a prison, depending on alternatives at any given time (Blois 1998).

Researchers from a variety of disciplines have studied franchising, including those in economics (e.g., (Kirchhoff 1991); (Williamson 1975)), law (e.g., (Brown 1985); (Mendelsohn and Bynoe 1995)), strategic management (e.g., (Jarillo 1988); (Thorelli 1986)) and entrepreneurship (e.g., (Birley, Leleux et al. 1997); (Shane and Spell 1998); (Stanworth, Purdy et al. 1997)). Franchising has also been studied from more focused perspectives, as a method of contracting (e.g., (Hart 1987); (Lafontaine and Slade 1998)), or marketing (e.g., (Morgan and Stoltman 1997); (Thompson 1971)). Stanworth and Curran suggested that a major reason for restricted focus in these and other studies is that franchising does not appear to fit comfortably within the limits of any single academic discipline (Stanworth and Curran 1999). Although insightful, narrow perspectives have often revealed conflicting observations, leading Koiranen to conclude that franchising's complexity could best be understood by investigating its *paradoxicalness* (Koiranen, Hyrsky et al. 1997).[4] This paradoxical view of franchising was shared by several researchers, as summarized in Table 1.2.

Table 1.2: Paradoxes in Franchising

Independence/ Autonomy	Interdependence	Dant et al., 1992; Stanworth, 1993[a]
Innovation	Replication	English & Hoy, 1995[a]
Responsibility	Limited Decision-Making Authority	Hoy, 1994[a]
Creativity	Conformity	English & Hoy, 1995; Stanworth et al., 1996[a]
Support	Supervision	Hing, 1995[a]
Conformity	Lower Failure Rates	Price, 1997
Cooperative Entrepreneurship	Conflict	(c.f., Shane & Hoy, 1996; Spinelli & Birley, 1996)

[a] Source: *Paradoxes and Reaction Pairs in Franchising* (Koiranen, Hyrsky et al. 1997).

1.2 Justification for the Research

One aim of this study is to further the current base of knowledge about entrepreneurship within franchising. This topic is relevant for several reasons. First, franchising's global economic and social impact justifies further examination of entrepreneurship's role within this context. Second, despite its economic impact, relatively little is known about entrepreneurship within franchising beyond a franchisor's creation of a concept. Third, studies of franchising have focused on failure rates and agency theory, with few if any attempts to link entrepreneurial processes with performance. Finally, results of this study add valuable data to the literature on franchising. Its findings have relevance to academics, practitioners, and policy makers. Each of these areas of justification is addressed in the following sections.

[4] An example of the paradoxical views of franchising is found in Price's expansive monograph: "how can franchisors stress conformity, rather than innovation, and also simultaneously expect fewer failures than independent businesses?" (Price 1997, p. 506).

1.2.1 Franchising's Economic Impact

Franchising's socio-economic impact makes it worthy of study within the discipline of entrepreneurship. Consistent with other entrepreneurship studies, franchising's impact is often measured in economic terms (Trutko, Trutko et al. 1993), including job creation and sales turnover. Job creation has been widely used to measure the economic impact of entrepreneurial processes (e.g., (Birch and McCracken 1987); (Stevenson and Jarillo 1990)). Consistent with this approach, Hoffman and Preble observed that creation of new business units and jobs is central to franchising's mission (Hoffman and Preble 1993), and further research appeared justified, given its exponential growth and its role as a source of job creation (Morrison 1995). Franchising's job creation is exemplified by one of the best-known franchises, McDonald's, who has employed more than 16 million people during its 40-year history (Bradach 1998).

Although measurements of franchising's economic impact sometimes differ depending on the source of the data, its impact is considerable. Mendelsohn found that 1.5 million Europeans are employed by 4,000 franchisors in 170,000 franchised outlets; employment numbers exceed 2.5 million if those firms that supply franchised outlets are also considered (Mendelsohn 1999). Another measure of economic impact is sales turnover. France's 600 franchisors recorded nearly $25 billion in 1998 sales[5], while annual gross turnover for business format franchises in the UK reached an aggregate £7.4 billion (Mendelsohn 1999). A report by the U.S. and Foreign Commercial Service, as summarized in Table 1.3, notes the number of systems, number of units, number of employees and sales turnover recorded in the European franchise market.

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[5] Source: Arthur Andersen, LLP, 1999 Franchise Survey of 40 countries, available at: http://www.arthurandersen.com/Framesalt.asp?/FranchiseServices/index.asp.

Table 1.3: The European Franchise Market - 1997				
Country	**Franchises**	**Franchise Units**	**Employees**	**Sales in $ billion**
Germany	530	22,000	230,000	13.4
Italy	436	21,390	49,658	11.0
France	470	25,750	355,000	8.4
Netherlands	345	11,910	100,000	8.4
Great Britain	474	22,570	222,700	8.1
Spain	288	13,161	69,000	6.2
Sweden	230	9,150	71,000	5.2
Belgium	170	3,500	28,500	2.8
Norway	125	3,500	N/A	2.7
Hungary	220	5,000	45,000	2.4
Austria	210	3,000	40,000	1.5
Denmark	98	2,000	40,000	.917
Portugal	220	2,000	35,000	.917
Czech & Slovenia	40	80	760	.76
Yugoslavia	18	620	2,810	.513
Total Europe	**3,874**	**148,761**	**1,289,928**	**78,607**
Source: European Franchise Federation, published by U.S. and Foreign Commercial Service and U.S. Department of State, 1998, National Trade Data Bank Market Report, 08-01-98.				

In the United States, sales through franchised outlets approached $1 trillion (Bradach 1998), and were expected to account for 50% of all retail sales by the year 2000 (Dant 1995). By most measures of economic impact, franchising is worthy of further study.

Franchising's expansion in Europe and other global markets has enabled international franchising to develop at an unprecedented rate (Preble and Hoffman 1995), representing an important export for the United States. Shane found that between 1971 and 1985, U.S. franchisors added foreign outlets by 17% per year, almost twice as fast as they added domestic outlets (Shane 1996). Payment of franchise fees to U.S. franchisors by overseas franchise operations is a significant source of income for U.S. franchisors, exceeding $569 million in 1999 (Mann, Brokenbaugh et al. 2000). Table 1.4 presents geographic sources of franchise fee revenues from 1996 through 1999.

Table 1.4: Franchise Fees Receipts to U.S. Franchisors (in $ millions)				
	1996	**1997**	**1998**	**1999**
Canada	36	29	41	35
Europe	170	192	230	253
Latin America[a]	38	44	53	56
Africa	9	12	12	14
Middle East	24	34	38	43
Asia and Pacific	131	148	123	147
Other	11	17	9	22
Total	**$ 419**	**$ 475**	**$ 506**	**$ 569**

Source: U.S. Department of Commerce, *U.S. International Services: Cross-Border Trade in 1999 and Sales Through Affiliates in 1998* (2000).
[a] Includes other Western Hemisphere Countries not listed elsewhere

As indicated in Table 1.4, Europe represents a substantial and growing market for U.S. franchisors. On a percentage basis, however, growth in receipts from Europe from 1998 to 1999 grew at 10 percent, while total receipts increased by 12.4 percent.

Within Europe, the impact and growth rates of U.S. franchisors differs among countries, as revealed in the comparative franchise fee receipts in Table 1.5.

Table 1.5: Franchise Fees Receipts from Europe to U.S. Franchisors (in $ millions)				
	1996	**1997**	**1998**	**1999**
Belgium-Luxembourg	2	2	3	3
France	10	18	15	15
Germany	81	76	80	89
Italy	3	3	20	22
Netherlands	3	5	6	8
Norway	2	3	5	6
Spain	4	5	5	10
Sweden	4	4	6	7
Switzerland	2	2	2	1
United Kingdom	34	42	48	53
Other	23	31	40	39
Europe Total	**$ 170**	**$ 192**	**$ 230**	**$ 253**

Source: U.S. Department of Commerce, *U.S. International Services: Cross-Border Trade in 1999 and Sales Through Affiliates in 1998* (2000).

According to U.S. Department of Commerce data, Germany represents the largest source of franchise fee revenues for U.S. franchisors, followed by the United Kingdom.

In addition to its global economic impact in terms of job creation and revenue generation, franchising's ubiquity also suggests that the phenomenon is material and worthy of analysis (Harrigan 1998). Franchising's effects often reach beyond those readily apparent.[6]

1.2.2 Research Gap

In spite of its present and potential economic impact, franchising has received limited attention in recent literature (Falbe, Dandridge et al. 1998). One reason may be that some researchers view franchising as a programmed, non-entrepreneurial mode of entry (Phan, Butler et al. 1996). Another may be that entrepreneurs are often associated with innovation (Filion 1998), an instrument by which entrepreneurial firms exploit change to create wealth (Drucker 1985). While innovation has been considered the most important characteristic associated with success (Baldwin 1995), some consider franchising to be the antitheses of innovation, responsible for homogenization of commercial cultures and a lack of variety in many retail sectors (Kaufmann and Dant 1998).

Although entrepreneurship research on franchising exists, contributions from recent literature have been heavily weighted towards franchisors as sole contributors of entrepreneurial value. Despite more than 225 articles published by Society of Franchising, and more than 80 articles published by entrepreneurship researchers, franchisees have been one of the least studied of entrepreneurial types (Phan, Butler et

[6] An example of franchising's impact was provided by Bradach, who observed that McDonald's had recently surpassed the U.S. Army is the "institution that trains the greatest number of American youth-nearly 700,000 teenagers annually" (Bradach 1998, p. 4).

al. 1996). Studies that measured growth (e.g., (Shane 1996)), innovation (e.g., (Kaufmann and Dant 1998)), and entrepreneurial behaviour (e.g., (Baucus, Baucus et al. 1996)) have all focused on entrepreneurial activities by franchisors. Potential entrepreneurial behaviours by franchisees may be overlooked, as franchisors have stated they prefer managers to entrepreneurs, in order to protect their business system from unauthorized change (Falbe, Dandridge et al. 1998). Price's expansive monograph *The Franchise Paradox*, viewed entrepreneurial activity by franchisees as a paradox (Price 1997). In contrast to studies of franchisors, little research has been devoted to entrepreneurial opportunities within franchise systems, presumably because of its apparently unpromising environment for entrepreneurial experimentation by franchisees.

Recently, however, Bercovitz observed that variations in contractual arrangements between franchisors and franchisees remained largely unexplained (Bercovitz 1999). She found substantial diversity in some pecuniary and non-pecuniary contract provisions, influenced by levels and types of hazards present in a contract (p. 26). Although her study suggested that possibilities of opportunity exploitation may vary among franchising firms, relationships between contractual provisions and success or performance of franchising firms remains largely unexplored.

Shane and Hoy posited that creation of a franchise network is an entrepreneurial act (Shane and Hoy 1996). Although entrepreneurship research has generally accepted franchisors as entrepreneurs (Falbe, Dandridge et al. 1998); (Shane and Hoy 1996), exclusion of franchisees would require an extremely narrow definition of the field (Hoy 1994). Whether franchisees should be regarded as entrepreneurs is an emerging area of interest (Fenwick and Strombom 1998), especially when entrepreneurship is considered to involve more than merely starting a business (Westhead and Wright 1998). There is little empirical evidence, however, on the nature and extent to which franchise networks exist within franchising.

Increasingly complex and dynamic global business environments require that firms quickly and effectively adapt to competitive pressures (Slevin and Covin 1995), and explaining how and why organizations change has been a central and enduring quest of scholars (Van de Ven and Poole 1995). With few exceptions, global competition, rapid technological progress, and many other factors have heightened the need for organizations to become more entrepreneurial in order to survive and prosper through innovative and proactive behavior (Dess, Lumpkin et al. 1999). Making a corporation more *entrepreneurial* is now a minimum requirement in many industries simply to stay in the competitive game (Herbert and Brazeal 1999). In contrast to entrepreneurial firms, both small and large, Bucklin concluded that franchising "thrives upon resistance to change" (Bucklin 1971). Zahra suggested that additional research is needed if the association of governance and ownership systems with corporate entrepreneurship is to be better understood (Zahra 1996). Concepts developed within corporate entrepreneurship's constructs have not been applied in hybrid governance systems such as franchising.

In summary, although entrepreneurship has been widely accepted as a determinant of success in small firms, and a positive and strengthening linkage between corporate entrepreneurial behavior and financial performance has been established (Covin and Miles 1999), entrepreneurship's relationship with firm performance within franchising has yet to be systematically explored. One aim of this study is to take a first step toward identifying aspects in the formal and operational contexts of franchising where entrepreneurial opportunities may exist.

1.2.3 Relative Neglect of Methodology

In their synthesis of recent literature, Elango and Fried (1997) concluded that past research often presented an incomplete view of franchising, tied too closely to theories of agency and power, and often ignored franchisee's perspective (Elango and Fried 1997). With roots in legal, marketing and economics disciplines, franchise research has usually focused on agency and risk reduction theories, transaction cost analysis, and ownership redirection (Price 1997). Morrison proposed that future studies should investigate a broader theoretical framework, incorporating the role of entrepreneurship (Morrison 1995). Recognizing the limitations of past research, a broader theoretical framework was introduced by Stanworth and Curran, who offered a sociological model of franchising, which provides a skeletal structure for studies of franchising at societal, organizational and individual levels (Stanworth and Curran 1999). Empirical studies employing constructs outlined in Stanworth and Curran's study are not evident at this time of this work.

Reporting on two major research projects conducted in Britain, Stanworth found substantive disparities between the one-sided relationship that exists between franchisors and franchisees in their formal or contractual level, and the "operational realm" in which daily activities take place (Stanworth 1995, p. 165). Franchisees reported relatively high levels of independence, despite comprehensively prescriptive contractual provisions. Drawing further distinctions between formal and operational levels, more than 80 percent of franchisee respondents reported that their franchisor "never mentioned the contract to them in their everyday relations" (p. 165). Stanworth concluded that examinations of franchisor-franchisee relations exclusively at the formal level is misleading, as franchisors need the goodwill of franchisees. Although franchised businesses are frequently contrasted with non-franchised businesses, Stanworth noted substantial variety *between* franchises in levels of autonomy enjoyed by franchisees. Further examinations of differences between franchises, considering both formal and operational realms, are not evident in recent studies of franchising.

1.2.4 Usefulness of Applications of Findings

Findings of this study have applicability for academics, practitioners, and policy makers. This work contributes to continued development of entrepreneurship research by examining a previously understudied and substantive group of firms. It extends research performed in small firms and studies in corporate entrepreneurship to franchising's hybrid governance structure.

Practitioners and potential franchisees may also benefit from this study and its typology to better evaluate franchise opportunities. Potential franchisees may benefit from this work's analysis of franchising, encouraging a more critical look among firms engaged franchising, using indicators of potential entrepreneurial opportunities. Because recruiting franchisees is an important part of franchising, franchisors may be more forthcoming, and loosen constraints in their systems to allow for increased latitude on the part of franchisees, encouraging innovation and wealth creation within their systems. Entrepreneurial activity by franchisees implies a partnership in adapting to a changing environment. As the global environment becomes more competitive, a need for entrepreneurial activity within franchising is likely to increase dramatically (Falbe, Dandridge et al. 1998).

Policy makers in both the United States and Europe may benefit from insights provided by this study as it pertains to disclosure. The current system of disclosure in the U.S. is expensive to produce and administer. It may prove ineffectual as a disclosure instrument if it does not provide information for prospective franchisees of growth and potential success of franchises. In the U.S., improvements to the existing system of disclosure may reduce the incidence of litigation and disputes in franchising, reducing the need for additional franchise legislation. In Europe and other parts of the world, where franchise disclosure issues are being debated, this work provides insights on mechanisms of disclosure in the U.S.

1.3 Methodology

The exploratory nature of the first part of this study justified use of a field study to examine official documents governing franchise relationships. Primary data were collected from 55 franchise systems over a period of fourteen months in the United States, specifically in the cities of Charleston and Columbia, South Carolina. The U.S. provided a fertile setting for this initial portion of the study because of its uniform, federal disclosure laws. Access to documents not normally available to the public was provided with permission from the Secretary of State's Office in Columbia, South Carolina.

In addition to primary data collected from franchise documents, facts derived from official records and surveys were also examined. Datasets were constructed from facts gathered through *Entrepreneur Magazine*, FRANDATA, and Bond's *Franchise Guide*. These larger datasets provided an opportunity to employ quantitative methods of analysis including correlation, factor analysis, and multiple regression analysis. Data used to construct these datasets have been shown to be both consistent (Mehta, Luza et al. 1999) and reliable (Shane 1998).

In order to gain further insights in franchising's operational realm, this study includes semi-structured interviews with four present franchise owners, including one area developer franchisee, and two former franchise owners. Additionally, interviews with the general counsel and chief financial officer of a fast growing franchise were conducted to gain insights from a franchisor's perspective.

1.4 Summary

Arguably, entrepreneurship is best understood as a process within a context (Low and MacMillan 1988), the constituents of which are entrepreneurs, engaged in a persistent search for opportunities, and the efforts to marshal the resources needed to exploit them (Hill and McGowan 1996); (Timmons 1994). The context in which individuals and firms exist affects their ability to identify, recognize, and exploit opportunities. Entrepreneurial behaviour has been shown to have a positive and significant effect on firm performance in small firms through examining individual and firm behaviours. Corporate entrepreneurship studies have demonstrated that in large firms, entrepreneurial behaviours by firms and individuals within it also is associated with improved performance.

As a hybrid, contractual governance structure, firms and individuals engaged in franchising may be thought to exist in two distinct contexts: a formal context defined by contractual provisions and detail disclosures, and an operational realm in which everyday operations are conducted. Considering franchising's formal context, comparatively little is known about factors that differentiate firms and their contributions to firm performance. Specifically, the presence or absence of franchise networks and their influence on firm performance has not been systematically examined. In its operational realm, additional work is needed to better understand the role of disclosure and the effects of contractual provisions on both a franchise selection process and daily operations of a franchised business.

This study initially employed a case study approach to explore franchising's formal context through direct examination of franchise disclosure and contractual documents. Next, quantitative methods were used to examine datasets operationalized from secondary sources, including correlation analysis, factor analysis, and multiple regression. Finally, semi-structured interviews were used to extract the subtleties and perceptions found in franchising's operational realm.

1.5 Outline of this Thesis

This work follows the basic framework of a five-chapter dissertation format, adapted to present analysis in three separate chapters, and a separate chapter for definitions and hypotheses development. Chapter 2 begins with an inter-disciplinary review of the recent literature, with an emphasis on entrepreneurship and corporate entrepreneurship contributions. Following the literature review, a chapter is devoted to definitions and a unit of analysis discussion to provide clarity. Research questions and hypotheses emerging from the literature are presented in this chapter.

Next, the methodologies used in this study are presented in chapter four, which includes descriptions of the datasets. Analysis of the data follows in chapters five, six, and seven. The first analysis chapter describes exploratory case studies of official documents, while the second tests the hypotheses using secondary data derived from both official documents and survey instruments. The third analysis chapter presents semi-structured interviews. Finally, the eighth chapter contains discussion, conclusions, implications, and suggestions for further research.

2.0 ENTREPRENEURSHIP AND FRANCHISING: CONTRIBUTIONS FROM THE LITERATURE

2.1 INTRODUCTION

The overall aims of this study are to explore entrepreneurial opportunities within franchising. Consistent with other concepts in the social sciences, entrepreneurship studies often require a multidimensional approach, as certain theories have more relevance in some contexts than in others. Increasingly, empirical research in franchising has revealed complexities that justify employment of a multi-disciplinary approach.

In franchising, a formal context is created by the contractual nature of franchise relationships, governed by detailed disclosure requirements and regulatory oversight not typically found in other business environments. Although comprehensive, franchise agreements cannot cover all possible contingencies, and may have only a partial effect on the daily operations of a franchised business. Examination of the operational context is required to provide a more complete view of the phenomenon. This study, therefore, examined both the formal and operational contexts of franchising, including perspectives from the United States and other countries. This chapter reviews relevant theoretical and empirical literature, focused on entrepreneurial processes in general, and those applicable to franchising in particular.

Various theories have been employed in studies of entrepreneurship phenomena, in part because the paradigm had not yet developed "distinctive methods and theories of its own" (Bygrave 1989, p. 7). Research in economics (e.g., (Schumpeter 1934); (von

Mises 1949)); social anthropology (e.g., (Rosa and Bowes 1990); (Caulkins 1988)), psychology (e.g., (Chell, Haworth et al. 1991); (Shaver and Scott 1991)), sociology (e.g., (Reynolds 1991)); strategic management (e.g., (Zahra 1993); (Barney 1991)) and other disciplines have shaped the theoretical underpinnings of entrepreneurship research. Although these contributions have provided valuable insights, they were found to have limitations when used exclusively in studies of entrepreneurship.

In similar fashion, exclusive use of some theories has presented a less than complete view of franchising, despite an apparent uniformity of franchising's context. Price argued that franchise research, often rooted in legal, marketing, and economics theories, had "shown a preoccupation with agency theory, transaction cost analysis, ownership redirection, and risk reduction theory" (Price 1997, p. 533). He concluded that, in and of themselves, these theories provided incomplete rationales, failing to explain the dynamics found in empirical studies of franchising. Noting limitations in these theoretical approaches, Stanworth and Curran observed that franchising "does not comfortably fit within the limits of any single academic discipline or area of management practice" (Stanworth and Curran 1999, p. 324). They argued that views of franchising as merely a contractual form of business or as a form of marketing were too narrowly focused. The authors advocated a more encompassing approach, linking organizational characteristics and strategies to behavior patterns of individual actors.

Considering that franchising extends into a variety of academic disciplines, a multi-disciplinary design was adopted for this literature review. Because this study includes analysis of the formal context of franchising, as defined by its disclosure and contractual provisions, the first section begins with franchise research from a contracting perspective. Although narrow in its focus, a contracting perspective provides insights into contractual relationships between franchisors and franchisees. Contributions from organizational theory follow, which includes views of cooperative relationships such as networks and strategic alliances. Next, contributions from economics, and psychology disciplines are presented. As a contractual form of business, franchising is subject to both general business and specific laws, which is influenced by the regulatory environment in which it operates. Therefore, an overview of the legal environments in which franchising operates is provided, with particular emphasis on regulations in Europe and the United States. The second section of this chapter reviews theoretical and empirical studies found in entrepreneurship literature. Because opportunities for entrepreneurship in franchising must also consider its organization structure, this study includes a review of the corporate entrepreneurship literature.

2.2 Contracting

Shane and Hoy argued that previous research in franchising viewed it in narrow terms, simply as a contractual form of business between firms (Shane and Hoy 1996). Klein concluded that underlying economic forces found in franchise contracts may also be found in most distribution arrangements, which makes franchising a "good laboratory in which to study contractual arrangements" (Klein 1995, p. 36). Studies focused on contracting have considered ranges of formal and informal methods used to regulate exchanges, not just legal documents prepared by lawyers and signed by the parties (Hudson and McArthur 1994). Contracting research has provided insights relevant to franchising's formal context, as well as aspects of trust between parties in contractual business relationships.

2.2.1 Contracting- Review of Selected Theoretical and Empirical Literature

Firms enter into contractual business relationships for various reasons, one of which is to gain a competitive advantage (Baucus, Baucus et al. 1996). Within franchising's context, competitive advantage is created when a franchisor's tested system, branded concept, and economies of scale are combined with a franchisee's local market knowledge and entrepreneurial talents (Stanworth, Purdy et al. 1998) in a unique form of cooperative entrepreneurship (Shane and Hoy 1996). At the epicenter of franchising's formal relationship are detailed disclosure and contractual agreements, making a contracting perspective an integral part of this and other studies of franchising.

In franchising, contracting is performed when two legally distinct entities, franchisors and franchisees, execute a franchise agreement (Castrogiovanni and Justis 1998). Through these agreements, franchisors grant permission to use their trademark and business system, typically in exchange for an up-front fee and continuing share of a franchisee's profits (Bradach 1997); (Shane 1996). Viewed strictly from a contracting perspective, franchise agreements have provisions similar to those found in other forms of contracting. For example, because a franchisee's right to operate a business is limited to the term of an agreement, Mendelsohn considered franchise agreements as a form of limited contract (Mendelsohn and Bynoe 1995). In cases where franchisees are required to purchase goods exclusively from a franchisor, a franchise agreement is a form of *tying* contract (Meese 1996). When aspects of remuneration are considered, franchise agreements are considered efficient contracts, because incentives are created for the parties through assignment of rights or authority over decisions and shares of profit (Mathewson and Winter 1994). Barzel suggested that franchise agreements also resembled shared tenancy contracts, "halfway between fixed-rent and wage contract(s)" (Barzel 1989, p. 37). Shared tenancy aspects of franchise agreements establish a franchisee's claim to residual profits, and were found to create entrepreneurial incentives for franchisees (Birley, Leleux et al. 1997); (Michael 1993); (Spinelli and Birley 1996).

Although long-term relationships exist between the parties, a franchise agreement is considered neither a discrete market or futures contract, nor an employment contract (Brickley and Dark 1987). Considering franchising's dynamics, Leblebici and Shalley viewed franchise agreements as "long-term, incomplete, relational contracts" (Leblebici and Shalley 1996, p. 409). Franchise agreements are long-term because their duration may extend to 30 years[7], with provisions that are seldom re-negotiated within a contracted period (Lafontaine and Shaw 1999). They are considered incomplete contracts because a franchisor, *ex ante*, cannot predict all relevant situations likely to occur during an agreement's term, and cannot cover all possible contingencies (Phan, Butler et al. 1996). Despite inclusion of discrete obligations, such as specific purchase requirements, franchise agreements are generally viewed as relational contracts, more complex than those that only specify market transactions (Baucus, Baucus et al. 1996). As such, studies of other relational contracts have considered elements such as flexibility, and assignment of rights and duties within agreements, aspects considered to have particular relevance to franchising (Leblebici and Shalley 1996).

[7] A McDonald's restaurant franchise agreement, for example, has a 20-year duration (Kaufmann and Lafontaine 1994).

Franchise agreements seldom contain provisions for collaborative or joint decision-making, with unilateral authority typically retained by franchisors (Price 1997). Unlike other contractual agreements, franchise agreements are seldom negotiated, presented to prospective franchisees "on a take-it-or-leave-it basis," sometimes with "callous disregard for fair play and even fundamental rights" (Brown 1985, p. 1-6). Franchise agreements contain terms and conditions that obligate both franchisors and franchisees. As such, they have been viewed as "mutual business plans," fortifying promises made by each party (Lewis 1990, pp. 92-3). Falbe and Dandridge offered another view, arguing that franchise agreements are designed by franchisors specifically to ensure franchisees adherence to their terms (Falbe and Dandridge 1992). Martinez and Jarillo also considered franchise agreements as an integral part of a franchisor's coordination and monitoring mechanism[8] (Martinez and Jarillo 1989). Contractual provisions that include a right to monitor a franchisee's business has often been justified by a franchisor's need for trademark protection (Selden 1998).

In addition to considering an agreement's provisions and terms, contracting studies have also examined trust, cooperation, and control mechanisms in contractual relationships. Within the context of joint business endeavors, trust was defined as one entity's expectation of ethically justifiable behavior on the part of the other entity (Wicks, Berman et al. 1999). Tsai found that trustworthiness was positively associated with facilitating resource exchanges and combinations, creating value for a firm, and encouraging innovation (Tsai and Ghoshal 1998). Ring posited that trust between contracting parties enabled use of less formal norms and sanctions, which facilitated

[8] Martinez and Jarillo defined coordination mechanism as "any administrative tool for achieving integration among different units within an organization" (Martinez and Jarillo 1989, p. 490).

ongoing cooperative relationships between organizations (Ring 1996). Written contracts with specific terms and safeguards, argued Hudson, were necessary only when there was no prior relationship, or when there was no reason for one party to trust the other (Hudson and McArthur 1994). In their empirical study, Frankel et al. found that manufacturers, merchandisers, and service providers in their sample did not believe that formal agreements or contracts were necessary in order to achieve effective alliance relationships (Frankel, Whipple et al. 1996). Das argued that control was used in contracting relationships only when adequate trust was not present, and that disparate levels of trust and control were reliable indicators of the parties' degree of confidence of cooperation (Das and Teng 1998).

Despite its use as an indicator of cooperation, trust has not been considered a requisite for cooperation,[9] since enlightened self-interest and legal mechanisms allow strangers to work together for a common purpose (Fukuyama 1995). Although not a prerequisite, trust is considered to be essential (Gentry 1996) or at least an important element in the success of inter-firm relationships (Jeffries and Reed 2000) and contracting longevity (Hudson and McArthur 1994). The most critical time for trust formation between parties, whether among individuals or organizations (Jones and George 1998), was found to be at the initial stage of their relationship (McKnight, Cummings et al. 1998).

[9] Fukuyama (1995) stated, "…people who do not trust one another will end up cooperating only under a system of formal rules and regulations, which have to be negotiated, agreed to, litigated, and enforced, sometimes by coercive means. This legal apparatus, serving as a substitute for trust, entails what economists call "transaction costs" (Fukuyama 1995, pp. 27-8).

2.2.2 Contracting Literature- Interpretive Summary

Despite their prominent role in franchise relationships, relatively little is known about franchise agreements beyond fees and royalty rates (e.g., (Baucus, Baucus et al. 1993); (Lafontaine and Shaw 1999)). Two recent studies, however, have advanced the knowledge base in franchise contracting, highlighting a need for further work in this area.

Leblebici and Shalley examined allocations of contractual rights, establishing four categories of variables in their exploratory examination of 30 franchise contract attributes[10] (Leblebici and Shalley 1996). Although franchise agreements are generally considered relational, their sample revealed that discrete rights and obligations were more prevalent in formation and termination provisions. The authors concluded that because franchise contracts bring together future expectations of both parties, "franchisors can improve their prediction of new venture success by evaluating the contractual arrangements specified for their firms" (p. 416).

Additionally, Bercovitz observed that variations among franchise agreements remained largely unexplained (Bercovitz 1999). In her study of exchange hazards, she found that contractual arrangements between franchisors and franchisees contained significant variations in contract duration, territorial restrictions, and termination clauses. While it is generally assumed that contractual provisions in franchise agreements are designed to control free riding by franchisees, her study noted that "essentially no empirical work

[10] Leblebici and Shalley grouped their variables into four major categories: (1) characteristics of the franchise, (2) the contract characteristics in terms of allocation of rights and obligations, (3) the governance structure of the contract with respect to monitoring, control, and dispute resolution, and (4) contract performance in terms of the number of legal disputes that may exist between the franchisor, and the franchisees and the growth of the franchise operations (Leblebici and Shalley 1996, p. 411).

(exists) exploring how the adoption of specific contract terms can alleviate this hazard" (p. 1). Bercovitz's study filled a gap in the literature by investigating both non-pecuniary and payment-related contract terms in franchising, and uncovered differences in franchise agreements beyond franchise fees and royalties.

Although a contracting perspective is integral to understanding franchise relationships, the legal environments in which this form of contracting takes place must also be considered. For example, franchise agreements may contain conditional terms, restrictions, and provisions, such as those that grant exclusive territories or exclude competition among suppliers. As such, franchise agreements are not only subject to laws that regulate business contracting in general, but also, in certain jurisdictions, to laws specifically drafted to regulate franchising. Differences in legal environments may shape the provisions of some franchise agreements, and therefore, must be considered in studies of franchising.

Viewed from a contracting perspective, detailed and restrictive provisions typically found in franchise agreements suggest that little or no trust exists between franchisors and franchisees. Lutz suggested, however, that franchisees' freedom of action might be more dependent on a franchisor's ability to monitor performance than on specific contractual provisions (Lutz 1995). Although trust between parties in franchising remains largely unexplored, Falbe and Dandridge argued that an environment of trust and co-operation would benefit both franchisors and franchisees (Falbe and Dandridge 1992). Low levels of trust among firms engaged in cooperative relationships are not, however, unique to franchising. Mudambi and Helper found that of the 675 U.S. firms in their survey, only a small number had relationships where high levels of trust existed (Mudambi and Helper 1998).

In summary, a contracting perspective provides some valuable insights, but may present somewhat of a myopic view when used exclusively to examine complex franchising relationships. Despite widespread belief that franchise contracts create a uniform and highly regimented environment, there appears to be mounting empirical evidence to the contrary.

2.3 Networks, Alliances, and Cooperative Interorganizational Relationships

Cooperative relationships exist as forms of governance for transactions between economic actors, different from traditional supplier relationships or licensing arrangements (Ring 1996). Cooperative relationships are defined as voluntary formal or informal contractual arrangements where mutual collaboration results in risks and rewards. These and other cooperative strategies among firms are of growing interest in entrepreneurship research (Brush and Chaganti 1996). Low and MacMillan observed that entrepreneurial opportunities were created both within and among organizations as a result of ongoing relationship networks and exchanges that take place within them (Low and MacMillan 1988).

Franchising has been called "the most ubiquitous and fastest growing form of cooperative arrangements among entrepreneurs" (Gassenheimer, Baucus et al. 1996, p. 67); "arguably one of the most important organizational innovations of the last half century" (Lafontaine and Masten 1995, p. 1). Despite studies of various forms of licensing, strategic alliances, joint ventures, and other quasi-integrated organizations, there has been a scarcity of research on franchising as a form of strategic alliance (Harrigan 1998).

2.3.1 CIOR, Strategic Networks and Alliances- Review of Selected Theoretical and Empirical Literature

Ring and Van de Ven included strategic alliances, partnerships, coalitions, joint ventures, franchises, research consortia, and other various forms of networked organizations under the heading of cooperative interorganizational relationships (CIOR) (Ring and Van de Ven 1994). Their propositions offered reasons why CIORs formed, why some succeeded, and why others failed. They posited that CIORs would emerge when sufficiently favorable business conditions and motivations existed, causing two or more firms to explore exchange through a cooperative relational contract. A simple set of heuristics would then guide the parties through initial and recurrent sequences of negotiations, leading to commitments to action. The authors suggested that CIORs may be formed from pre-existing friendships, institutional mandates, resource dependencies, or brokered deals by venture capitalists or investment bankers.

In practice, most CIORs emerge incrementally among strangers, beginning with small, informal deals that involve little risk and do not rely on trust. Citing work by Aldrich (1979) and Powell (1990), Ring and Van de Ven posited that one reason for failure among organizational relationships is that they are poorly matched with environmental conditions, an explanation more appropriate for those engaged in discrete contractual relationships than those in relational forms of exchange (Ring and Van de Ven 1994).

The authors concluded that endogenous forces arise over time within a relationship, which might help to explain a CIOR's survival or failure.

One form of cooperative interorganizational relationship (CIOR) is a strategic network. Jarillo defined strategic networks as “long-term, purposeful arrangements among distinct but related for-profit organizations that allow those firms to gain or sustain competitive advantage vis-à-vis their competitors outside the network” (Jarillo 1988, p. 32). Entrepreneurs typically developed network relationships with individuals and entities such as suppliers, customers, accountants, and bankers (Hill and McGowan 1996), serving as vehicles to acquire external resources (Winborg and Landstrom 1997). An effective network was found to reduce requirements for specific contract terms and conditions, using trust, reciprocity, and obligation in their stead (Hudson and McArthur 1994).

Jarillo posited that strategic networks are preferred to integrated firms when four conditions are present. First, when widely differing optimal scales exist. That is, when a large firm may best carry out some activities, while other activities are best performed by small firms. Second, when some activities of a firm require a specific *culture* or mentality that substantially differs from other activities within the firm. Third, when innovations within a large firm come primarily through motivations of small units within the firm. Finally, firms benefit from strategic networks when different activities within a firm contribute widely different rates of profitability (Jarillo 1993).

Several aspects of Jarillo's network perspective were found to be relevant to franchising. Viewed from a network perspective, franchisees have considered themselves as partners with franchisors in a strategic relationship (Spinelli 1997). Although networks have been viewed as examples of interdependence among firms (Wicks, Berman et al. 1999), a network perspective suggests that levels of operational independence may exist for franchisees, whose decisions can influence performance at a franchised outlet (Baucus, Baucus et al. 1996); (Phan, Butler et al. 1996); (Stanworth and Gibb 1984). On the other hand, clear distinctions between parties, a requirement in Jarillo's definition, are not always evident in franchises. Continuing franchisor control over a franchisee's business operations poses a question of whether a franchisor-franchisee 'network' should be considered as one business or many (Adams, Jones et al. 1997).

Another type of cooperative interorganizational relationship (CIOR) is a strategic alliance. Strategic alliances are cooperative arrangements between firms that typically involve exchanges, such as sharing or co-development of products or technologies (Gulati 1998). Exchanges may take place either across or within industries at a firm-to-firm level (Brush and Chaganti 1996). Similar to other forms of business partnerships, strategic alliances establish relationships considered analogous to marriages (DeRose 1994). Shared objectives and satisfactory levels of cooperation have been considered vital to success in strategic alliances (Das and Teng 1998).

Although some similarities exist, several aspects of franchising raise questions about the validity of a strategic alliance perspective in studies of franchising. Brown observed that there was gross disparity in bargaining power, financial strength, access to relevant information, and economic exposure to loss between the parties in a franchise (Brown and Dev 1997). In some instances, these disparities were used to create value for franchisors at the expense of less-informed franchisees (Birley, Leleux et al. 1997). Despite this power imbalance, franchisors have not been considered to stand in a fiduciary relationship[11] with franchisees (Price 1997), a view supported by virtually all U.S. courts that have issued opinions on this subject (Emerson 1998).

In addition to an imbalance of power, evidence of incongruous goals between franchisors and franchisees has also been presented (Phan, Butler et al. 1996); (Spinelli and Birley 1996). Because royalties are most often tied to sales, franchisor's are concerned with volume and turnover, not retail unit profit (Cohen 1971). Differences in this basis of compensation may cause some franchisors to encourage growth beyond profit-maximizing levels (Baucus, Baucus et al. 1996). A manifestation of goal incongruity is realized when a franchisor sets the hours of operation for a franchised unit without regard for whether or not it is profitable for a franchisee to be open. Arguably, the shared objectives found in other strategic alliances may not always be found in franchising.

2.3.2 Cooperative Interorganizational Relationship- Interpretive Summary

Similarities have been found between franchising and various forms of cooperative interorganizational relationships (CIORs), including networks, and strategic alliances. Following Ring and Van de Ven's criteria, franchise agreements appear similar to CIORs initiated among strangers. Unlike these cooperative relationships, however,

[11] The fiduciary status places on the fiduciary a trustee's duty to serve the beneficiary with undivided loyalty and not "profit at the expense of the other." However, a significant part of the transactions (discussions, negotiations, or otherwise) between franchisor and a potential franchisee are of a commercial nature, with each party having some access to information in some bargaining power. So long as each party can recognize and take actions favoring its own best interests, judicial or legislative imposition of a fiduciary status is inappropriate. For this reason, virtually all courts issuing opinions on the subject have refused to characterize the franchise relationship as a fiduciary one (Emerson 1998).

franchises usually involve substantial monetary investments, and have considerable exit costs for franchisees. Whether or not a franchise relationship involves little or no risk is currently a subject of considerable debate (c.f. (Bates 1995); (Castrogiovanni, Justis et al. 1993)).

Franchising also appears different from the two general types of networks introduced by Dyer and Singh: those formed by de-centralized large firms, and networks made up of a large number of companies who came together in a *natural* way, normally within the same geographic environment (Molina 1998). Further, Thorelli argued that in order to serve as an engine of growth, strategic planning among network members was necessary (Thorelli 1986). Limited information is presently available on how franchise participants conduct strategic planning (Parsa 1999), and no empirical evidence supports a premise that franchisees engage in strategic planning. Shortcomings notwithstanding, a network perspective may prove useful in studies that link value chains of franchisors, franchisees, and suppliers. An example of a franchise value chain is provided in Appendix A, Figure A1.

Unlike other strategic alliances, long-term franchise agreements are assumed to prevent either party from responding or adapting to change. This attribute may explain a scarcity of research on franchising as a form of strategic alliance. In contrast to franchise relationships, strategic alliances are generally dynamic "evolutionary products" with new exogenous and endogenous ties developed in the network over time (Gulati 1998). Another reason for an absence of research in this area may be that a legal and economic distinction between firms engaged in the relationship is inherent in definitions of a strategic alliance. Although legally separate, economic distinctions between franchisors and franchisees are often blurred, a topic addressed in more detail in the next section of this chapter. As noted earlier in this section, continued franchisor control in franchise relationships makes this form of alliance different from others, which may reduce the effectiveness of comparative studies between franchised and non-franchised alliances.

In summary, although some aspects of cooperative interorganizational relationships (CIORs) have direct relevance, franchise relationships appear to have distinctive and unique properties and characteristics that must also be considered, limiting the effectiveness this perspective's exclusive use.

2.4 ECONOMICS

Economists were among the first to consider an entrepreneur's role as one separate from that of a capitalist. Viewed from this perspective, entrepreneurs "are the change agents of capitalism" (Thurow 1999, p. 83), whether through creative destruction of the status quo (Schumpeter 1934) or entrepreneurial discovery (von Mises 1949). Change through innovation and bearing of risk were central themes in economists' views of entrepreneurship.

2.4.1 Economics- Review of Selected Theoretical and Empirical Literature

Most economists and many non-economists alike have accepted Schumpeter's identification of *entrepreneurship* with *innovation* (Stevenson and Jarillo 1990). Cahill observed that the terms *innovation* and *entrepreneurialism* were frequently used interchangeably (Cahill 1998). Although Baumol also considered a "firm-organizing entrepreneur" as legitimate, it was an "innovating entrepreneur" who was responsible for economic growth and progress in productivity, accomplished through transformation of “inventions and ideas into economically viable entities” (Baumol 1993, p. 198). Innovation has consistently been associated with firm success (Baldwin 1995), and an ability to sustain competitive advantage has been dependant upon a firm's ability to develop capabilities for innovation (Lado, Boyd et al. 1997). Arguably, discovery of opportunities became a core issue of entrepreneurship (Kirzner 1997), in part because, as Smilor posited, "For the entrepreneur, opportunity is based in innovation," (Smilor 1997, p. 343).

In organizational contexts, economic theories revolve around concepts that view humans as fundamentally rational beings who seek to maximize utilities, and that organizations are formed to enhance efficiency (Freeman 1999). Organizations, argued Scott and Rosa, were a means to an end, mechanisms that translated the entrepreneurial vision through action, control and mobilization of resources to extract value and accumulate capital (Scott and Rosa). Consistent with these tenets, entrepreneurship has been associated with an individual’s commitment to capital accumulation, business growth, and assumptions of risks in a pursuit of opportunities in the market (Scase 1997), acting either as individuals or through organizations.

Of particular relevance to franchising, three constructs in the economics literature have provided valuable insights and models: (1) resource scarcity or capital acquisition model; (2) agency theory; and (3) transaction costs economics. According to resource scarcity theory, businesses that grow by vertical integration face higher capital constraints than businesses that expand via franchising. Through payment of up-front fees, franchisees fund a franchisor's business expansion, thereby providing an efficient source of capital (e.g., (Caves and Murphy 1976); (Dant 1995)). Capital provided by franchisees may be used to expand a franchisor's trademark through more locations, increase marketing power within a system, and/or increase overall economies of scale of a system (Birley, Leleux et al. 1997).

Based on 200 years of economic research, agency theory assumes humans as rational actors who seek to maximize their individual utility (Jensen & Meckling, 1976 in (Davis, Schoorman et al. 1997). Agency problems arise when division of labor requires that a principal delegate decision-making authority to an agent (Jones and Butler 1992). Agency theory explains how best to organize relationships in contexts where one party determines work that another party undertakes (Eisenhardt 1989). Within franchising's context, agency theory has been applied to studies of situations where monitoring is difficult or expensive, or when motives of the parties differed. Agency theory predicts that companies will favor franchising over company ownership where high monitoring costs are present (Brickley and Dark 1987).

Viewed from an agency theory perspective, residual claims to profits more closely align incentives of franchisors and franchisees, compared to those of corporate managers (Eisenhardt 1989). Managers of company-owned outlets neither bear full costs nor receive full benefits from their efforts, because their individual compensation and financial performance of their outlet are not always directly linked (Kehoe 1996). In contrast, compensated on residual claims, franchisees bear most of the costs of shirking (Stanworth and Curran 1999).

In addition to capital scarcity and agency theory, transactions cost economics also provides insights relevant to franchising. Transactions cost economics is fundamentally about how economic activities are bundled in organizations (Freeman 1999). Viewed from this perspective, firms exist because they reduce negotiation and enforcement costs associated with exchanges (Coase 1937). Transactions cost economics is built on traditional economic theory, which views relationships among independent businesses as short-term exchanges, terminated at the conclusion of a transaction (Brown and Dev 1997). It specifies conditions under which firms should manage economic exchanges within their organizational boundaries, and when exchanges should be outsourced. Transaction cost economics adopts John R. Commons's (1934) proposition that a transaction is the basic unit of analysis (Williamson 1991). Exchange issues considered relevant to transactions cost include costs of a governance mechanism, and threat of opportunism in exchanges (Barney 1999).

Bello concluded that transactions cost analysis was the dominant theoretical framework employed to model variations in governance structures (Bello, Dant et al. 1997). A variety of organizational forms between market and vertically integrated hierarchies are explained by the underlying attributes of transactions, namely asset specificity, uncertainty, and frequency (Leblebici and Shalley 1996). Although transactions cost proved useful in predicting when and why a franchisor may decide to vertically integrate (Williamson 1991), it was considered less useful in analyses of ongoing, contractual relationships of independent contractors, and in specific studies of firms that operate somewhere between market and hierarchical poles (Lassar and Kerr 1996).

Ongoing cooperation between entities in business exchanges typically involves elements of interdependence. A threat of opportunism arises when one party in an exchange requires a disproportionate investment in transaction-specific assets by the other party (Williamson 1975); (Williamson and Winter 1993), a condition found in many franchise systems. In franchising, threats of opportunism are addressed in detailed contractual terms, specified in disclosure documents and franchise agreements. Economists have demonstrated that franchise contracts can reduce free riding by franchisees (Meese 1996). Coase, Williamson, and Klein, Crawford, and Alchian concluded, however, that there are transaction costs associated with writing contracts (Hart 1987, p. 140). In this regard, formal rules and regulations serve as a legal substitute for trust, with costs of litigation, negotiation, and enforcement acting as a tax on economic activity (Fukuyama 1995).

In empirical studies of franchising, agency theory has received qualified support, while support for resource scarcity theory was mixed. Shane, in his study of 157 franchise systems, found support for agency theory, but rejected predictions based on resource constraint theory (Shane 1998). Agency theory was also supported in Kehoe's study, which found strong support for use of franchising in the hotel industry to overcome principal-agent problems (Kehoe 1996). Support for resource scarcity was mixed because although franchisees may be viewed as an efficient source of capital, they may demand a higher return on their capital than passive investors. Franchisees are typically unable to sufficiently diversify their risk among several outlets in a chain (Norton, 1995; Rubin, 1990) in (Combs and Ketchen 1999).

2.4.2 Economics- Interpretive Summary

A summary of different views offered by four of the economics schools of thought is provided in Table 2.1.

Table 2.1 Summary of Views from Economics "Schools of Thought"

Neoclassical	Firm is an input combiner Humans are motivated by self-interest. Critical resources are immobile, intangible, and self-compounding. Demand is heterogeneous and dynamic. Information is imperfect. Firms are content with superior financial performance. The firm is not a black box. Market equilibrium is pernicious abstraction. Markets are in constant turmoil.
Austrian	Firm is an innovation seeker. Markets are dynamic processes of discovery that mobilize disbursed and imperfect information. The firm is motivated by desire for supranormal profits as vehicle for promoting discovery and realizing opportunities in constantly changing (disequilibrium) marketplace. Assuming market efficiency, persistent profit opportunities are precluded. Profits exist only to the extent of uncertainty and disequilibrium. Entrepreneurs see mismatches (imperfection) between offerings and demand; their arbitrage results in profits.
Transaction Costs	Firm is avoider of transaction costs resulting from market exchange. Such costs include all the negotiation, monitoring, and enforcement costs. Asset specificity, uncertainty, and bounded rationality are critical concepts constraining the firm's achievement. Focus is on deployment and combination of resources to meet heterogeneous and dynamic demand rather than on avoidance of negative aspects of market exchange.
Resource Based	Firm is a seeker of unique or otherwise costly-to copy inputs. The appropriate unit of analysis is the firm, not industry. The management (internal efficiency) of the firm is a salient factor. Firm behavior is a deliberate choice more than a foregone conclusion from external factors. Healthy earnings can result from less-than-innovative leaps of the Schumpeterian type. Focuses on deployment and combination of resources to meet heterogeneous and dynamic demand rather than on other considerations, such as avoidance of negative aspects of market exchange. The resource-based theory's focus is on short-or medium-term behavior.

Source: Deligonul, Z. Seyda and Cavusgil, S. Tamer, *Does the Comparative Advantage Theory of Competition Really Replace the Neoclassical Theory of Perfect Competition?* (Deligonul and Cavusgil 1997).

Despite some empirical support, agency theory, when used exclusively to study organizations, ignored "a good bit of the complexity" and presented "only a partial view of the world" (Eisenhardt 1989, p. 71). When applied to studies of franchising, agency theory alone provided insufficient insights into the ubiquity of company-owned and franchised units within the same chain (e.g., (Bradach 1997); (Bradach 1998); (FFCA 1999)), or a prevalence of multi-unit ownership by franchisees (e.g., (Bates 1997); (FFCA 1999); (Kalnins and Lafontaine 1996)). Agency theory, focused on incentives, monitoring and geographic dispersion, provided inconsistent predictive power into a firm's decision whether to franchise or vertically integrate. Supermarkets, for example, have highly dispersed retail outlets and almost never franchise (Maness 1996). [12] Recognizing these and other limitations to agency theory, Elango and Fried concluded that past franchise research was tied too closely to theories of agency and power (Elango and Fried 1997).

The literature of transaction-cost economics has focused primarily on a firm's boundary activities, ignoring to some extent a firm's internal functioning (Gibbons 1999). Transaction cost economics adopts an approach in which a transaction is made the basic unit of analysis (Williamson 1991). It suggests that only costs of a governance mechanism and threats of opportunism in an exchange are relevant (Barney 1999). Long-term relational aspects associated with a franchise may limit transaction cost's effectiveness in franchising studies. Additionally, Demsetz concluded that aspects of opportunism, moral hazard, and shirking were difficult to derive exclusively from transactions cost considerations (Demsetz 1987, p. 167). These aspects are important to franchising, since franchisees potentially shirk on product quality, because gains accrue solely to the shirker while costs are borne by all members of a franchise system (Shane 1996).

[12] Michael concluded that diffused residual claims associated with franchising lowered quality standards in the outlet, a characteristic inherent in franchising (Michael 2000). He found that quality was negatively associated with the percentage of franchised outlets in chains of hotels and restaurants.

In summary, Bhide posited a more critical limitation of exclusive use of economics theory in studies of business, arguing "Mainstream economics has little to tell us about how and why some firms survive and grow and others do not" (Bhide 2000, p. 242).

2.5 Legal

Franchising is a form of business that touches many different areas of domestic and international law (anonymous 1999). A complete review of all applicable legal literature relevant to franchising is beyond the scope of this study. Rather, this section reviews studies that provide insights on the legal landscape in which franchising operates, focused on North America and Europe.

2.5.1 Legal- Review of Theoretical and Empirical Literature

As presented earlier in this chapter, franchising is considered a contractual form of business between two legally distinct entities, although ongoing controls and financial interdependence have called into question whether franchise participants are one business or many (Adams, Jones et al. 1997). In a franchise relationship, franchisors typically maintain unilateral control (Selden 1998), to a degree that some may consider franchisees an extension of a franchisor in the marketplace (Morgan and Stoltman 1997). Considering aspects of control and interdependence, Rubin argued that the definition of a franchisee as a separate entity is a legal not an economic distinction (Rubin, 1978 in (Castrogiovanni and Justis 1998). Legal distinctions between franchisors and franchisees are often tested when liability issues are litigated (Morgan and Stoltman 1997). Although a consensus view in the literature is not evident, franchisees have generally been considered legally independent of but economically dependent upon the business system of a franchisor (Kuratko and Hodgetts 1995).

Similar to other forms of contractual business, franchising is subject to a broad range of common and civil laws.

Table 2.2: Franchise Legislation from Selected Countries

Country	Applicable Legislation	Requirements
United States	Federal- Franchise "Rule[13]" Additional State Laws[14]	Required disclosure Required registration
Canada	No Federal Law Only Alberta has specific franchise law	Required disclosure Civil remedies for breach Obligation of "fair dealing"
France	*Loi Doubin* covers all forms of business where license or trademark is involved.	Required disclosure of "sincere information"
Mexico	Industrial Property Law	Required disclosure Required registration with Mexican Institute of Industrial Property
Brazil	Franchising Law of 1994	Required disclosure Standard franchise agreement
Spain	Retail Trade Act of 1996	Required registration Required disclosure
Australia	Franchising Code of Conduct 1998	Required disclosure
Indonesia	Government Regulation on Franchising 1997	Required disclosure Required registration Required priority to small and medium sized entrepreneurs
Russia	Civil Code	Required registration
Romania	Ordinance	Pre and Post contractual requirements Required disclosure

Source: Konigsberg, Alex S., 1999, *Around the World with Franchise Legislation* (Konigsberg 1999)

Despite its worldwide growth, and the law's role in governing franchise business relationships, Mendelsohn posited, "there is no such thing in England, or indeed

[13] U.S. Federal Trade Commission *Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures*, Title 16 "Commercial Practices," Chapter 1, Subchapter D- "Trade Regulation Rules."

[14] States requiring franchise company registration: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington, Wisconsin (anonymous 1999). Thirteen of the state laws treat the sale of a franchise in a fashion similar to the sale of a security. State laws provide important legal rights to franchise purchasers, including the right to bring private lawsuits for violations of state disclosure requirements (anonymous 2000).

anywhere else, as franchise law" (Mendelsohn and Bynoe 1995, p. xiii). A number of countries have enacted legislation with requirements relevant to franchising, a selected sample of which is provided in Table 2.2.

Franchising's worldwide growth has prompted a number of countries to consider legislation in order to regulate different aspects of a franchise relationship.[15] Poland, for example, has been viewed as a market "ripe for franchising," with rapidly expanding media and advertising sectors, several successful franchise systems already in operation, and identified prospects in retail, services and fast-food industries (Service 1998). Although Poland currently has no laws that govern franchising, a need for legislation has been predicted as franchising becomes an important element of their economy (Minsker 2000). Some countries with specific franchise laws are considering expansion of their regulatory legislation. Although Canada has no federal laws regulating franchising, the Province of Ontario has recently drafted Bill 93, following U.S. Federal Trade Commission legislation and existing franchise disclosure laws in Alberta.[16]

Homogenization of preferences among consumers separated by national boundaries has helped to promote expansive growth of franchising (Levitt 1983 in (Teegen 2000). At

[15] Beales III and Muris explained one reason why a need for specific legislation exists beyond enforcement of the contract as written. They posit that successful franchisors have established and valuable trademarks, representing standards of quality among consumers in the marketplace. Although franchisees must expend their resources to maintain the value of the trademark, they have an incentive to avoid expenditures, realizing the full benefit but incurring only part of the cost. Even if explicit terms are written into the franchise agreement, reduced quality by franchisees may be difficult to detect, such as decreased employee monitoring or training, which leads to poor service. To prevail in litigation, franchisors must convince external observers, often before a jury that is likely to favor 'the little guy' in disputes with the 'bigger' franchisor (Beales III and Muris 1995, pp. 159-60).

[16] The Alberta Franchises Act applies only to those franchises which are both operated in Alberta and where the prospective franchisee is an Alberta resident or is an entity with a permanent establishment in Alberta (Cohen 1999).

the vanguard of this trend are U.S. franchisors (Hoffman and Preble 1993). Shane found that from 1971 to 1985, U.S. franchisors added foreign outlets at a rate of 17% per year, almost twice as fast as they added domestic outlets (Shane 1996), while another study revealed that 400 U.S. franchisors increased their number of overseas units by more than 70 percent during the 1980s (Preble and Hoffman 1995). It follows, then, that the regulatory landscape in North America and abroad are of considerable interest to U.S.-based franchisors.

The European Union represents the largest market for franchising outside the U.S., and for many franchisors, the UK serves as the gateway to the rest of Europe[17] (Tuttle and Marcheso 2000). U.S. franchisors considering entry into the UK marketplace find no disclosure laws, no registration requirements, and no laws focused on termination or renewal, a legal climate described as "a breath of fresh air" (Nelson and Marcheso 1998, p. 1). Canada's legal climate is also of particular interest because 25% of the country's 1,300 operating franchise systems are U.S.-based, making it one of the largest single foreign markets for U.S. franchisors (anonymous 2001).

Table 2.3: Franchise Fees Receipts to U.S. Franchisors (in $ millions)

	1996	**1997**	**1998**	**1999**
Canada	36	29	41	35
Europe	170	192	230	253
Latin America[a]	38	44	53	56
Africa	9	12	12	14
Middle East	24	34	38	43
Asia and Pacific	131	148	123	147
Other	11	17	9	22
Total	**$ 419**	**$ 475**	**$ 506**	**$ 569**

Source: U.S. Department of Commerce, *U.S. International Services: Cross-Border Trade in 1999 and Sales Through Affiliates in 1998* (2000).

[a] Includes other Western Hemisphere Countries not listed elsewhere

[17] As of November 1999, there were 570 systems with 30,000 franchised units operating in the UK, which recorded $11.2 billion in turnover (Tuttle and Marcheso 2000).

Fees from overseas royalties and payments to U.S. franchisors totaled $569 million in 1999, up from $419 million in 1996 (Mann, Brokenbaugh et al. 2000). Franchising is clearly a substantial export for the United States. Table 2.3 summarizes the international receipts of franchise fees to U.S. franchisors.

Although its worldwide potential was considered exponential (anonymous 1999), franchising's growth may be influenced by differing regulatory climates. In broad terms, laws relevant to franchising include those that address aspects of intellectual property and those that govern franchisor-franchisee relationships, both pre-purchase and during the term of a franchise agreement. Intellectual property refers to trademarks, registered designs, and copyrights that form part of an intangible asset base of a company[18] (Blackett 1998). Intangible assets were found to represent a substantial potion of the total assets in most franchise systems (Spinelli and Birley 1996), achieving their highest values when brand name, trademarked logo, and operational know-how are combined (Smith 1997). Because of substantial investments in marketing and operational development by franchisors, laws that protect trademarks and brand names are considered important in franchising (Johnson 2000); (Morgan and Stoltman 1997).

2.5.1.1 Intellectual Property Protection

A company's name, trademarks, trade names, service marks, brands, and brand names are forms of intellectual property typically found in franchising. Since legal

[18] Blackett (1998) observed that the earliest trademarks recognized by statute law in England were hallmarks used by the cutlers of Sheffield, drawn up during the reign of Elizabeth I, and codified under the Cutler's Company Act of 1623. The first trademark registered under the British Trade Marks Act of 1987 was the red triangle of Bass pale ale (Blackett 1998, pp. 6-7).

terminology sometimes differs among jurisdictions, definitions for various forms of intellectual property as they are used in Europe and the U.S. are provided in Table 2.4.

Table 2.4: Intellectual Property Definitions

Trademark	Name, sign, or symbol used to distinguish products or services of individual or enterprise from those of others.[a]	"Any word, name, symbol or device or any combination thereof, adopted and used by a manufacturer or merchant to identify its goods and distinguish them from those manufactured or sold by others." 15 U.S.C. § 1121[b]
Trade Name	Name used to distinguish individual or enterprise offering goods or services.[a]	"Any name used by a person to identify his or her business or vocation." 15 U.S.C § 1127[b]
Service Mark	Trademark used specifically to distinguish service as opposed to goods.[a]	Type of trademark which identifies source of services (Celedonia 1999).
Brand	Trademark or combination of trademarks, which through promotion and use has acquired significance over and above its functional role of distinguishing the goods or service.[a]	
Brand Name	Most common form of trademark, central component of brand.[a]	

[a] Source: Blackett, Tom, *Trademarks* 1998, page 7-8
[b] Source: United States Code

Although a number of European countries maintain individual trademark protection laws, the Office for Internal Harmonization in the Internal Market, opened on April 1, 1996, provided a single trademark registration that covers all 15 EU member countries (Kaufman and Hines 1997). The system, known as the Community Trademark or CTM, is open to all Paris Convention countries, including the U.S., which provides a cost-effective means of registering trademarks in the European Union.

In the European Union and in most other countries, trademark rights arise from formal registration of the mark, while in the U.S., trademark rights arise from the mark's use in the marketplace (Celedonia 1999). Trademark protection in the U.S. is afforded under common law, selected state laws, and by federal statutes in Title 15 of the U.S. Code, The Trademark Act of 1946 (anonymous 1998). Known as the "Lanham Act,"[19] this law descended from earlier generations of trademark law, and was designed to encourage registration and protect marks from unfair competition (anonymous 1996). Until the Canadian government enacted fundamental reform of its trademark laws in 1993, substantial differences existed between trademark laws in the U.S. and those in Canada (Burshtein 1998).

2.5.1.2 Pre-Contract Relationship

Whether on a state, provincial, or federal level, jurisdictions that have enacted specific franchise legislation frequently have included requirements for franchisors to disclose aspects of their company to prospective franchisees before execution of a franchise agreement. The Canadian Province of Alberta adopted laws in 1971 requiring franchisors to furnish disclosure documents to prospective franchisees at least 14 days before agreement signing (Konigsberg 1999). Alberta's franchise legislation was updated with the enactment of the Franchises Act, Chapter F-17.1 of the Statutes of Alberta, in 1995, a summary of which is presented in Appendix B, Table B1.

The first country outside of the U.S. and Alberta to adopt legislation directly relevant to franchising was France. In 1989, the French government enacted *Loi Doubin*, a disclosure requirement that applies to all agreements involving a trademark or license (Konigsberg 2001). Disclosure Document requirements for *Loi Doubin* are provided in Table 2.6:

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[19] Introduced by Texas congressman Fritz Lanham, signed into law on July 5, 1946 by President Harry S. Truman. In January 1996, President Clinton signed the Federal Trademark Dilution Act, which strengthened the Lanham Act and harmonized U.S. trademark laws with those of many other nations (anonymous 1996).

Table 2.6: Disclosure Document Requirements *Loi Doubin*		
1.	General Information About the Franchisor	a. Date business founded b. Stage of development c. Address of franchisor's head office d. Franchisor's legal form of business e. Nature of franchisor's activities f. Name(s) of management g. Business experience of management
2.	Registrations	Relevant registration numbers, dates of registration of trademarks.
3.	Bank Information	Names and addresses of five principal banking locations.
4.	Goods and Services	General and local market forecast of possible future growth and development.
5.	Financial Statements	Annual statements from last two fiscal years.
6.	Franchise Network	List of all franchisees; number of franchisees bound by similar agreement; all franchisees who ceased to be members of network in preceding year.
7.	Other	a. Term of agreement and conditions for renewal b. Provisions for termination and assignment c. Scope of exclusivity granted to franchisee d. Estimate of amount and nature of expenses and capital investment
8.	Language	Implied obligation to provide French language version of franchise agreement.
Source: Konigsberg *Franchise Legislation in France* (Konigsberg 2001)		

Although specific disclosure requirements also exist in Mexico, Brazil, Spain, Indonesia, South Korea, and a host of other countries, the United States arguably has the most extensive federal disclosure laws specifically designed to govern franchising (Emerson 1998).

The U.S. Federal Trade Commission's Trade Regulation Rule, known as "The Franchise Rule" includes specific requirements for pre-purchase disclosures of material facts for U.S. franchises.[20] In broad terms, pre-purchase disclosure laws were designed to help prospective franchisees make more informed decisions about their investment

[20] The actual title of "The Franchise Rule" is "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures" 16 CFR Part 436.

(Cohen 1998), which, according to the FTC, The Franchise Rule was intended to do[21] (anonymous 1994). The FTC's disclosure statement is provided in Table 2.7 below:

Table 2.7: U.S. Federal Trade Commission Franchise Disclosure Statement	
Disclosure Statement	
Pursuant to 16 CFR 436.1 et seq., a Trade Regulation Rule of the Federal Trade Commission regarding Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, the following information is set forth on (name of franchisor) for your examination:	
1.	Identifying information as to franchisor.
2.	Business experience of franchisor's directors and executive officers.
3.	Business experience of the franchisor.
4.	Litigation history.
5.	Bankruptcy history.
6.	Description of franchise.
7.	Initial funds required to be paid by a franchisee.
8.	Recurring funds required to be paid by a franchisee.
9.	Affiliated persons the franchisee is required or advised to do business with by the franchisor.
10.	Obligations to purchase.
11.	Revenues received by the franchisor in consideration of purchases by a franchisee.
12.	Financing arrangements.
13.	Restriction of sales.
14.	Personal participation required of the franchisee in the operation of the franchise.
15.	Termination, cancellation, and renewal of the franchise.
16.	Statistical information concerning the number of franchises (and company-owned outlets).
17.	Site selection.
18.	Training programs.
19.	Public figure involvement in the franchise.
20.	Financial information concerning the franchisor.
Source: Code of Federal Regulations, 16CFR436	

2.5.1.3 Competitive Practices

In addition to legislation that protects intellectual property and provides for pre-purchase disclosure, laws that govern competitive practices also have relevance to franchising. The centerpiece of franchise law applicable to competitive practices in Europe is EU Commission Regulation 4087-88, which essentially created an exemption from the EU competition laws contained in Section 85 (Minsker 2000). In Europe, agreements between franchisors and franchisees have been viewed as *vertical agreements*, similar to contracts between suppliers and customers concerning marketing

[21] Since taking effect in 1978, the FTC has obtained judgments of more then $4 million in civil penalties, and $41 million in consumer redress through enforcement of the Franchise Rule (anonymous 1994).

of goods or services. Vertical agreements do not usually give rise to competitive practices concerns unless (1) one of the parties in an agreement has significant market power, or (2) a large network of similar agreements exists (anonymous 1999). A supplier who contractually attempts to control a distributor's conduct, either through resale price maintenance, or selective distribution within a territory or category of customer is employing *vertical restraints*, which restrict or distort competition (Howe 1996). The 1958 Treaty of Rome, the foundation of competition laws in Europe, expressly prohibits practices such as vertical restraints.

Two articles of the Treaty have been considered most relevant to business law, Article 85 that prohibits unfair forms of competition, and Article 86, which prohibits abuse of a dominant position[22] (Davidow and MacKernan 1997). The market power of a franchisor, the network of franchise agreements, and restrictions and obligations typically found in franchising were found to contravene Article 85.1 of the Treaty of Rome (Abell 1998). Since February 1, 1989, franchises have operated under Regulation 4087/88; the so-called *Franchise Block Exemption*, an exemption to Article 85, renewed by the EU Commission at the end of 1999. Although some countries supplement EU Commission laws with a patchwork of civil laws governing general business practices (Krondstrom 1998), and laws may differ among individual countries

[22] Article 85(1) of the Treaty condemns all agreements to restrain or distort competition. Article 85(2) declares void all agreements contrary to 85(1). Article 85(3) gives the European Commission power to exempt agreements which it finds are not seriously anti-competitive or further technical or economic progress while benefitting consumers. A wide variety of arrangements and schemes have been found to violate Article 85. These include cartels, price fixing, resale price maintenance, exclusive distribution systems which impose barriers on trade between members states, illegal tying, market sharing agreements, price discrimination, loyalty rebates and a host of other exclusionary practices (Davidow and MacKernan 1997)

(Nelson and Marcheso 1998), EU countries have relied primarily on Commission rules to govern competitive practices in franchising.

Cunningham observed that the EU Commission has tolerated the otherwise anti-competitive practices of franchising, provided their restrictions fell within certain permitted parameters (Cunningham 1998). An example of the restrictions considered acceptable (white list) and unacceptable (black list) is listed below in Table 2.8.

Table 2.8: *White* list and *Black* list of Terms in Franchise Agreements
***White* List**
Stipulated limits for a specified geographical area of a subfranchise unit (previously expressly prohibited)
Active sales outside of the agreed area may be prohibited
Franchisor can prohibit the franchisee from selling competing products
Non-competition clauses of up to one year
Clauses stating a minimum product assortment are allowed
Franchisor may prescribe certain training or education
***Black* list**
Franchisor denies a franchisee the right to purchase similar products (for example one soft drink brand rather than another)
Contract forbids the use of "common knowledge" or know-how
Control or command of franchisee prices in the contract (Franchisor may recommend a certain retail price).
Franchisor prohibits "passive sales".
Source: Krondstrom 1998 *Franchising- Sweden*

In the United States, the Federal Trade Commission (FTC) through its generic statute, the Federal Trade Commission Act, enforces a variety of federal antitrust and consumer protection laws. Established by Congress in 1914, the FTC is an independent agency charged with enforcing provisions of the Act, among which are those that prohibit unfair or deceptive acts or practices[23] (anonymous 2000). The FTC's mission is to ensure that U.S. markets function competitively and efficiently, free of undue restrictions and unfair or deceptive acts (anonymous 2000). Among the competitive

[23] Under Section 5 of the FTC Act, the Commission has determined that a representation, omission, or practice is *deceptive* if: (1) it is likely to mislead consumers acting reasonably under the circumstances; and (2) it is material, that is, likely to affect consumers' conduct or decisions with respect to the product at issue (anonymous 2000).

practice laws enforced by the FTC are the Sherman Antitrust Act of 1890, the Clayton Act of 1914, which was later amended by the Robinson-Patman Act of 1936, and the Federal Trade Commission Act. Antitrust legislation in the U.S. describes unlawful practices in general terms, relying on the courts to decide which are illegal based on individual facts and circumstances (anonymous 2000). A table summarizing the similarities and differences between EU and U.S. competitive practice laws is presented in Appendix B, Table B2.

In addition to competitive practices, legal systems are also used to resolve disputes between franchisors and franchisees. Typical of other dyads and networks, franchises are typically embedded in constitutions, legislation, and regulations, creating exogenous safeguards that define limits within which contracting must be conducted (Hudson and McArthur 1994). Despite popular acclaim, franchise relationships have often become adversarial (Emerson 1998), with a comparatively high rate of litigious activity (Shane and Hoy 1996). Using a random sample of 75 companies from a pool of 1,031 franchising companies, Bygrave & Spinelli found that 91% of franchisors in their sample were involved in litigation with their franchisees (Bygrave and Spinelli 1992). Although franchise agreements often require arbitration or mediation as forms of dispute resolution, litigation between franchisors and franchisees is prevalent in franchising, especially in the United States.

2.5.2 Legal- Interpretive Summary

In summary, legal environments appear to be evolving both in countries where franchising is in its infancy, and in countries where it is already well established. Already considered to have the most extensive franchise laws (Emerson 1998), the

United States has recently held hearings in the House of Representatives' Judiciary Committee on the Small Business Franchise Act[24] (Coble 1998), which proposed additional federal regulations specific to franchising. Legislators and practitioners appear polarized in their positions on this issue, as are some prominent academic researchers (c.f. (Bates 1999) and (Adler 1999); (LaFalce 1999) and (Cohen 1999); (Kezios 1999) and (Wieczorek 1999)). Among provisions of the Act are imposition of fiduciary duties on franchisors for advertising funds, limits on the ability of franchisors to open outlets near existing ones, and terms that prohibit franchisors from restricting choices regarding sources of supply (Allen 1999).

The effects of legislation on franchising's expansion has yet to be determined through empirical analysis. In some respects, franchisors may avoid markets where extensive legislation exists, favoring those markets with little or no regulatory requirements. Spain's 40 percent annual growth rate of franchising (Gamir and Mendez 2000), one of the few countries in Europe with specific franchise legislation, suggests that the legal environment in which franchising operates, in and of itself, is not a reliable predictor of franchise expansion.

In summary, legal environments in which franchising is conducted shape intellectual property, disclosure, and other provisions found in franchise agreements and disclosure documents such as the UFOC. Because of its extensive federal regulatory requirements, especially those related to disclosure, the United States provides fertile ground for studies of franchising.

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[24] H.R. 4841, 105th Congress, Congressional Record E2162 (1998) (Coble - Small Business Franchise Act of 1998) was introduced on October 14, 1998.

2.6 PSYCHOLOGY

Industrial and organizational psychology has provided supplemental or complimentary research related to individuals and their role in a venture's success (Sexton 1987). According to Stevenson and Jarillo, the *psychological/sociological* approach to studies of entrepreneurship began with McClelland (1961), and Collins and Moore (1964), in the early 1960s (Stevenson and Jarillo 1990). These studies focused on entrepreneurs as individuals, with the idea that individual backgrounds, environments, goals, values, and motivations were the real objects of analysis. According to the authors, causes of entrepreneurial action were of primary interest to these early psychology researchers.

2.6.1 Psychology- Review of Theoretical and Empirical Literature

Among contributions in the psychology literature are studies of individual traits and behaviours, including examinations of entrepreneurial intentions (Bird 1988), self-efficacy (Whyte, Saks et al. 1997), and the effects of self-efficacy on intentions (Boyd and Vozikis 1994). Self-confidence (Krueger and Dickson 1994), and overconfidence (Camerer and Lovallo 1999) have also been examined, as well as a study on the reluctance of some individuals to enter into business (Galbraith and Latham 1996), personality patterns (Miner 1996), emotionality (Jehn 1997), propensity to take risks (Brockhaus 1980), and the influence of biology on psychology (Weaver 1996). Filion observed that behaviourists typically ascribe characteristics of creativity, persistence, locus of control and leadership to entrepreneurs (Filion 1998).

Empirical studies that examined linkages between individual traits and the success of their firms have produced conflicting results. An empirical study by Blanchflower and

Oswald set out to find the impact of psychological traits on entrepreneurship, as measured by self-employment[25] (Blanchflower and Oswald 1998). Using an econometric analysis of the National Child Development Study (NCDS) of 11,407 individuals born in Great Britain, the authors found that 1,279 were self-employed. Because the NCDS study recorded outcomes of psychological tests performed on these individuals as children, Blanchflower and Oswald examined correlations between traits and self-employment.[26] They found that a quantitatively small but clear correlation between those anxious for acceptance when they were children and those who were less likely to start their own business. The authors concluded, "psychology apparently does not play a key role in determining who becomes an entrepreneur" (p. 13).

On the other hand, Kauranen found that personality traits of entrepreneurs were interrelated with firm success, and were particularly apparent in small firms, where the role of an entrepreneur is central to the operation of the business (Kauranen 1997). In studies of individuals within organizations, Eggers found a strong correlation between a CEO's behavior and a firm's financial performance (Eggers, Leahy et al. 1996). Leadership traits and an ability to communicate a vision were also found to have a positive effect on firm performance among those in Baum et al.'s sample of 183 CEOs (Baum, Locke et al. 1998).

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[25] Blanchflower and Oswald considered self-employment as the simplest form of entrepreneurship (Blanchflower and Oswald 1998).

[26] The National Child Development Study (NCDS) is a "longitudinal birth cohort study that takes as its subjects all those living in Great Britain who were born between March 3 and March 9, 1958. These children were surveyed at birth and at ages 7, 11, 16, 23, and 33. At the first three follow-ups, information was obtained from parents, teachers, and doctors. At the most recent sweep, conducted in 1991 when all subjects were age 33.." (Blanchflower and Oswald 1998, p. 5). Details of the survey are summarized in Elias, Peter, and Blanchflower, David G., The Occupations, Earnings and Work Histories of Young Adults: Who Gets the Good Jobs? Research Paper no. 68. London: Department of Employment, 1989.

Gartner suggested that behaviors should be the focus of study as opposed to traits or characteristics (Gartner 1988). He concluded that research focused on psychological traits of entrepreneurs (e.g., (Carland, Hoy et al. 1984); (Chell, Haworth et al. 1991); (Kets de Vries 1985); (Shaver and Scott 1991)) had proven "unfruitful" (Gartner 1988, p. 47). Gartner advocated a shift in focus toward "what the entrepreneur does and not who the entrepreneur is" (Gartner 1988, p. 57). Individual entrepreneurial behavior (e.g., (Mitton 1997)), and links between individual behavior and firm performance (e.g., (Jennings and Beaver 1997)) have been examined under psychology constructs. Other behaviors studied included time commitment to work and family (Parasuraman, Purohit et al. 1996) and time allocation (Cooper, Ramachandran et al. 1996).

Although insightful, studies of individual behavior in small firms has proven problematic, in part because small business research frequently fails to distinguish entrepreneurial behaviour from that of small business owner-managers (Deeks 1976); (Jennings and Beaver 1997). Recognizing the heterogeneity of both individual behaviors and the small business sectors in which they operate, some researchers have advocated studies of individual behavior in a variety of settings, such as business start-up and multiple business ownership circumstances (Westhead and Wright 1998).

Individual traits and behaviors within franchise organizations have included studies of franchisee personality (Schell and McGillis 1995); the psychological climate within franchising (Strutton, Pelton et al. 1995); and franchisee behaviour (Dant 1995); (Felstead 1991); (Stanworth and Curran 1999). In addition, studies of cooperation and trust within franchise systems (e.g., (Baucus, Baucus et al. 1996); (Ring 1996)), opportunistic behavior (e.g., (Withane 1991); (Das and Teng 1998)), and level of franchisee satisfaction (e.g., (Koiranen, Hyrsky et al. 1997); (Morrison 1997)) have all contributed to the knowledge base of individual behavior in franchise systems.

2.6.2 Psychology- Interpretive Summary

Mitchell concluded that apparently no *typical* entrepreneur exists, citing failure of characteristics-and demographics-based research in psychology and sociology to discover cause-effect linkages between personality types or backgrounds and success (Mitchell 1997). Storey's empirical findings suggested that although there was considerable speculation, it was difficult to draw a clear pattern of the impact of an individual's personal characteristics on whether or not they survive in business (Storey 1994). Studies that focus on an individual's cognitive processes or training may present only a partial view, because although discovering opportunities is important, it represents an incomplete view of complete entrepreneurial processes.
As Kets de Vries argued "Many people have ideas, but very few have the stamina to turn their ideas into action, ...and as some aspiring entrepreneurs have discovered the hard way, a vision without action is nothing more than an hallucination" (Kets de Vries 1996, p. 24).

Psychology researchers have employed different definitions of an entrepreneur, which has made comparative studies difficult. Table B3 in Appendix B presents various definitions and characteristics from empirical studies that examined traits, characteristics, and behaviours with author(s) definitions of entrepreneurs if one was provided. Chell summed up limitations of behaviour approaches, stating that the paradox for this field of study has been that although entrepreneurship appeared to be directly related to individual behaviors, much of human behavior was too complex to count (Chell).

2.7 MARKETING

Mendelsohn and Bynoe (1995) concluded that "franchising, at its core...is a method of marketing goods and services" (Mendelsohn and Bynoe 1995, p. xiii). Proponents of franchising have viewed it as a dynamic method of combining advantages of both large and small businesses to benefit the small businessperson (Vaughn 1979). Franchising has also been called the most important type of contractually linked vertical marketing system (Parsa 1999). The International Franchise Association (IFA) stated that John Naisbitt, author of *Megatrends,* said, "Franchising is the single most successful marketing concept ever."[27]

Conversely, critics of franchising viewed it as representative of homogenization in our commercial culture, "singularly responsible for the lack of variety in a number of retail sectors" (Kaufmann and Dant 1998, p. 6). Further, Cohen argued that there is a "basic flaw built into the structure of this form of marketing," (p. 175) citing the prevalence of destructive conflicts between franchisors and franchisees (Cohen 1971). He concluded that conflicts result because franchisors are able to make decisions and set policies that do not maximize franchisee's profits.

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[27] Source: (anonymous), IFA's Franchise Opportunities Guide, Summer 1995 Edition.

2.7.1 Marketing- Review of Theoretical and Empirical Literature

In narrowly focused terms, franchising represents an important method of distribution, a "quasi-integrated alternative to markets and hierarchies" (Kaufmann, Gordon et al. 2000, p. 217). On a continuum ranging from individually negotiated transactions at current market conditions to one where movement of goods is an automatic part of a long-range marketing plan, franchising as a mode of distribution may be said to occupy the middle ground (Bucklin 1971, p. 33).

Viewed as categories within a context of marketing channels, Thompson proposed four forms of vertical organization structures, a summary of which is presented in Table 2.11.

Table 2.11: Vertical Organization Structures Within Marketing Channels

Free and Open (Conventional)	Supplier merely sells product to buyer.	Duplication of effort, inefficient scheduling, high selling costs, no economies of scale
Ownership Integration	Combined successive stages of production and distribution under single ownership	Maximized control, operating economies through corporate directives.
Administered System	Channel member influences behavior of vertically adjacent firms by exerting leadership or economic muscle within channel.	Pertains to line or classification of merchandise, rather than complete store operation.
Contractual Agreements	Independent firms at different distributive levels, integrated programs on contractual basis to obtain systemic economies and an increased market impact.	Contractual integration occurs where various stages of production and distribution are independently owned, but relationships between vertically adjacent firms are covered in a contractual arrangement such as those found in franchise, voluntary, and cooperative forms of organization.

Donald N. Thompson Contractual Marketing Systems: An Overview in Contractual Marketing Systems Thompson, Donald N., Heath Lexington, Lexington, MA 1971

Thompson argued that in each type of contractual system and in every vertical channel, conflicting and cooperating objectives may be found, although contractual system members typically have more harmonious interests than conflicting ones (Thompson

1971). He posited that cooperation or conflict in a contractual channel varied with the life cycle of a system. For example, franchisees are usually anxious to cooperate with their franchisor initially, accepting the value of services in their franchise package. This may change as a franchisee gains experience, particularly if a franchisor's services are intangible. Thompson posited that "If a franchisee obtains only an initial expertise accompanied by the use of a trademark, he may begrudge the franchisor attempts to exercise control" (p. 23). He concluded that a root cause of conflict within contractual marketing systems such as franchising is role incongruency.

The role of power in channel relationships has received a great deal of attention from marketing researchers (Keh and Park 1998), studies that appear to have relevance to franchising. Gaski found that 56 percent of articles in four primary outlets for distribution channel research addressed the topic of interorganizational power (Gaski 1996). He noted that power, as it pertains to marketing channels, was defined as "the ability to control the decision variables in the marketing strategy of another member in a given channel" (p. 64). A franchisor's control of strategic marketing activities suggests that studies of power in marketing channels have applicability to franchising.

In addition to marketing channels, theories that relate to brand power, consumer value, awareness, and purchasing patterns have also had applicability in studies of franchising. Brand power may extend beyond the intrinsic qualities of a product or service in the minds of consumers. For example, McCracken took an anthropological approach to brands, arguing that brands have value because they add value, and they add value by adding meaning (McCracken 1993). His study of 11 Canadians showed that cultural meanings existed in beer brands. Based on his exploratory research, he concluded, "the chief cultural meaning carried by beer is masculinity" (p. 137). Lane posited that regard for a brand arises from consumers' perceptions of quality, the user's satisfaction, and prestige (Lane 1998). She argued that appeal and familiarity with brands go hand-in-hand; with consumers choosing those brands they know and like. Each year, marketers spend millions of dollars creating and developing brand images, considered crucial for their firm's long-term success (Bhat and Reddy 1998).

Although initially required to build brand awareness, marketing was considered most important during the middle of a product or company's life cycle, when identities had been established, but consumers are still concerned about quality (Treynor 1999). Brand names are a source of differentiation in environments where physical differentiation among products is difficult, and consumers are willing to pay a premium for them (Kohli and Thakor 1997). In situations where consumers are aware of a number of brands that fit their criteria, they are unlikely to expend much effort in seeking out information on unfamiliar brands[28] (Macdonald and Sharp 1996).

Using a brand's power to influence consumer buying patterns through an efficient distribution channel, franchising combines economies of scale and local production. Franchising was considered to be an important means of leveraging brand equity, a critical and inimitable resource in a firm's quest for competitive advantage and value creation (Harrigan 1998). Brand equity is a term used in finance to describe the

[28] Macdonald and Sharp noted, "A further way brand awareness may affect choice within the consideration set is by influencing perceived quality. In a consumer choice study by Hoyer and Brown (1990) over 70% of consumers selected a known brand of peanut butter from among a choice of three, even though another brand was 'objectively' better quality (as determined by blind taste tests), and even though they had neither bought or used the brand before. This result is even more surprising considering the subjects were given the opportunity to taste all of the brands" (Macdonald and Sharp 1996, p. 3).

premium a consumer would pay for a branded product or service, compared to an identical unbranded version of the same product/ service[29] (Biel 1993). Empirical support for brand equity may be found in Wu's comparative study of 90 franchised and 65 independent hotels, in which he found that room rates in franchised motels were 21 percent higher than that charged by independent motels (Wu 1998). This finding supported his hypothesis that franchises were able to extract price premiums from consumers.

2.7.2 Marketing- Interpretive Summary

Kim attributed an overall lack of attention in the marketing literature to the presence of different contexts in marketing channels, arguing, "no single framework or model relating to behavioural phenomena can apply across all channel systems" (Kim and Frazier 1996, p. 19). More specifically, Wren and Simpson observed that little attention had been devoted to understanding how control and coordination is achieved in marketing channels, particularly those involving small firms (Wren and Simpson 1998). Citing an earlier work by Romano and Ratnatunga (1995), Siu and Kirby noted "an absence of a structured literature base which designated relevant linkages and established the nature and weight of marketing on small enterprise research" (Siu and Kirby 1998, p. 40). Recent attention is found, however, in the work of Stewart and McAuley, who developed a taxonomy of strategies used by Canadian and UK SMEs in the manufacturing sector (Stewart and McAuley 2000). Marketing perspectives nonetheless provide valuable insights to this and other studies of franchising in several ways.

[29] "Brand equity can be considered the additional cash flow achieved by associating a brand with the underlying product or service" (Biel 1993, p. 69).

First, a view of franchise relationships as relational marketing channels introduced dynamics such as dependence, flexibility, expectations and trust beyond contractual and economic perspectives. For example, Johnson found that close interfirm relationships encouraged strategic integration, building strong, enduring partnerships that turn the negative view of dependence into a positive, strategic asset (Johnson 1999). She concluded, however, that measures of flexibility and relationship quality constructs, although important, did not perform well in her study of 160 industrial machinery companies, suggesting that future research was needed.

Second, a marketing perspective introduced concepts of brand awareness and equity, integral parts of franchising. This perspective contributes to an understanding of franchising's past successes at penetrating new markets, and insights on franchisors'expansion plans in new markets. It is also helpful in understanding how advertising and franchise fee structures are developed and justified within franchising, extending those offered by the economics literature or simple accounting measures. Since both consumers and potential franchisees are likely to be influenced by franchise marketing, this perspective may also provide insights on why potential franchisees are attracted to certain franchise concepts.

Third, marketing literature contributed to this study by recognizing the importance of integration with other paradigms, such as strategic management and entrepreneurship (e.g., (Parsa 1999); (Stewart and McAuley 2000)). Lastly, contributions from marketing have highlighted a need to consider the context in which theoretical gestalts are applied. For example, Anderson and McAuley found through their study of rural entrepreneurs that "marketing theory cannot be applied universally without taking account of context" (Anderson and McAuley 1999, p. 176).

2.8 Entrepreneurship

In formulating theoretical foundations for this study, entrepreneurship provided a number of potentially useful models. This section of the literature review is divided into two parts: the first covers the broad topic of entrepreneurship, the second focused on corporate entrepreneurship, the study of entrepreneurship within organizations.

When the birth of firms is used as a measure of entrepreneurship (e.g., (Blanchflower and Oswald 1998); (Gartner, Mitchell et al. 1989); (Reynolds 1991)) a quantifiable indicator of the phenomenon is available. Reliability of this indicator, however, had been questioned in a number of recent studies. For example, Jennings and Beaver observed that entrepreneurial activity was not an essential prerequisite for small business formation[30] (Jennings and Beaver 1997). Although small business' dynamic environment has provided fertile ground for entrepreneurship studies, a growing trend is to make clear distinctions between the concepts of small business and that of entrepreneurship (Huse and Landstrom 1997). Further, in their study of portfolio and habitual entrepreneurs, Westhead and Wright argued that entrepreneurship involved more than the act of starting a business (Westhead and Wright 1998). In many contexts, distinguishing entrepreneurial behaviour from others has proven problematic, and further development of theoretical foundations in entrepreneurship have been

[30] Blatt summarized the relationship between small business formation and entrepreneurship: "Not every small business is entrepreneurial and not every entrepreneur runs in small business. Some small businesses are run by entrepreneurs and some entrepreneurs runs small businesses; they are not usually exclusive nor mutually inclusive categories" (Blatt, 1988 in (Dana 1992).

complicated by an apparent lack of consensus on a definition for the term (Bull and Willard 1993).

2.8.1 Entrepreneurship- Review of Theoretical and Empirical Literature

Entrepreneurship has been viewed not as a singular monolithic consideration, but rather as a concept that covered a broad range of activities (Herbert and Brazeal 1999). It is a process, not a single act (Block and MacMillan 1993). Therefore, it follows that the nature of entrepreneurship involves more than simply forming a business. Using the number of new businesses created may not be "a reliable indicator of the development of entrepreneurship" (Westhead and Wright 1998, p. 174).

Churchill observed that entrepreneurship is widely recognized as creating value- albeit initiated through starting a new venture (Churchill 1997). He posited that value is actually created as an enterprise grows, creates jobs, and satisfies the needs of additional customers, while making money for stakeholders in the process. According to Churchill, a growing company continues to create value if it introduces new products or services, creates additional jobs, and pays more taxes, thereby renewing itself. Entrepreneurship is viewed, therefore, as a continuing process of opportunity recognition and realization (Stevenson and Jarillo 1990).

Considered in isolation, studies that exclusively focus on entrepreneurial processes may only present a partial view of the phenomenon. Kao argued that entrepreneurship resulted from interrelationships of a person, a task, and an organizational context, requiring a more holistic view as opposed to a single frame of reference[31] (Kao 1991). An individual's industry-specific knowledge and reputation, for example, have their greatest value when applied in similar contexts, and are likely to influence opportunity selection and recognition (Hart, Stevenson et al. 1995). In order to further progress within the entrepreneurship discipline, Low and MacMillan advocated theory driven research that is both contextual and process driven (Low and MacMillan 1988).

One process, deemed central to entrepreneurship, is that of creating successful organizational relationships (Shane and Hoy 1996). Within franchising's organizational context, the role of a franchisor as entrepreneur is generally accepted in the literature (Falbe, Dandridge et al. 1998); (Spinelli 1997). Ray Kroc, for example, is widely recognized as an entrepreneur, despite the fact that he did not invent McDonald's operation, but merely discovered it (Block and MacMillan 1993). Excluding franchisees from entrepreneurship would require an extremely narrow definition of the field (Hoy 1994), although their role is much less defined than that of a franchisor. Studies that measured growth (e.g., (Shane 1996)), innovation (e.g., (Kaufmann and Dant 1998)), and entrepreneurial behavior (e.g., (Baucus, Baucus et al. 1996)) have all described entrepreneurial activities of franchisors. Price viewed entrepreneurial activity by franchisees as a paradox, illegitimate in franchising's context of replication and standardization (Price 1997).

[31] Kao defined *organizational context* as "the immediate setting in which creative and entrepreneurial work takes place. Such issues as organizational structure and systems, the definition of work rules, and group culture affect significantly the nature of the creative or entrepreneurial environment. Such factors may limit or facilitate creativity and entrepreneurship, and become an increasing factor to contend with as the organization evolves" (Kao 1991, p. 6).

In order to protect their business systems from unauthorized changes, franchisors have stated that they prefer managers to entrepreneurs as franchisees (Falbe, Dandridge et al. 1998). Barrow cited a Bank of America official who said: "the best franchisee, as far as many franchisors are concerned, is someone who is smart enough to understand and operate the system, but not smart enough to try to improve on it" (Barrow 1989, p. 170). Opportunities for entrepreneurial behaviours by franchisees may exist in some systems, however, because agreements cannot cover all possible contingencies, and a franchisor's ability to impose strategic direction over franchisees is limited, as long as franchisees comply with contractual provisions (Phan, Butler et al. 1996).

Arguably, the most contentious issue in franchising research centers on franchise failures (e.g., (Bates 1997); (Lafontaine and Shaw 1998); (Shane 1997); (Stanworth, Purdy et al. 1997)). Fueling debates are wide discrepancies in reported failure rates reported by popular, industry, and academic sources. Failure rates of approximately 4 percent had been reported in both the popular press (Hoy 1994) and by franchise associations (Stanworth, Purdy et al. 1998), conclusions substantiated by some academic research (e.g., (Castrogiovanni, Justis et al. 1993)). Although not citing a specific rate, Barrow concluded that franchise failure rates were much lower than for the small business sector as a whole (Barrow 1989). The annual British Franchise Association/National Westminster Bank survey estimated franchisee failure and turnover combined were around 10 percent per annum (Stanworth, Purdy et al. 1998), while Storey cited a study of survival factors amongst franchisees that found results similar to those for small-business owners in general (Storey 1994).

Studies by Bates, however, found failure rates for young franchises that exceeded those of non-franchised businesses (Bates 1995); (Bates 1996). In a later study, using a sample of 82,202 franchise firms, Bates concluded that some franchisees were less likely to survive than independents (Bates 1997). Using longitudinal data, Shane found that 75 percent of new franchises in a sample of 157 companies were found to fail within 12 years (Shane 1997). Confirming that survival rates differed among franchises, Shane later found that within his sample, new franchise systems were especially prone to failure (Shane 1998).

Explanations for failures within franchising include some of the same reasons for failure of non-franchised businesses, including failure to achieve employment of others and failure to achieve high levels of turnover (Storey 1994). Unlike non-franchised businesses, some franchisees were unable to grow through increases in same store sales (Baucus, Baucus et al. 1996), often prohibited from adding products or services designed to increase sales by provisions in their franchise agreement. Often promoted as a business panacea (Stanworth, Purdy et al. 1998), disputable failure rates caused some to label franchising as a trap for the trusting (Brown, 1969 in (Stanworth, Purdy et al. 1997). According to Chrisman et al., attributes that increase likelihood of a venture's success may simultaneously decrease its probability of survival[32] (Chrisman, Bauerschmidt et al. 1998). Although insightful, use of failure rates as measures of relative success have proven problematic, at least in part because of inconsistencies in

[32] Chrisman et al. argued that strategic management theory suggests that a business unit's performance is related to the environment of the industry in which it competes, the resources it controls, the strategy used to align resources with opportunities, and the organizational structure, processes, and systems it employs to implement its strategy. Survival, on the other hand, depends on the organization's ability to secure tangible resources (such as capital, credit, land, facilities, etc.) with which to do business (Chrisman, Bauerschmidt et al. 1998).

definition and measurement (DeCastro, Alvarez et al. 1997); (Stanworth, Purdy et al. 1998); (Watson and Everett 1996).

In addition to studies of success and failure, entrepreneurship research has contributed to an understanding of value creation and extraction in franchise systems. In his study of franchisees, Phan speculated that some franchisees were probably acting entrepreneurially, and therefore, should create value[33] (Phan, Butler et al. 1996). He argued "unanticipated contractual contingencies become the focal points for entrepreneurial value creation by the franchisee" (p. 382). Opportunities for value creation are considered important, as Birley et al. concluded, "prospective wealth creation is a major motivation for both franchisor and franchisee" (Birley, Leleux et al. 1997, p. 1). Further support for wealth maximization as a general motivation for franchisees was offered by (Michael 1993), (Spinelli and Birley 1996), and (Williams 1998).

Kaufmann and Lafontaine, who studied McDonald's franchisees, provided a specific, albeit atypical example of a wealth extraction process in franchising (Kaufmann and Lafontaine 1994). Although the authors acknowledged that their study was not of a typical franchise, they found substantial *ex post* and *ex ante* rents were available to McDonald's franchisees. They determined that franchisees earned ex post rents when they achieved a minimum of $900,000 in annual sales[34], while ex ante rents were

[33] Phan assumed that the entrepreneurial phenomenon was apparent whenever opportunities were pursued that required resources beyond those controlled (Stevenson and Jarillo 1990).
[34] Sales measured in 1982 dollars. Examination of sales data from 5,400 McDonald's restaurants revealed that as of December 1982, 76 percent had attained sales of over $900,000 (p. 422). Calculation of economic rent in the study included the opportunity costs of interest and franchisee labor. The

available to franchisees leaving the system, in part because McDonald's acceptance rate of new franchisees was about 7.5 percent (p. 418).

Phan (1996) observed that despite 225 published articles under the Society of Franchising, franchisees have been one of the least studied of entrepreneurial types (Phan, Butler et al. 1996). Kaufmann and Dant (1998) argued that franchising "provides a unique and fertile setting for research in entrepreneurship: franchisor as entrepreneur, franchisee as entrepreneur, and the franchise relationship as an entrepreneurial partnership" (Kaufmann and Dant 1998, p. 14). Despite previous work by entrepreneurship researchers, a number of questions about franchising remain largely unanswered: Do franchisees create new combinations, causing discontinuity? (Hoy 1994). Are there opportunities within the franchising system for franchisees to conduct entrepreneurial processes that create wealth? (Spinelli 1997). Can the assumption that franchisees are creating value because they act entrepreneurially be borne out by empirical data? (Phan, Butler et al. 1996, p. 399). A summary of theoretical and empirical studies related to franchising is provided in Appendix B, Table B4.

2.8.2 Corporate Entrepreneurship (CE)- Review of Theoretical and Empirical Literature

Entrepreneurial processes within corporate organizations have recently become a topic of discussion among both practitioners and academics (Sharma and Chrisman 1999). What makes a firm entrepreneurial? Lumpkin and Dess argued that an entrepreneurial

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opportunity cost of labor assumed that franchisees worked longer hours than managers of company-owned stores (Kaufmann and Lafontaine 1994).

firm is one that effectively combines autonomy, innovativeness, risk taking, proactiveness, and competitive aggressiveness (Lumpkin and Dess 1996). The most common examples of corporate entrepreneurship (CE) are found where an established organization enters a new business; an individual or individuals within a corporate context champion a new product; and when an organization embraces an entrepreneurial philosophy in its operations[35] (Covin and Miles 1999). Once considered an oxymoron (Stevenson and Jarillo 1990), CE has been legitimatised by growth in the field of firm-level entrepreneurship research (Zahra, Jennings et al. 1999). CE has been linked to profitability, survival, and growth (Zahra 1996), the pursuit of competitive advantage (Covin and Miles 1999), improved firm performance[36] (Peters and Waterman Jr. 1982), value creation (Vozikis, Bruton et al. 1999), and organizational adaptation and renewal in firms (Falbe, Dandridge et al. 1998).

CE largely encompasses two types of phenomena and the processes that surround them: (1) Strategic Renewal- organizational transformation through renewal of key ideas on which they are built; and (2) Venturing- the birth of new businesses within existing organizations (Guth and Ginsberg 1990). Global competition, delayered management structures, and rapid technological innovation have served as catalysts for organizational transformation, as corporations strived to become entrepreneurial (Dess,

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[35] Herbert & Brazeal contrasted the concept of corporate entrepreneurship with that of an individual. "The classic conceptions of entrepreneurship is that of the *individual, independent* entrepreneur who assumes financial and other risks in order to exploit a new idea or product possibility; and that the risks of failure uniquely devolve upon the entrepreneur. In *corporate* entrepreneurship, however, individual or group entrepreneurship is fostered within a preexisting *organizational* setting; the organization provides *support* for the development and exploitation of one or more innovations which are deemed *strategically and financially consistent with the supporting organization's mission.* Thus, executives attempting to implant entrepreneurial activities, support for them, and rewards for them typically and by definition are interested in corporate entrepreneurship (Herbert and Brazeal 1999).

[36] Dess observed that the literature generally supports the notion that corporate entrepreneurship is related to performance, but that the relationship may not immediately be apparent (Dess, Lumpkin et al. 1999).

Lumpkin et al. 1999), and overcome the powerful force of homeostasis found in many large organizations (Barrett and Weinstein 1998). In response to increased pressure, corporate executives have sought ways to eliminate the organizational barriers to innovation, and unleash creative talents in their people (Herbert and Brazeal 1999). Chung concluded that the nature, speed, direction, and variety of entrepreneurial ideas and initiatives were significantly affected by organizational context (Chung and Gibbons 1997). Traditional organizational models, built around rigid hierarchies, were considered poorly suited for today's entrepreneurial firms (Dess, Lumpkin et al. 1999). Covin argued that innovation is at the center of the nomological network that encompasses the construct of corporate entrepreneurship (CE) (Covin and Miles 1999). "Innovating companies" posited Kanter, "provide the freedom to act which arouses the desire to act" (Kanter 1996, p. 142).

Corporate venturing, the second aspect of CE, has been well documented in the literature (e.g., (Block and MacMillan 1993); (Burgelman 1983)). A new venture is the result of a process of new business creation and organization, for the purpose of profit and growth, which produces and markets products or services to satisfy unmet market demands[37] (Gartner 1985). Biggadike defined a corporate venture as "a business marketing a product or service that the present company has not previously marketed and that requires the parent company to obtain new equipment or new people or new knowledge" (Biggadike 1979, p. 104). Corporate venturing is internal generation of new businesses (Block and MacMillan 1993), or more specifically, creation of new

[37] Chrisman observed that new ventures can take several forms: joint ventures between two or more established firms; a corporate venture initiated as a self-contained organizational unit; or as an independent venture initiated and controlled by one or more individuals (Chrisman, Bauerschmidt et al. 1998).

businesses by members of firms that already exist (Venkataraman in (Greene, Brush et al. 1999); (Zahra 1996). Table 2.12 provides a summary of corporate entrepreneurship definitions.

Table 2.12: Corporate Entrepreneurship Definitions

Author and Date	**Definition**
(Burgelman 1983)	Corporate entrepreneurship refers to the process whereby the firms engage in diversification through internal development, requiring new resource combinations to extend the firm's activities in previously unrelated areas. (p. 1349)
(Chung and Gibbons 1997)	Corporate entrepreneurship is an organizational process for transforming individual ideas into collective actions through management of uncertainties. (p. 14)
(Covin and Slevin 1991)	Corporate entrepreneurship involves extending the firm's domain of competence and corresponding opportunity set through internally generated new resource combinations. (p. 7, quoting Burgelman, 1984, p. 154)
(Guth and Ginsberg 1990)	Corporate entrepreneurship encompasses two types of phenomena and the processes surrounding them: (1) the birth of new businesses within existing organizations, i.e., internal innovation or venturing; and (2) the transformation of organizations through renewal of the key ideas on which they are built, i.e. strategic renewal. (p.5)
(Jennings and Beaver 1997)	Corporate entrepreneurship is the extent to which new products and/or new markets are developed. An organization is entrepreneurial if it develops a higher than average number of new products and/or new markets (p. 489)
(Scheidl 1998)	Corporate entrepreneurship involves the notion of birth of new businesses within ongoing businesses, and… the transformation of stagnant, ongoing businesses in need of revival or transformation. (p.2)
Spann, Adams, & Wortman (1988)	Corporate entrepreneurship is the establishment of a separate corporate organization (often in the form of a profit center, strategic business unit, division, or subsidiary) too introduce a new product, server or create a new market, or utilize a new technology. (p. 149)
Vesper (1984)	Corporate entrepreneurship involves employee initiative from below in the organization to undertake something new. An innovation which is created by subordinates without being asked, expected, or perhaps even given permission by higher management to do so. (p. 295)
Zahra (1993)	Corporate entrepreneurship is a process of organizational renewal two distinct of related dimensions: innovation and venturing, and strategic renewal (p. 321)
Zahra (1995, 1996)	Corporate entrepreneurship- the sum off a company's innovation, renewal, and venturing efforts.[38] (1995, p. 227; 196, p. 1715)

[38] Innovation involves creating an introducing products, production processes, and organizational systems. Renewal means revitalizing the company's operations by changing the scope of its business, its competitive approaches or both. It also means building or acquiring new capabilities and then creatively leveraging them to add value for shareholders. Venturing means that the firm will enter new businesses by expanding operations in existing or new markets.

Sharma and Chrisman further refined the concept, differentiating between external and internal corporate venturing, the former creating semi-autonomous or autonomous entities, while the latter created entities that reside within an existing organizational domain (Sharma and Chrisman 1999). Venturing, therefore, involves not only creatively entering new markets, but also creating new opportunities within existing markets (Vozikis, Bruton et al. 1999). Both entering new markets and creating new opportunities within existing markets are considered entrepreneurial activities, because they help businesses to create new revenue streams (Zahra, Nielsen et al. 1999). Although a number of definitions for CE are evident in the recent literature, Stevenson and Jarillo observed that the "crux" of corporate entrepreneurship is that opportunities for a firm must be pursued by individuals within it (Stevenson and Jarillo 1990).

Guth and Ginsberg concluded that despite growing interest in CE, "there appears to be nothing near a consensus on what it is" (Guth and Ginsberg 1990, p. 6). Covin and Miles observed that despite general agreement in the literature that firms *per se* can be entrepreneurial, there is no consensus on what attributes must be present to label a firm *entrepreneurial* (Covin and Miles 1999). In his review of the literature, Sharma observed that although authors generally agreed on unique features of CE, they often used different terms to express themselves (Sharma and Chrisman 1999). Table B17 in Appendix B presents definitions used in previous studies of corporate entrepreneurship. Organizational characteristics that foster corporate entrepreneurship are presented in summary form in Table 2.13 below.

Table 2.13: Organizational Characteristics that Foster Corporate Entrepreneurship		
Characteristic	**Study**	**Conclusions**
Appropriate Use of Rewards	Fry; 1987; Sathe, 1985; Block & Ornati, 1987; Scanlan, 1981; Souder, 1981; Kanter, 1985	In order to be effective, reward system must consider goals, feedback, emphasis on individual responsibility, and rewards based on results.
Management Support	Hisrich & Peters, 1986; Sykes, 1986; Souder, 1981; Sykes & Block, 1989; MacMillan, Block, & Narasimha, 1986; Quinn, 1985	Managers must be willing to facilitate entrepreneurial projects.
Resource Availability	Sathe, 1985; Von Hippel, 1977; Souder, 1981; Sykes, 1986; Hisrich & Peters, 1986; Katz & Gartner, 1989	Employees must perceive availability of resources for innovative activities.
Organizational Structure	Souder, 1981; Sathe, 1985; Hisrich & Peters, 1986; Sykes, 1986; Burgelman, 1983; Schuler, 1986; Bird, 1988; Sykes & Block, 1989	Identified in various ways, but always an essential factor
Risk Taking	MacMillan, Block, & Narasimha, 1986; Sathe, 1985; Sykes, 1986; Burgelman, 1983, 1984; Quinn, 1985; Ellis & Taylor, 1988; Kanter, 1988; Bird, 1988; Sykes & Block, 1989	Employees and management must be willing to take a risk and have tolerance for failure should it occur.
Source: *An Interactive Model of the Corporate Entrepreneurship Process,* (Hornsby, Naffziger et al. 1993).		

2.8.3 Entrepreneurship- Interpretive Summary

Despite an apparent lack of definitional consensus, theoretical foundations of corporate entrepreneurship (CE) may provide a useful prototype for this study of entrepreneurial opportunities within franchise systems. First, Zahra et al. called the empirical evidence "compelling" that CE improves firm performance[39] (Zahra, Nielsen et al. 1999). In a previous study, they posited that corporate governance can significantly impact CE, and called for additional research on their association (Zahra 1996). Firm performance has

[39] An example was cited by Covin and Miles of a 1995 Zahra and Covin study of three separate samples and a total of 108 firms where a positive and strengthening relationship between CE behavior and subsequent financial performance was revealed (Covin and Miles 1999).

been considered as the ultimate dependent variable[40] (Covin and Slevin 1991), a measure of a firm's ability to create value for its customers in a sustainable and economically efficient manner (Barney 1991); (Chrisman, Bauerschmidt et al. 1998).

Second, CE views entrepreneurship as a process, one that includes both venturing and innovative entrepreneurial processes within an organizational context. CE also considers that contributions to firm performance may be made by individuals or teams of individuals within organizations. This view is consistent with Miller's argument that what is most important is not who a critical actor is, "but the *process* of entrepreneurship and the organizational factors which foster and impede it" (Miller 1983, p. 770). Increasingly, corporate governance mechanisms have come under scrutiny for their ability to foster or constrain entrepreneurship (Blair 1995).

Lastly, relationships between performance and entrepreneurship remain a fruitful area for research (Zahra, Jennings et al. 1999). Bhide concluded, "Entrepreneurs who start and build new businesses are more celebrated than studied" (Bhide 2000, p. 3). Stevenson acknowledged a need to establish links between entrepreneurship and corporate management, if the formers' large body of research is to benefit the latter (Stevenson and Jarillo 1990). Within franchising's context, Price concluded that measuring performance, like most aspects of franchise studies, is under-researched (Price 1997, p. 473). This could be due, at least in part, to a lack of a suitable model for analyzing entrepreneurial processes within franchising's hybrid organizational form (Michael 1993).

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[40] Schwartz and Teach concluded that there was no general agreement on which performance measures were *right* to study (Schwartz and Teach 2000).

Despite CE's potential application, models developed in non-franchised businesses may require modification for studies of franchising firms. Corporate governance models assume that individuals are employees. In franchising, recipients of directives are not at-will employees but franchisees, equity owners with a significant stake in a legally distinct component of a networked business (Selden 1998). Additionally, the formal context of franchising depicts an organizational form that meets Weber's six characteristics of a bureaucracy,[41] making it a theoretically unpromising environment for entrepreneurial processes. Kantner argued that in these environments, benefits derived from entrepreneurial processes would be severely limited, and only take place when companies: (1) mandated change from the top; (2) set up formal tests of ideas initiated at the top; (3) bring in outsiders free from the constraints facing employees; or (4) are unable to maintain complete control, which allows a few "holes in the system" (Kanter 1996, p. 84). Unlike non-franchised businesses with organic organizational structures, contractual provisions in franchising are likely to prevent substantive changes in organizations for the term of an agreement.

Dess et al. suggested that making bureaucratic organizations more flexible and efficient through corporate entrepreneurship, and the use of CE as a means for strategic renewal is one of the most promising areas for future research (Dess, Lumpkin et al. 1999). Covin and Miles posed this challenge to management researchers:

[41] There is consensus among social scientists that six characteristics of bureaucracy, all part of Weber's original description, are roughly as follows: (1) A hierarchical chain of command; (2) Specialization by function; (3) Uniform policies covering rights and duties; (4) Standardized procedures for each job; (5) A career based on promotions for technical competence; and (6) Impersonal relations (Pinchot 1994, pp. 22-3).

> The principal challenge to management researchers is to identify the entrepreneurial processes that lead to various forms of corporate entrepreneurship, and then to theoretically predict and empirically verify the forms of this phenomenon that produce the best results for firms in various business and industry contexts (Covin and Miles 1999, p. 65).

Sharma argued that in order to advance theory from abstract concepts to concrete solutions, classifications of groups or populations of organizations that share large numbers of characteristics and differ sharply from other groups is desirable (Sharma and Chrisman 1999).

2.9 SUMMARY OF LITERATURE REVIEW

This review of selected literature acknowledged contributions made by studies of contracting. Organization theory, economics, legal, psychology and marketing disciplines were also covered. Additionally, because of its relevance to this study, a more comprehensive review of the entrepreneurship literature was presented, with a separate section devoted to a review of the contributions made by corporate entrepreneurship researchers. Although valuable in furthering an understanding of franchising, some common themes emerged from the literature that highlighted a need for additional work in this area.

First, as previously described, franchising resembled a shared tenancy contract, "halfway between fixed-rent and wage contract(s)" (Barzel 1989, p. 37) with aspects of both relational and discrete contracts. As an organizational form, franchising has been considered a hybrid (Shane 1996), requiring a governance structure with control systems that allow both coordination and adaptation (Spinelli and Birley 1996). Central features of franchise organizations are a simultaneous presence of both firm- and market-like characteristics (Norton 1988). From an economics perspective, franchise firms operate near the middle of a continuum between markets and hierarchies (Brown 1998), with medium levels of adaptation, incentives, and controls (Williamson, Winter et al. 1991) as illustrated in Table 2.14 below.

Table 2.14: Economic Organizations Comparison				
	Unilateral Adaptation	**Coordinated Adaptation**	**Incentives**	**Administrative Control**
Market	High	Low	High	Low
Hybrid	Medium	Medium	Medium	Medium
Hierarchy	Low	High	Low	High
Source: Williamson (1991), "Comparative economic organization: The analysis of discrete structural alternatives. *Administrative Science Quarterly* 36: 269-296.				

Viewed from a marketing perspective, franchising as a mode of distribution is said to occupy the middle ground between the planned end of an integrated system and the day-to-day pole of the independent system (Bucklin 1971). Entrepreneurship researchers have viewed franchising as "somewhat of a half-way house, lying somewhere between entrepreneurship and employment" (Barrow 1989, p. 166), or "exactly mid-way between solo independent entrepreneurs and large corporate managers (Knight, 1984 in (Price 1997). Although useful when contrasting franchises with non-franchised firms, these narrowly-defined approaches may have limited use in comparing firms engaged in franchising when used exclusively. One explanation offered by Stanworth and Curran, "franchising does not fit comfortably within any single academic discipline" (Stanworth and Curran 1999, p. 324).

Theoretical paradigms used in previous research often encountered difficulties in explaining some prevalent phenomena found in empirical studies of franchising. For example, the widespread presence of multi-unit ownership by franchisees and various forms of master franchising (Kaufmann and Lafontaine 1994); (Kaufmann and Dant 1998) indicate organizational complexity within what is sometimes considered a simple, dyadic relationship between franchisors and franchisees. As increasing numbers of large firms strive to emulate small firms by nimbly adapting to survive in changing markets, (Kanter 1997), Price's paradox of how conformity and fewer failures in franchising remains largely unexplained (Price 1997).

Additionally, despite franchising's ubiquity and global economic impact, except for studies by Bates (Bates 1996), Shane (Shane 1995)(Shane 1995), (Shane 1997) and Stanworth (Stanworth and Kaufmann 1996), comparatively little is known about factors that differentiate successful franchises from unsuccessful ones. Further, as Bradach described, firms engaged in franchising often used a combination of franchised and company-owned stores to expand their chains (Bradach 1997). This *plural form* phenomenon also remains largely unexplained, as does differential performance among firms engaged in franchising.

Stanworth and Curran recognized that franchising extends into "a multiplicity of fields such as law, marketing, economics, entrepreneurship, human resource management, psychology, sociology, and organizational theory" (Stanworth and Curran 1999, p. 324). The authors formed propositions that spanned macro, organizational, and individual levels, offering 15 general propositions as guidelines for hypothesis generation and testing. Employing a typology based on the work of Stanworth and Curran, this study addresses franchising at organizational and individual levels. The next chapter describes development of hypotheses that emerged from this literature review, and a discussion of units of analysis used in this study.

3.0 DEFINITIONS, UNITS OF ANALYSIS, AND HYPOTHESES DEVELOPMENT

"How much more agreeable it would be to reduce everything to a handful of aspects and explain it by a handful of causes" (Landes 1969, p. 554).

3.1 INTRODUCTION

The previous chapter reviewed recent literature with relevance to franchising. Contributions have been made from a number of different countries and academic disciplines, including economics, marketing, and entrepreneurship, focused primarily on franchising's formal context. Albeit to a lesser extent, academics, legal practitioners, and consultants have also studied franchising's operational realm. Emerging from the literature were several points that helped to shape this study.

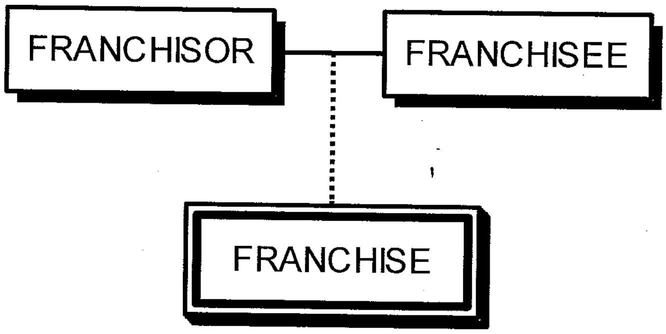
First, clarity and consistency in terminology is important in studies of franchising. Failure rates in franchising, a topic frequently studied by researchers from various disciplines, have historically had problems of definition and measurement (Stanworth, Purdy et al. 1998). As a contractual form of business between legally distinct entities, franchising may also become entangled in tortuous and complex legal definitions (Mendelsohn and Bynoe 1995). The British Franchise Association, International Franchise Association, and the Code of Ethics of the European Franchise Association have each adopted different definitions of a *franchise*.[42] While the U.S. Department of Commerce defined *franchising* as a form of licensing (Kostecka 1988), academic studies have also viewed it as a form of marketing or distribution (Vaughn 1979), or to describe the collective groups of firms who engage in the use of a franchise as part of

[42] Adams concluded, however, that each essentially describes, "a contractual relationship between the parties under which one party (the franchisor) licenses the other party (the franchisee) to carry on business under a name, etc. owned or associated with the franchisor" (Adams, Jones et al. 1997, p. 22).

their business strategy (e.g., (Bates 1996)). To improve clarity and consistency, a section providing definitions used in this study is provided.

Second, franchising involves organizational complexity and diversity that must be considered in its units of analysis. On the surface, franchising's components appear to fit together in a simple, straightforward manner. As depicted in Figure 3.1 below, and posited by Vaughn: "The parent company is termed the *franchisor*; the receiver of the privilege the *franchisee*; and the right or privilege itself, the *franchise*"[43] (Vaughn 1979, pp. 1-2).

Figure 3.1: Basic Franchise System



Empirical studies of franchising have revealed, however, that what appears to be a conceptually simple, dyadic business relationship is actually more complex, with additional organization layers and product or service variations. Multi-unit ownership by franchisees, area developers, and co-branding in retail outlets are a few examples of organizational complexity found within franchising.

[43] The word *franchise* is derived from the old French word, *franchir*, meaning, "to free from slavery" (Emerson 1998).

A third point to emerge from the literature is that beyond the role of a franchisor, comparatively little is known about entrepreneurial opportunities and processes within the context of franchising. Franchising is built on replication, standardization, uniformity, and compliance, in contrast to the attributes of innovation and adaptation most commonly associated with entrepreneurship. Franchisors maintain unilateral authority through detailed agreements and operations manuals that govern activities and behaviours by franchisees. It would appear that discretion, innovation, and other behaviours typically associated with entrepreneurship are inherently illegitimate in franchising, consistent with Kirzner's view of highly structured organizations (Kirzner 1997).

Lastly, entrepreneurship studies of franchising that examined growth (e.g., (Shane 1996)), innovation (e.g., (Kaufmann and Dant 1998)), and entrepreneurial behaviour (e.g., (Baucus, Baucus et al. 1996)) have predominantly focused on activities of franchisors. In contrast, little research has been devoted to entrepreneurial activities within franchising, presumably because of its seemingly unpromising environment for experimentation and adaptation. In their literature review, Phan et al. observed that despite more than 80 articles published by entrepreneurship researchers, the franchisee has been one of the least studied entrepreneurial types (Phan, Butler et al. 1996).

The aims of this chapter are to address measurement and definition problems, clarify levels and units of analysis, and to develop research questions and hypotheses used in this study of franchising. This chapter begins by defining terminology used in this study. Next, a review of franchising's organizational and product/service variations is presented. Research questions and hypotheses are presented next, followed by a summary of the chapter.

3.2 DEFINITIONS

Stanworth and Curran argued, "theoretical discussion of a phenomenon first requires a clear definition of that phenomenon" (Stanworth and Curran 1999, p. 324). Many definitions used in entrepreneurship research have been considered incomplete, unable to withstand the scrutiny of other researchers (Gartner 1988). A goal of this section is not to debate definitions used in previous studies, but rather to provide clarity and consistency in the terminology used in this study.

This study viewed entrepreneurship as a phenomenon extending beyond the birth of a new firm (Westhead and Wright 1998). Consistent with Shane's approach, this study considered entrepreneurship to include sources of opportunities, processes of discovery, evaluation and opportunity exploitation, and the individuals and firms that exploit them (Shane 2000). Shane's approach followed constructs developed by Low and MacMillan, who argued that entrepreneurship is a context and process driven phenomenon (Low and MacMillan 1988). Because franchising exists within an organizational context, this study also included corporate entrepreneurship paradigms of organizational innovation and venturing (Guth and Ginsberg 1990).

3.2.1 Franchise

In broad terms, a *franchise* is any arrangement in which the owner of a trademark, trade name, copyright, or other proprietary product or process allows another to use it in the selling of goods or services (Kuratko and Hodgetts 1995). In the context of this study, a franchise is a legal, contractual license between two distinct entities, whose relational parameters are established by terms and conditions in a UFOC and franchise agreement.

3.2.2 Franchisor

A *franchisor* is an individual or company that has developed some product or service (Caves and Murphy 1976), and contractually licenses its use for a period of time to another entity through a franchise agreement. A *franchisor* is legal owner of the product, service, trademark, or other form of intellectual property being licensed. A *franchisor* may be an individual, a group of individuals, or distinct corporate entity.

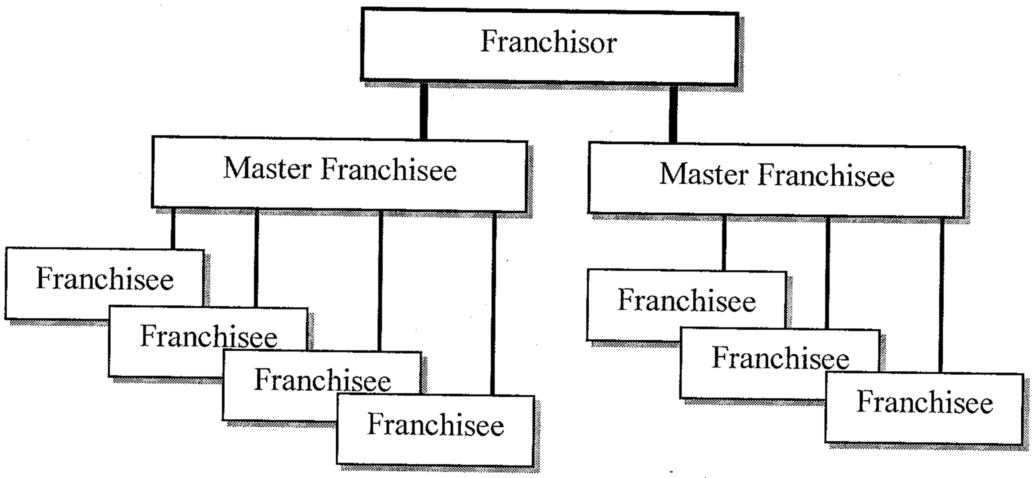
3.2.3 Franchisee

A *franchisee* is a recipient of a contractual license (franchise) granted by a franchisor. The relationship between franchisor and franchisee is formally governed by a franchise agreement. A license grants a franchisee the rights to market designated products or services in a specified location, in accordance with provisions set forth in a franchise agreement. In exchange for these rights, franchisees pay a certain sum of money to franchisors to operate the business, rights limited to the term of the agreement, or to a lesser period if an agreement is terminated (Mendelsohn and Bynoe 1995). A franchisee may be an individual, a group of individuals, or distinct corporate entity.

3.2.4 Master Franchisor and Master Franchisee

There are many definitions of master franchising (Kaufmann and Kim 1995). Justis and Judd defined a *master franchisor* as "an independent business person who has contracted with the franchisor to sell franchises to franchisees in a specific geographic area or territory" (Justis and Judd 1986, p. 17). As a recipient of specific marketing rights for a specified term in exchange for a fee, a signatory of a master franchise agreement is considered a *master franchisee*. The signatory may be an individual, group of individuals, or distinct corporate entity, and functions at an intermediate level in a franchise organizational structure between franchisor and franchisee. This relationship is depicted in Figure 3.2.

Figure 3.2 Master Franchisee



For purposes of this study, a distinction between *master franchisor* and *master franchisee* will be based on whether this entity is viewed from a franchisor's or franchisee's perspective. Although legally a franchisee, master franchisees may assume roles in marketing and quality control that are normally viewed as responsibilities of a franchisor. Their duties, responsibilities, and activities are likely to differ substantially from those of owner-operators of individual franchised outlets, more closely resembling that of a franchisor. To those owner-operators of franchised outlets, master franchisees are not peers, but rather individuals holding a position of authority in a hierarchy.

3.2.5 Area Director/Developer Franchisee

Similar to master franchisees, *area directors/developers* introduce an organizational layer in franchise systems, serving a role between franchisees and either a franchisor or master franchisor. Unlike master franchisors, area directors do not have a right to offer franchises, but rather serve as marketing or sales representatives of a franchisor or master franchisor.[44] Area directors/developers are franchisees, signatories to area development agreements with a franchisor or master franchisor. Their duties, however, include quality inspections and technical support for unit franchisees, duties and responsibilities typically associated with franchisors.

3.2.6 Franchise Agreement

A *franchise agreement* is a contract between two legally distinct entities, a franchisor and a franchisee (Castrogiovanni and Justis 1998). In the United States, franchise agreements are used in combination with disclosure documents, such as the Uniform Franchise Offering Circulars (UFOC), as well as exhibits, addendums, and attachments. In contrast to franchise agreements, UFOC and other disclosure documents associated with franchising are required to be written in "plain English."[45]

3.2.7 Uniform Franchise Offering Circular (UFOC)

Created by the North American Securities Administration Association (NASAA), a Uniform Franchise Offering Circular (UFOC) provides a systematic framework of categories for disclosure of material facts about a franchise. It includes a regimented

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[44] Although Kaufmann and Kim (1995) included sub-franchising and area development as "types" of master franchising arrangements, distinctions are made in this study to improve clarity.

[45] A "plain English" requirement for business contracts means that a reasonable person would be able to understand the terms and conditions as set forth in the document.

system of numbering and labeling, with guidelines and examples published by the NASAA. These guidelines and requirements not only specify categories and numbering schemes, but also stipulate whether material information about a franchise is to be presented in narrative or tabular format. A partial copy of guidelines and requirements is provided in Appendix O.

3.2.8 Franchising

Franchising describes use of a franchise as a mechanism by which one firm purchases a right to use a brand name and operating system of another (Shane and Hoy 1996).[46] Franchising is an organizational form based on a legal agreement between a parent organization (the franchisor) and a local outlet (the franchisee) to sell a product or service using a process and brand name developed and owned by the franchisor (Shane 1996). In this study, a firm that is presently offering franchises for sale or has operational franchised outlets is considered to be engaged in franchising.

3.2.9 Trade Name and Business Format Franchising

Franchising has often been divided into two broad categories, trade name and business format. *Trade name* franchising is an arrangement where the franchisee purchases the right to operate under the name of the franchisor that acts as a source of centralized purchasing for the franchisee and promotes the trade name (Litz and Stewart 1997). In contrast, *business format* franchising is an ongoing relationship that not only includes product, service, and trademark, but also the entire concept of the business (Elango and

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[46] Although many definitions of franchising exist, Mendelsohn observed that they usually contain five basic features: (1) Branding in one form or another; (2) A system; (3) The grant of a right to use the branding and system; (4) The payment of some form of direct or indirect consideration by the franchisee to the franchisor; and (5) The investment in, and ownership of, the franchised business by the franchisee (Mendelsohn and Bynoe 1995).

Fried 1997). Compared to business format franchising, trade name arrangements usually leave significantly more residual power in the hands of the individual franchisee (Litz and Stewart 1997). Both trade name and business format franchising are distinguishable from most other forms of business by the "symbiotic relationship of inter-dependence existing between two legally distinct economic entities" (Stanworth and Kaufmann 1996, p. 57). In both trade name and business format franchising, franchisees are legally independent but economically dependent to varying degrees on an integrated business system of a franchisor (Kuratko and Hodgetts 1995).

3.2.10 Franchise System

The term *franchise system* has been used to describe the specific governance structure (Blair 1995) or organizational context (Falbe, Dandridge et al. 1998) created by a franchise. In this study, the term *franchise system* will be used to describe the organization created by a firm engaged in offering franchises, which includes multiple-concept offerings, various forms of master franchising, and includes both franchised and company-owned outlets.

3.2.11 Franchise Concept

Franchise concept is a term commonly found in franchise disclosure documents to differentiate among different programs or business types offered under the same agreement. Concept is used among practitioners to describe or categorize the specific type of business being licensed by a franchise. A distinction between a franchisor and a franchise concept is important, as many franchisors license more than one concept. For example, Tricon Global Restaurants, a franchisor, offers franchises in Pizza Hut, KFC, and Taco Bell concepts, each utilizing different franchise agreements.

3.2.12 Franchised Outlet

A franchised outlet is a single establishment or territory governed by a franchise (Curran and Stanworth 1983). For this study, a franchised outlet may include both co-branded and single concept outlets.

3.2.13 Earnings Claim

In the context of franchising in the United States, the Federal Trade Commission defines an *earnings claim* as any representation of "actual or potential sales, costs, income or profit."[47] The UFOC Guidelines define it as information "from which a specific level or range of actual or potential sales, costs, income or profit from franchised or non-franchised units may be easily ascertained" (Wieczorek 1999, p. 16). Currently, franchisors are not required to make an earnings claim, but should they elect to do so, it must be disclosed in Item 19 of the UFOC.[48]

3.2.14 Exclusive Territory

An exclusive territory is a specified boundary within which a franchised business operates. A franchise provision that grants *exclusive territory* prohibits granting of another identical franchise within a specified geographic boundary. This exclusivity may or may not be associated with a sales quota, and has been considered an important element in franchise growth (Bradach 1995).[49]

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[47] Source: U.S. Federal Trade Commission Franchise Rule, 16 CFR Section 436.1(a)(24)(b).
[48] Price found that 26 percent of the franchises in her sample made these voluntary earnings disclosures (Price 2000).
[49] Bradach (1995) found that existing franchisees dominated new franchisees as a source of growth within a given franchise system. He concluded that "The most important constraint on growth with existing

3.2.15 Passive Ownership

A provision found in franchise agreements and disclosure documents that defines ownership requirements. Franchises that permit *passive ownership* do not require a commitment by prospective franchisees to management of a franchised outlet.

3.2.16 Franchise Fee

An up-front payment made by a franchisee to a franchisor in exchange for rights to operate a franchised business. A franchisor typically provides a franchisee with the right to use intellectual property as contained in a franchise in return for a lump sum *franchise fee* payment and an annual royalty fee (Shane 1996).

3.2.17 Royalty

Ongoing fee paid by a franchisee to a franchisor, usually based on a percentage of gross sales or revenues.[50]

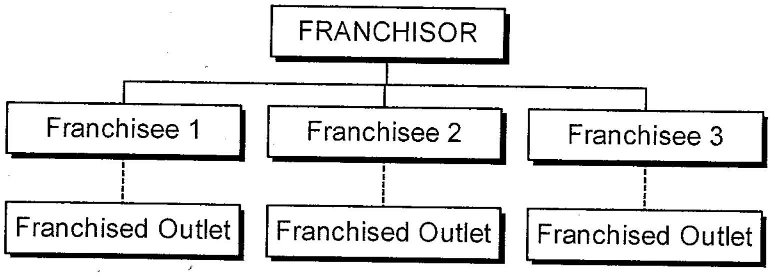
3.3 Franchise Unit of Analysis Considerations

In simple franchise systems, as depicted in Figure 3.3 below, each franchisee is an owner-manager of one franchised outlet. In this configuration, there is little difference between the success, failure, or performance of any given franchisee and a

franchisees occurred when a franchisee owned an exclusive territory and did not want to develop it aggressively" (Bradach 1995, p. 75).

[50] Lafontaine reported in a 1992 study that 123 of the 127 responding franchisors charged some form of royalties, of which 112 were based on a percentage of sales or revenues (Lafontaine and Slade 1998).

Figure 3.3: Simple Franchise System



franchisee's outlet. Empirical studies of franchising have found, however, that few franchise organizations resemble this simple system.

Variations in organizational complexity among franchising firms introduce variables that must be considered in studies of franchising at an individual or firm level of analysis. Among the types of organizational complexity prevalent in franchising are passive ownership, multi-unit ownership by franchisees, various forms of master franchising, and combined use of both franchised of company-owned outlets.

3.3.1 Passive Ownership

Passive ownership is a contractual provision where the owner of a franchised outlet need not manage the daily operations of the outlet. In franchises where passive ownership of outlets is allowed, financial buyers may purchase one or more franchised outlets based on the investment's ability to provide economic returns. Franchised outlets with passive ownership introduce organizational complexity that must be considered because of separation between ownership and management of the franchise. In other words, a franchisee and manager of a franchised outlet are likely to be different individuals under a passive ownership arrangement. Passive owners are likely to differ in their motivations and relationships with their franchisor from that of owner-manager franchisees.

3.3.2 Multi-Outlet Ownership

Bradach opined that a common assumption in the literature is a view of franchise systems as an agglomeration of single unit franchisees (Bradach 1995). Kaufmann posited that modern franchising "is replete with multi-unit operators" (Kaufmann and Kim 1995, p. 50), and although the term *franchisee* conjures an image of a franchised outlet's owner-manager (Caves and Murphy 1976), empirical evidence suggests otherwise. Empirical support for the prevalence of multi-unit ownership was provided by Kalnins & Lafontaine, who found that single-unit owners made up less than 11% of the total units in their sample of 3,400 restaurants in Texas (Kalnins and Lafontaine 1996). Similarly, Bates discovered that 84 percent of recently-started restaurant franchise units in his sample were owned by multi-establishment corporations (Bates 1997).[51]

Although some franchisee-owned chains may consist of one or two outlets, others have evolved into organizations of considerable size, structure, and complexity. One franchisee, NPC International, owns 785 Pizza Hut restaurants, with annual turnover in excess of $455 million, while another franchisee, Ameriking, owns 379 Burger King restaurants, with $395.9 million in turnover, 17,069 employees, and operations in 12

[51] One explanation for the multi-unit phenomenon is that reduced training and administrative costs make existing franchisees a "relatively inexpensive source of growth for chain organizations" (p. 61) (Bradach 1998). Another view is that because most franchise agreements contain non-compete clauses (Lafontaine and Slade 1998), the purchase of an additional outlet is one of a limited number of available choices for existing franchisees to expand their business interests.

U.S. states.[52] Ranked in terms of number of units, franchisee-owned chains account for 63 of the largest 150 restaurant chains in the United States, with 10,142 of the 45,779 total units in the rankings.[53] The Franchise Finance Corporation of America (FFCA), one of the largest providers of financing to franchised businesses, concluded that the operational proficiency and management sophistication required to operate a large chain of restaurants by a franchisee is closer to that of a franchisor than an owner-manager franchisee (FFCA 2000).

3.3.3 Master Franchising

In addition to multiple outlet ownership by franchisees, some franchises employ various forms of master franchising in their organizations. Kaufmann and Kim called master franchising "one of the most important additions to the franchising landscape" (Kaufmann and Kim 1995, p. 50). The authors observed that master franchising is a form of "umbrella licensing agreement," (p. 50) which provides granting of an exclusive territory, and introduces an additional level of control between franchisors and franchisees. They found that 57 percent of franchises in their sample engaged in some combination of sub-franchising, area development, and/or master franchising.

Area development agreements typically grant a right to an area developer to establish a pre-specified number of units in an exclusive territory, over a prescribed period of time

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[52] NPC International is a publicly-traded firm on NASDAQ (NPCI). Ameriking, Inc. is a privately held company. Financial data on the company obtained at http://www.hoovers.com/co/capsule/8/0,2163,51328,00.html.

[53] While Pizza Hut had 22 operators in the largest chains, Subway had only one in the ranking, and despite its number one ranking in terms of domestic sales, no McDonald's operators made the FFCA's Top 150 list. The FFCA found that no correlation existed between the percentage of units franchised and the prevalence of large franchisee operators, and that "corporate philosophy is more of a factor in determining how large franchisees become" (FFCA 2000, p. 75).

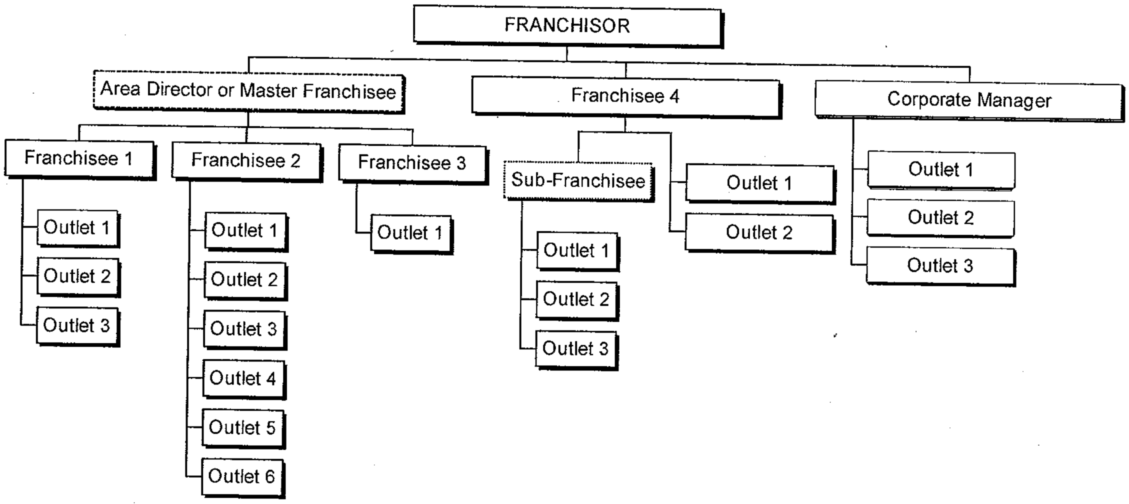
(Kalnins and Lafontaine 1996). Area director or area development agreements, master franchise agreements, and sub-franchise agreements introduce organizational layers between the franchisor and franchisee, adding organizational complexity beyond that of the simple dyad depicted in Figures 3.2 and 3.3.

3.3.4 Plural Organization

The third example of organizational complexity in franchising is found in those firms that use combinations of franchised and company-owned outlets within the same system. Many firms that engage in franchising also operate company-owned outlets, in what Bradach termed "the plural form" of organization (Bradach 1997). Using an ethnographic case study approach, he found that a plural organizational form facilitated innovation in the five restaurant chains studied. Bradach concluded that most restaurant chains operate as plural forms, and suggested that plurality kept their control processes fresh. For the firms in his sample, plural organizations enabled management to better focus on opportunities and adaptation.

Multi-unit ownership by franchisees, master franchising, and the prevalence of both franchised and company-owned outlets suggest that studies of franchise organizations must consider organizational variations, as depicted in the representative franchise organization in Figure 3.4 below:

Figure 3.4: Representative Franchise Organization



Organizational complexities are sometimes overlooked in empirical studies of franchising, especially those using questionnaire and survey instruments. A survey of franchisees, for example, is likely to include owner-managers of a single outlet, owners of multiple outlets, and passive owners, representing differing levels of involvement in the daily operations of a franchised business. A franchisee, especially those with multi-unit ownership, may also be a corporation or partnership made up of several individuals, each with potentially different responsibilities and opinions.

In her study of job satisfaction among restaurant and non-food retail franchises, Morrison used a population of franchisees that included those with partial ownership interests in the franchised outlet (Morrison 1997). More than one-third of the sample included owners of multiple franchises, and measured franchisor relations and franchisee performance. This study did not differentiate between those franchisees with multi-unit ownership and those with single unit responsibilities, despite probable differences in their jobs, financial risks, organizational commitment, and franchisor relations. Morrison's study also did not consider whether area developers or master franchisees were part of the franchise organizations in her sample, organizational layers that may influence relations among franchisors and franchisees.

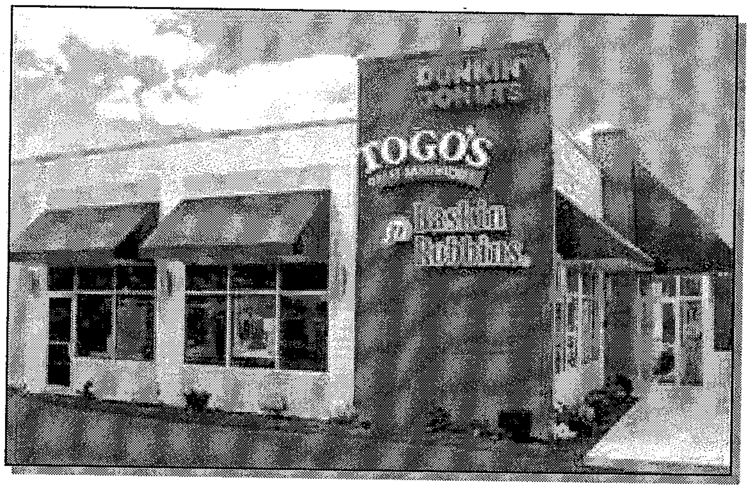
3.3.5 Franchise Concept Variations

In addition to organizational variations, some firms offer several different franchises within a single franchise system. The term *concept* is frequently used in franchise documents and among practitioners to describe an individual product and/or service franchise offerings. Some franchisors offer more than one concept franchise, using the same branded products or services in different configurations. The Coffee Beanery, for example, offers a kiosk or cart concept in addition to its traditional retail store franchise. Quizno's, a quick service sandwich shop, offers a smaller, limited service *Quizno's Express* franchise for airports, schools, and mall locations, in addition to its original concept offering. These different *concept* offerings may have different franchise fees, start-up costs and different contractual provisions. Although offered by the same franchisor, different franchise concepts may or may not be offered under the same franchise agreement.

In addition to different concept offerings under the same brand, some franchisors offer franchises incorporating different concepts and brands. One franchisor, Tricon Global Restaurants, for example, offers franchises in Pizza Hut, KFC, and Taco Bell concepts. Another franchisor, Dwyer Group, offers seven different franchise concepts: (1) Rainbow International; (2) Mr. Appliance; (3) Mr. Rooter; (4) Aire Serv; (5) Mr. Electric; (6) Glass Doctor; and (7) Dream Maker. Each of Tricon and Dwyer Group's franchise concepts are offered by a single franchisor through different UFOCs and franchise agreements. Tricon and Dwyer are not unique in this approach, as seventy-seven of the largest 150 restaurant chains in the U.S. operate in this multi-concept environment (FFCA 2000).

Multiple concept offerings by franchisors introduce product and/or service variations among franchised outlets in the same franchise system. One example of multi-concept offerings is known as *co-branding,* where more than one franchise concept is delivered within the same outlet (Young, Hoggatt et al. 1999). Another form of co-branding different concepts is found in franchised restaurants that operate within retail convenience stores, or video rental franchises that also offer coffee or pizza from another franchise. A third variation of co-branding multiple concepts is when offerings by the same franchisor are combined in a single outlet, as illustrated in Figure 3.5.

Figure 3.5 Example of Co-Branded Outlet



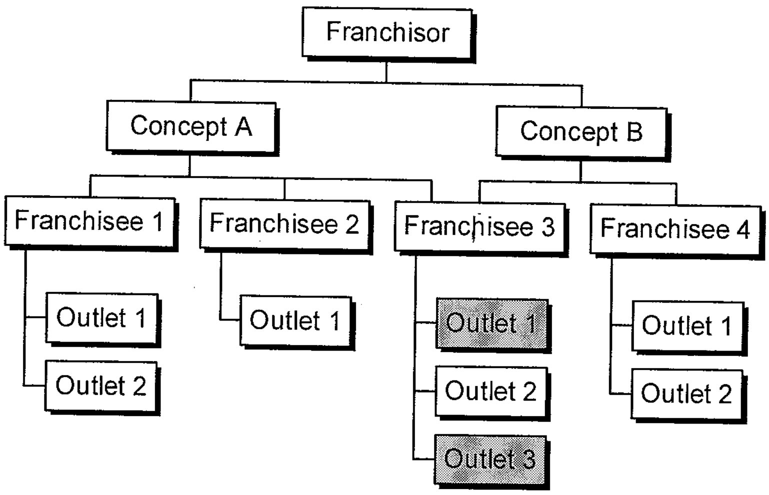
The outlet depicted in Figure 3.5 offers Allied Domecq PLC's Dunkin Donuts, Togo's, and Baskin Robbins Ice Cream concepts in a single facility.[54] According to this

[54] Dunkin' Donuts, Baskin Robbins, and Togo's are separate corporations operating as Allied Domecq Quick Service Restaurants (AD-QSR), an unincorporated division of Allied Domecq PLC.

franchisor, multi-concept strategies are designed to optimize capital and labor utilization within a single facility.

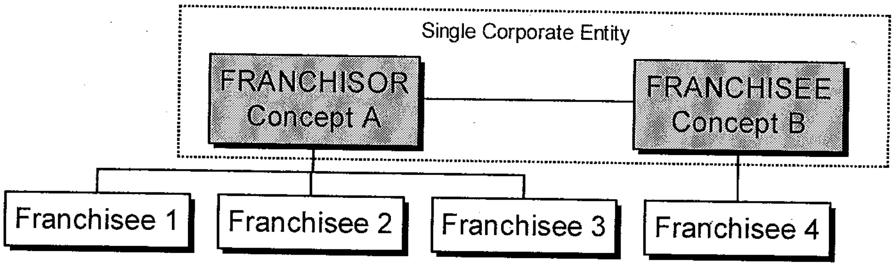
Viewed from an organizational standpoint, franchise organizations that employ multi-concept offerings and/or co-branded outlets introduce potential inconsistencies in the unit of analysis, as illustrated in Figure 3.6 below. In this example, Franchisee #3 is licensed by the franchisor to distribute both Concept A and Concept B, and may employ co-branding in Outlet #1 and Outlet #3, while operating Outlet #2 as a single concept outlet.

Figure 3.6: Multi-Concept Franchise System



Multi-concept product offerings and co-branded outlets are not the only product or service variations found among firms engaged in franchising. Some firms operate as franchisor for one or more concepts, while simultaneously licensed as a franchisee for other concepts. RTM Restaurant Group, for example, is franchisor of 133 Lee's Famous Chicken outlets, and is a franchisee with 710 Arby's and 350 Del Taco restaurants. Whether RTM is considered as franchisor or franchisee is dependent upon the specific concept being studied. A single corporate entity may also act as franchisor of one or more concepts and master franchisee for one or more additional concepts. This type of single entity franchisor/franchisee organization is portrayed in Figure 3.7.

Figure 3.7: Simultaneous Franchisor/ Franchisee



3.4 Research Questions and Hypotheses Development

"The literature makes it clear that opportunities do not drop from the sky" (Low and MacMillan 1988, p. 155). Low and MacMillan posited that opportunities are created within and among existing organizations, and that the same relationships needed to identify opportunities are also necessary to obtain the resources required to exploit them. The authors recommended that future research in entrepreneurship should focus on contextual and process oriented studies using different levels of analysis to "provide a much richer understanding of the entrepreneurial phenomenon" (p. 157). Following the broad framework outlined by Low and MacMillan, this work explores the context of franchising for potential entrepreneurial opportunities. This section begins by first developing the research questions and specific hypotheses for this study.

3.4.1 Exploration of the Formal Context of Franchising

As described in the literature review, recent research in franchising has often been guided by agency theory, transaction cost analysis, ownership redirection, and risk reduction theories (Price 1997). In their synthesis of the literature, Elango and Fried concluded that these studies, although helpful, focused primarily on franchisors, and often ignored opportunities *within* franchise organizations (emphasis added) (Elango and Fried 1997). Although potential for entrepreneurial opportunities within franchising has been posited (Phan, Butler et al. 1996), the nature of or extent to which these opportunities exist remains largely unexplored.

On the surface, franchising appears to create a highly regimented, uniform, and theoretically unpromising environment for entrepreneurship, especially when compared to non-franchised businesses. Institutional constraints created through legislative and regulatory agencies establish strict legal boundaries within which franchise contracting must be conducted (Hudson and McArthur 1994). Franchisors impose a variety of product or service controls, contractual specifications, financial reporting requirements, and regularly monitor activities at a franchised outlet (Morrison 1997). Franchisors retain unilateral authority and often seek to curtail franchisee autonomy in the best interests of the overall system (Hoy 1994), and some are ruthless with those who deviate from prescribed methods (Price 1997). Built on replication, standardization, uniformity, and conformity with detailed procedures, it would appear that innovation and other behaviours commonly associated with entrepreneurship are inherently illegitimate in highly structured organizations such as those found in franchising (Kirzner 1979). Unlike owners of non-franchised businesses, a franchisee's path to success appears to be one of efficient implementation of a proven concept, as opposed to entrepreneurial behaviour.

On the other hand, there are several reasons why franchising potentially presents an ideal context in which to study entrepreneurship. First, actors are never completely constrained by formal rules of a system within which they operate (Bouchikhi 1993).

Franchisees, therefore, are potentially entrepreneurial "because a franchisor's ability to imposed a strategic direction on a franchisee is limited" (Phan, Butler et al. 1996, p. 380). Viewed from an organizational perspective, Shane and Hoy introduced the notion of a franchise as an entrepreneurial venture, positing the creation of a franchise network was an entrepreneurial act (Shane and Hoy 1996). Although franchising's context appears to constrain entrepreneurial behaviours, Kaufmann and Dant observed that to varying extents, all environments constrain entrepreneurship, and franchisees may have varying degrees of latitude in delivering a franchise system concept at their particular location (Kaufmann and Dant 1998). Empirical studies have supported a view that individuals within franchising may exert considerable influence over sales volume and profits (Fenwick and Strombom 1998). A given franchise system or concept, therefore, provides an organizational context that can either promote or constrain entrepreneurial attributes (Falbe, Dandridge et al. 1998).

Second, studies of entrepreneurship within organizational contexts, once considered an oxymoron, have received increased attention. Known to be a source of competitive advantage in small firms, an ability to innovate and rapidly respond to dynamic market conditions has also contributed to success in large firms (Kanter 1997). Corporate entrepreneurship theory posits that the primary characteristics of entrepreneurship typically associated with an individual, such as growth, innovation, and flexibility, are also considered to be desirable traits for corporations (Stevenson and Jarillo 1990).[55] Constructs and typologies, such as those developed by Covin and Slevin (Covin and Slevin 1989); (Covin and Slevin 1991) and Lumpkin and Dess (Lumpkin and Dess

[55] The crux of corporate entrepreneurship, according to Stevenson, is that opportunity *for the firm* must be pursued by *individuals within* the firm (emphasis added).

1996) have proven useful in both clarifying entrepreneurship's role within organizations, and in differentiating firms by their comparative entrepreneurial behaviours.

Although studies have found that corporate entrepreneurship (CE) is a determinant of survival, success, profitability, and growth in corporate hierarchies (Zahra 1996), comparatively little is known about entrepreneurship's role in hybrid organizations, such as franchising. Despite more than 225 articles published by Society of Franchising, and more than 80 articles published by entrepreneurship researchers, the franchisee remains one of the least studied of entrepreneurial types (Phan, Butler et al. 1996). This lack of attention is presumably because of franchising's apparently unpromising environment for entrepreneurial experimentation.

Lastly, franchising's formalized organizational structure creates a regimented and comparatively homogeneous context in which to examine opportunities and processes. The context in which franchised businesses operate is well defined by uniform disclosure requirements and legal provisions contained in detailed, long-term contracts. Franchise agreements define the organization structure, governance system, and work rules for each system, which significantly affect the entrepreneurial environment in which each system operates (Kao 1991). By comparison, non-franchised businesses, especially SMEs, typically adopt an informal structure, allowing them to rapidly adapt to changing market conditions, consumer preferences, and competitive pressures. Zahra concluded that entrepreneurial activities were likely to thrive in contexts characterized by dynamism and uncertainty (Zahra 1996). Entrepreneurs operating within franchising's context must resolve constant, yet evolving tension between the strategic imperatives of standardization and adaptation (Kaufmann and Eroglu 1998).

Researchers are likely to find a plethora of entrepreneurial opportunities and behaviours in non-franchised contexts. Once found, separating entrepreneurial behaviours and its effects from other determinants has proven difficult, however, and attribution of success and/or failure has been "complex, dynamic and problematic" (Jennings and Beaver 1997, p. 67). Franchising creates an apparent homogeneous context, especially when contrasted with the SME sector, which is known to be far from homogeneous in many respects (McMahon and Stanger 1995). In comparison to non-franchised businesses, franchising's context appears to reduce environmental complexity, to one prescribed, controlled, and delimited by contractual terms of a franchise agreement.

A highly regimented, seemingly uniform, and unpromising environment such as that found in franchising seems an unlikely context for studies of entrepreneurship. Kodithuwakku and Rosa argued, however, that environmental complexity was reduced in highly unpromising contexts (Kodithuwakku and Rosa 1999). The authors chose an apparently uniform social and economic environment in a Sri Lankan village, with a perceptible lack of opportunities and resources. Their research revealed that entrepreneurship was a major determinant of success on the part of some farmers in their sample.[56] They argued that because entrepreneurial behaviour was more readily

[56] Kodithuwakku and Rosa (1999) examined why some Sri Lankan farmers were more successful than others in the same village, given the same allocation and availability of resources. Ten years prior to the field study, a group of families each received two and one-half acres of cleared land and a small monetary grant. In fieldwork, they found "considerable economic and social differentiation" among the pioneers, despite the parity of their initial resources and the uniformly scarce resources available to the farmers. Although entrepreneurship studies frequently use success as the dependent variable (e.g., (Birley and

apparent in this constrained and relatively homogeneous context, it may be inferred that the greater the environmental constraints, the greater the possibility of observing entrepreneurial processes.

Before Kodithuwakku and Rosa's theme is extended into the apparently uniform and unpromising environment of franchising, a logical first step is to explore the formal context of franchising, as defined by its contractual provisions, for indicators of uniformity. This leads to the first set of research questions:

Q1a: To what extent is the formal context of franchising homogeneous?

Q1b: How do contractual provisions differ among franchising firms?

3.4.2 Differential Performance among Franchising Firms

Viewed from an Austrian economics perspective, continuous innovation is a driver of higher performance in firms. It is characterized by factors such as flexibility and interfirm heterogeneity (Deligonul and Cavusgil 1997). An organizational view suggests that organic structures and an entrepreneurial strategic posture contribute to high performance in firms (Covin and Slevin 1989). Although there is widespread acceptance that superior performance is associated with quick decision-making, simple administrative structures, and flexible operations, innovation has consistently been found to be associated with success (Baldwin 1995).[57] Lado et al. argued that once achieved, a firm's ability to sustain competitive advantage depends on the extent to

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Westhead 1993); (Gray 1998); (Monroe, Price et al. 1996)), the "quasi-experimental" context of this study made it somewhat unique.

[57] Consistent with the recent literature, Mone et al. defined innovation broadly as any action that either puts the organization into new strategic domains or significantly alters the way the organization attempts to serve existing customers or constituents (Mone, McKinley et al. 1998).

which it develops capabilities for innovation (Lado, Boyd et al. 1997). "For the entrepreneur, opportunity is based in innovation" (Smilor, p. 343).

In contrast, franchising is considered by some as the antitheses of innovation, representative of increasing homogenization in commercial cultures, singularly responsible for a lack of variety in several retail sectors, and an instrument of destruction for budding retail entrepreneurs (Kaufmann and Dant 1998). From an organizational perspective, franchising's Tayloristic organization form operates with mechanized efficiency (Morgan 1997), in stark contrast to organic structures found in entrepreneurial firms. Morgan observed that many franchising systems centralize their product or service design and development, while decentralizing implementation in a highly controlled fashion:

> "They use scientific methods to determine the work to be performed, produce manuals that set standards and codify performance in minute detail, have well-developed recruitment and training plans, and comprehensive systems of job evaluation often provide the recipe for success" (Morgan 1997, p. 28).[58]

To attain consistency in product or service at outlets within their chain, franchisors curtail franchisee independence and autonomy, under the premise that it represents the best interests of the overall system (Hoy 1994).

[58] Morgan noted that McDonald's and other firms in the fast-food industry provided the best examples of the mechanized approach. McDonald's has built a solid reputation for excellent performance in the fast-food industry by mechanizing all its franchise outlets all over the world, so that each can produce a uniform product, serving a mass market in a perfectly regular and consistent way, with all the precision that "hamburger science" can provide. McDonald's actually has its own "Hamburger U" for teaching this science to its managers, and has a detailed operating manual to guide franchises in the daily operations of the McDonald's system. The firm is exemplary in its adoption of Tayloristic principles and recruits a nonunionized labor force, often made up of high school and college students and part-time workers, that will be happy to fit the organization as designed. The "machine" works perfectly most of the time. The company also has a dynamic and innovative character, but this is for the most part confined to its central staff who do the thinking (i.e., the policy development and design work) for the corporation as a whole (Morgan 1997, pp. 27-8).

Further research on franchising using entrepreneurship constructs appeared justified; especially given franchising's economic impact and its role as a source of job creation (Morrison 1995). Although entrepreneurship has been studied for a variety of reasons, Covin and Slevin argued, "the overriding reason for the current interest in the topic is the widespread belief that entrepreneurial activity stimulates general economic development as well as the economic performance of individual firms" (Covin and Slevin 1991, p. 9). As such, entrepreneurship has often been viewed as a means of creating value (Stevenson, Roberts et al. 1985). While some consider entrepreneurship synonymous with starting a new venture (e.g., (Gartner 1985)), Churchill posited that value is really created as an enterprise grows, creates more jobs, and meets the needs of more customers (Churchill 1997).[59] Both the creation of new business units and jobs is central to franchising's mission (Hoffman and Preble 1993), making growth among firms within franchising a relevant topic within entrepreneurship. Venturing, the creation of new units within an organization, provides an accepted measure of the phenomenon.

A substantial research gap exists in studies of franchising firms. Although aggregate growth rates have been the topic of several academic studies (e.g., (Lafontaine and Shaw 1998); (Stanworth, Purdy et al. 1997)), few studies have examined differential growth among individual franchising firms. In their review of recent literature, Elango and Fried noted that actual operations of franchising systems have rarely been directly examined (Elango and Fried 1997). Within this context, little is known about

[59] De Rose cautioned that value is often vaguely defined, and frequently used as a substitute for cost or price. He defined value as "the satisfaction of customer requirements at the lowest total cost of acquisition, ownership, and use" (DeRose 1994, p. 12).

characteristics that differentiate growing franchises from others. Therefore, the broad question is: What characteristics and contractual provisions are associated with growing firms operating within the context of franchising? To address this broad research question, several hypotheses were developed.

The existence of franchising has been explained through capital acquisition models (e.g., (Caves and Murphy 1976); (Dant 1995)), ones that view franchisees as an efficient source of capital. Franchisees are responsible for purchasing equipment, inventory, real estate, and other costs associated with the initial start-up of their outlet. Start-up costs include an up-front franchise fee payment to the franchisor. Although lending institutions have generally supported franchisee borrowing (Stern and Stanworth 1993), franchisors may be in a better position to negotiate more favorable terms with lenders on behalf of their franchisees.

Franchises that offer financial assistance may be better able to attract franchisees as compared to those who do not. Access to capital is likely to become more important for those franchises with higher initial start-up costs and fees. Therefore,

Hypothesis 1a: Financial assistance will be positively associated with growth.

Hypothesis 1b: Financial assistance provisions will be positively associated with initial start-up costs.

Shane and Hoy posited that the act of creating a franchise network was an entrepreneurial act (Shane and Hoy 1996). Networks are created within franchising when franchisees begin as owners of single outlets, and subsequently purchase rights for additional outlets. The prevalence of multi-unit ownership within franchising has been revealed in previous empirical studies (e.g., (Kalnins and Lafontaine 1996); (Kaufmann and Dant 1996)). Bradach concluded that multi-unit ownership by franchisees provided franchisors with a more manageable, concentrated base (Bradach 1995). He argued that "the more concentrated the base of franchisees, the easier it is to decide on and implement proposed adaptations" (p. 79).

In addition to multi-unit ownership by franchisees, other forms of franchise networks are created through various types of master franchising. In their sample of 169 franchisors, Kaufmann and Kim found that 57 percent engaged in some form master franchising, area development, and/or sub-franchising arrangements (Kaufmann and Kim 1995). Using Compound Average Growth Rate (CAGR)[60] as a measure of outlet growth, the authors found that firms engaged in various forms of master franchising grew faster than those that did not. Although a third form of franchise network may be created through passive ownership of franchised outlets, there are no previous studies in which it was explored.

Franchisors periodically revise their franchise agreements. In addition to updating their financial statements and number of operational outlets, changes in contractual provisions may also be implemented. A franchise that presently includes master franchising, area development, and/or sub-franchising arrangements may or may not have offered those provisions since the firm's inception. If franchise network

[60] Kaufmann and Kim calculated growth rates as: CAGR= (current number of outlets)$^{1/n}$ – 1. The authors culled out franchise systems in existence for less than five years because of instability with the CAGR model.

provisions enable faster growth, arguably they are more likely to be associated with a firm's projected growth than its past performance. Therefore:

Hypothesis 2a: Area development provisions will be positively associated with growth.

Hypothesis 2b: Sub-franchising will be positively associated with growth.

Hypothesis 2c: Passive ownership will be positively associated with growth.

In their conceptual model of entrepreneurship as firm behaviour, Covin and Slevin considered external variables, strategic variables, and internal variables, all of which combined to make up *entrepreneurial posture*, as depicted in Appendix A, Figure A2 (Covin and Slevin 1991). External variables included dynamism and hostility of the environment, while internal variables such as top management values and organizational culture were also considered. The strategic variables included a firm's strategy and business practices. Covin and Slevin posited that entrepreneurial posture is highest among firms with growth strategies, and that entrepreneurial posture was positively associated with firm performance (p. 13).

On one hand, franchising enables a firm to achieve rapid expansion, consistent with a growth strategy. Shane found that the more a firm emphasized franchising, the faster the firm would grow (Shane 1996). Conversely, an ownership redirection thesis views franchising as simply a short-term or early stage development feature (Dant, Paswan et al. 1996). Ownership redirection posits that once franchisors gain financial and human capital, they will prefer to adopt more conventional growth strategies, such as opening company-owned outlets in order to meet their needs of future growth. Norton referred to simultaneous company and franchised outlet ownership as "a curious feature" of franchised organizations (Norton 1988, p. 199). Therefore,

Hypothesis 3a: Growth strategies will be positively associated with firms offering area development agreements.

Hypothesis 3b: Growth strategies will be positively associated with firms offering sub-franchising agreements.

Hypothesis 3c: Growth strategies will be positively associated with firms that permit passive ownership.

Hypothesis 3d: The ratio of franchised outlets to total outlets will be positively associated with growth.

Hypothesis 3e: The ratio of franchised outlets to total outlets will be negatively associated with the number of years a firm has been franchising.

Franchising as a method of growth is predicated on an assumption that value has been created by a franchisor through careful operation, testing and documentation of a commercially viable idea (Spinelli 1997). Spinelli argued that the essence of franchisee due diligence is to verify the ability of: (1) the franchise to create wealth through the franchisor's business format; and (2) the ability of the format to be transferred for local execution. In his study of Canadian franchisors and franchisees, Knight found that both groups advocated government regulations to improve disclosure (Knight 1986). In the United States, the UFOC Item 19, *Earnings Claims* provides an official vehicle for this aspect of due diligence.

In franchising, disclosure of earnings has been called "The Issue That Wouldn't Die" (Kolton 1999, p. 48). Unlike other Items in a UFOC, disclosure of earnings, actual or potential sales, or costs for both franchised and non-franchised units is voluntary under Federal Trade Commission guidelines. It is unlawful for franchisors to provide any earnings claim information to prospective franchisees unless formally disclosed in UFOC Item 19 (Wieczorek 1999). Debates over mandatory earnings claims disclosure have continued since the guidelines were enacted in 1986.

Kolton observed that those in favor of mandatory earnings claims question how a potential franchisee can make an informed decision about an important investment without some indication of potential returns on that investment (Kolton 1999). Those opposed to mandatory claims cite the difficulty of creating reliable earnings numbers from a system of disparate financial statements, and the liability for franchisors should franchisee performance differ from that disclosed. Despite continuing debates over earnings claims disclosure among practitioners, lawmakers, and those engaged in franchising, the topic has received little attention in the academic literature.

A notable exception was a recent study by Price, who found a negative relationship between a franchise system's size, in terms of number of units, and disclosure of earnings (Price 2000). In her analysis of 278 UFOC documents, only 73 (26 percent) provided voluntary earnings claim information. She found support for her hypothesis; franchisors that disclose earnings information face greater investment risk, and therefore must find ways to mitigate their risk through higher fees from franchisees. Although not examined in her study, franchisors may also mitigate investment risk through longer-term franchise agreements

Given the importance of earnings claim information to prospective franchisees, it follows that those franchise systems who voluntarily disclose earnings may have an edge in attracting potential franchisees over those franchises that choose not to disclose. Franchisors with above average earnings or sales at their outlets are more likely to voluntarily disclose earnings information than those with below average performance. It follows that they are likely to have a system with favorable wealth creation potential at a franchisee level. Earnings claim disclosure should also be important in those systems with higher reliance on franchising as a means of growth. Therefore,

Hypothesis 4a: Earnings claim disclosures will be positively associated with growth.

Hypothesis 4b: Earnings claim disclosure will be positively associated with franchise fees.

Hypothesis 4c: Earnings claim disclosure will be positively associated with longer-term agreements.

Hypothesis 4d: Earnings claim disclosures will be positively associated with the ratio of franchised outlets to total outlets.

3.4.3 The Operational Realm of Franchising

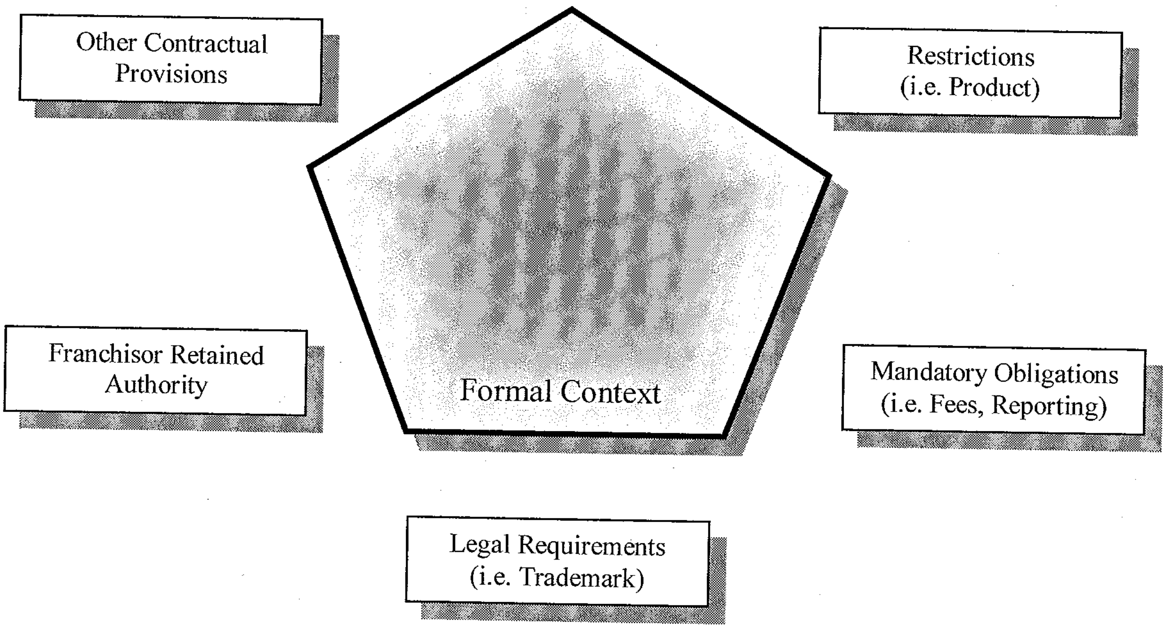
Previous sections of this chapter focused entirely on franchising's formal context, as defined by its official disclosure and legal agreements between franchisor and franchisee. Stanworth observed:

> "…at the formal level, relations between the franchisor and franchisee might be described as dependently one-sided since the contract is drawn up on a virtually non-negotiable basis by the franchisor and put to the franchisee on a take-it-or-leave-it basis" (Stanworth 1995, p. 165).

He suggested that an operational realm in franchisor-franchisee relations existed, one not necessarily revealed by an analysis of contractual provisions exclusively. His study found that despite explicit contractual obligations that circumscribed autonomy, franchisees reported relatively high levels of independence in daily operations of their businesses. Stanworth concluded that considerations based solely on the formal context of franchising are misleading, presenting only a partial view of the phenomenon.

Franchising's formal context is generally defined by legal requirements, contractual provisions, and franchisor authority retained in franchise agreements, as depicted in Figure 3.8. Its formal context appears to create boundaries of conduct, within which all business must be conducted at franchised outlets.

Figure 3.8: Boundaries Created by Formal Context of Franchising



Shane and Hoy observed that entrepreneurship scholars know relatively little about how entrepreneurs successfully manage cooperative relationships involving organizational routines, such as those found in franchising (Shane and Hoy 1996). They observed that franchising's high rate of litigation and low survival rates may be indicators that practitioners have little knowledge in this area as well. Despite franchising's ubiquity and economic impact, actual operations of a franchising system have rarely been directly examined (Elango and Fried 1997).

One approach is to explore the extent to which contractual provisions and firm characteristics explain performance among franchising firms. Therefore, the following research question is posited:

> *Q2. To what extent is firm performance explained by contractual provisions and characteristics of firms engaged in franchising?*

Stanworth found that more than 80 percent of his franchisee respondents claimed that franchisors made no mention of contractual provisions to them in their daily relations (Stanworth 1995). In the United States, meeting federal disclosure requirements and drafting detailed agreements is an expensive and time-consuming process, one in which costs are likely passed on to franchisees and ultimately consumers. Franchise legislation in a number of other jurisdictions, such as Alberta and Ontario Canada has been patterned after U.S. disclosure laws, in an effort to inform and protect potential franchisees from franchisor abuse. Despite its prominent position in debates concerning franchisor-franchisee relations, the role of official disclosure and contractual documents in a franchise selection process and daily operations of franchised businesses remains largely unexplored. Little is known about how contractual provisions are formulated and enforced by franchisors.

Falbe et al. opined that it is important for both researchers and practitioners to better understand the extent and role of entrepreneurial activity within franchise systems (Falbe, Dandridge et al. 1998). Since disclosure documents and contractual provisions are likely to play a substantial albeit partial role in entrepreneurial activity within franchising, the following research questions are proposed:

> *Q3a: What is the role of the UFOC and franchise agreement in the selection process and daily operations of franchised businesses?*
>
> *Q3b: How are franchise disclosure documents and contractual provisions formulated and enforced?*

3.5 Summary

This chapter provided definitions for terms used in this study. Research questions about the nature and extent of homogeneity within franchising's formal context that emerged from the literature were reviewed. Next, variations and organizational complexity among franchising firms was discussed. In the following section, several hypotheses were developed, designed to test the relationships between franchise firm characteristics and contractual provisions with measures of firm performance.

Evidence emerged from the literature that both a formal context and an operational realm exist in franchising. The extent to which characteristics and contractual provisions explains differential performance among franchising firms had not previously been examined. Finally, research questions that explore the link between the formal context and the operational realm were formulated. The next chapter reviews methods used in this study to address these research questions and test hypotheses previously discussed.

4.0 METHODS

4.1 Introduction

Franchising has often been compared to other forms of governance structures (e.g., (Harrigan 1998); (Michael 1996); (Norton 1988)). Failure rates among franchising firms have also been contrasted with those of non-franchised businesses (e.g., (Barrow 1989); (Bates 1996)). In these and other comparative studies, firms engaged in franchising appear as a monolithic group of businesses, existing in an environment as homogeneous and uniform as the products and services they provide.

Recent studies have suggested, however, that franchising's context and the firms engaged in it may be more complex and more diverse than is apparent. First, firms engaged in franchising often use both franchised and company-owned outlets, employing what Bradach called a "plural" organization form (Bradach 1998). Second, not all franchise firms have been found to share the same prospects for success. Newcomers to franchising and those with fewer outlets in their system were found to be more susceptible to failure than larger mature systems (Bates 1997). Third, strategies have been found to differ among franchisors. For example, those with larger systems were found more likely to expand overseas than their smaller, younger counterparts (Shane 1996).

Although it "does not comfortably fit within the limits of any single academic discipline or area of management practice" (Stanworth and Curran 1999, p. 323), aspects of franchising are fertile ground for entrepreneurship research (Kaufmann and Dant 1998). A logical emphasis for entrepreneurship research within this context is one focused on growth, since entrepreneurship has long been associated with growth among both small and large firms (e.g., (Drucker 1985); (Kanter 1996); (Penrose 1968); (Schumpeter 1934)). Review of the literature revealed that entrepreneurship research has focused on aspects of franchising at an organizational level, including studies where franchising was viewed as a means of delimiting organizational and financial constraints of firm growth (e.g., (Spinelli and Birley 1996)), and at an individual level, including franchising's role as a route to self-employment (e.g., (Kaufmann and Stanworth 1995)). At a firm level, studies in corporate entrepreneurship (CE) have linked entrepreneurship to firm performance within large firm organization structures (e.g., (Block and MacMillan 1993); (Zahra and Garvis 2000))), although CE's paradigms have not been tested in hybrid organizational forms, such as those found in franchising. Comparatively little is known about the role of entrepreneurship within franchising at a firm level, beyond that of a franchisor and the birth of an original concept.

The aim of this work is to contribute to the body of knowledge in entrepreneurship by exploring its role within franchising's context. To achieve this aim, a three-part study was undertaken. First, the nature and extent of uniformity within franchising's formal context were explored. To probe franchising's formal context, I employed a content analysis strategy to explore lengthy and detailed disclosure documents and contracts that govern franchising in the United States.[61] The franchise, as defined in its Uniform Franchise Offering Circular (UFOC) and franchise agreement, served as the unit of analysis for the first part of this study.

[61] Although franchising is considered a contractual relationship, Bercovitz observed that variations in these contracts remains an aspect of franchising that is largely unexplored (Bercovitz 1999).

Next, I tested hypotheses that emerged from the literature employing quantitative analysis. Secondary sources of data, based on UFOC analysis and a franchisor survey conducted by a publisher of franchise data were used to construct datasets for this portion of the study. Consistent with studies in corporate entrepreneurship, the premise guiding this section was that if opportunities for entrepreneurship were evident within franchising's formal context, they were more likely to be found in growing franchises. This section sought to identify factors and characteristics associated with growing firms within franchising's formal context.

Stanworth and Curran identified a need to "establish more definitely the separateness and distinctiveness of the franchised business form" (Stanworth and Curran 1999, p. 340). Arguably, the first two sections of this study provided a logical step toward addressing this need, by more closely examining contractual provisions, firm characteristics, and performance among franchising firms. Its objectives were to better understand the degree of homogeneity within franchising's context; and to examine similarities and differences among those firms that operate within it. Primary and secondary data were employed in the first sections of this study, although the focus of the first two sections of the study was delimited to that of the formal context of franchising.

Detailed and specific provisions in disclosure and contractual agreements, as described in the previous sections, characterize the formal context of franchising. The role of these documents in a franchise purchase decision and daily operations of franchised outlets, however, is largely unknown. To explore operational aspects of franchising, I performed semi-structured interviews with six franchisees, four current and two former franchise owners. To provide additional insights on legal and financial considerations of franchising, I conducted interviews with the general counsel and chief financial officer of a fast-growing franchisor. Stanworth posited that exploration of both formal and operational realms of franchising was required to obtain a complete picture of the phenomenon (Stanworth 1995). He observed that studies of franchising relations that focus solely at the formal level may be misleading, as the "operational realm…is not necessarily revealed by an contractual relations" (p. 165).

The United States provided fertile ground for this study, because of its uniform and comprehensive disclosure and regulatory requirements for franchising firms. There were, however, several limitations to this approach. First, there is no present requirement for franchisors to file UFOC and franchise agreements with any federal regulatory agency. Although franchisors are required to send a UFOC and franchise agreement to qualified prospective franchisees, these documents are generally not available to the public. Only eleven U.S. states require franchisors to register and file UFOC and franchise documents before offering franchises in those states, and nationally established franchises are often exempted from filing requirements.[62]

Second, although data derived from these lengthy documents is robust and reliable, obtaining a representative sample is problematic. In addition to those franchises exempted from filing requirements, regional franchises without any operating outlets in a given state are not likely to have their documents filed in that state. In other words, a regional restaurant franchise with a significant presence in the northeast U.S. is not

[62] The eleven states that require registration are: California, Illinois, Indiana, Maryland, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, and Washington.

likely to have a UFOC and franchise agreement on file in California. Exempted franchises are likely to include larger and more mature systems, introducing bias into a sample derived using this method.

Based on these considerations, I decided to supplement an initial sample of 55 UFOC and franchise agreements with datasets constructed from reliable sources of secondary data. Although the secondary data was less robust than that of UFOC and franchise agreements, the datasets provided information on a large number of franchises, enabling use of various quantitative analysis techniques. Use of these publicly available datasets also had the potential to improve the external validity of this portion of the study. Because a single, comprehensive dataset of franchises did not exist at the time of this study, three different datasets were employed. Each source provided different insights from a diverse sample of franchises.

This chapter is structured as follows. First, justification for the methodologies employed in this study is presented. To improve clarity and structure, and because multiple methodologies are employed in this study, each of the three issues are discussed separately, followed by a summary. Next, the three phases of the empirical work are presented. Each section is structured with separate headings for dataset description, data collection and sample, and measures used in the study. The chapter concludes with a summary.

4.2 Justification for the Methodologies

This section justifies in more detail the methodologies employed in the three main aspects of the analysis. Although use of multiple methods added complexity to this study, I considered this approach applicable, given the state of franchising research at the time of this study. It is also consistent with an approach advocated by Easterby-Smith et al., who posited, "one should attempt to mix methods to some extent, because it provides more perspectives on the phenomenon being studied" (Easterby-Smith, Thorpe et al. 1991, p. 31). To improve clarity and structure, the examination of UFOC and franchise agreements, exploration of secondary datasets, and interviews with franchisees are each presented separately.

4.3 Primary data: Examination of 55 UFOC and Franchise Agreements

Stanworth and Dant argued that entrepreneurial activities by franchisees were often constrained by contractual provisions (Stanworth 1995). Despite its prominent role in governing a franchise, comparatively little is known about the similarities and differences in contractual provisions among franchises. Bercovitz noted that traditional agency models have focused on payment terms, ignoring the non-pecuniary contractual features of franchising (Bercovitz 1999). To advance the field of knowledge in this area, I examined how provisions found in disclosure documents and franchise agreements differed among franchising firms. I focused on the franchise, as defined by its franchise agreement and disclosure documents, as the unit of analysis for this portion of the study.

Subjective interpretation of contractual terms and conditions was necessary to research this issue, requiring a strategy of data collection that would facilitate comparative analysis. To accomplish this task, I chose a content analysis strategy to guide data collection for this portion of the study. Marshall and Rossman observed that content analysis allowed derivation of objective and quantitative descriptions from these types of communication instruments, which facilitated subsequent pattern identification (Marshall and Rossman 1989). The authors posited that content analysis is useful for "producing descriptive information" or "cross-validating research findings," in an "unobtrusive and nonreactive" manner, allowing a researcher to determine "where the emphasis lies after the data have been gathered" (p. 99-100). This approach was consistent with heuristic theory building and exploration, the objectives of this first portion of the study.

Although franchise disclosure requirements in the United States provided documents with robust content, obtaining a representative sample of these documents was problematic. Routinely exceeding 150 pages, UFOC and franchise agreements are expensive for franchisors to produce and distribute. These documents contain a franchisor's financial statements, lists of existing franchisees with addresses and phone numbers, and in some cases earnings of franchised outlets,[63] information not intended for public distribution. While franchisors with growing sales and strong growth may willingly respond to surveys or requests for documents, those with a less than impressive record may be less inclined to have their performance published. At the time of this study, there was no singular, all-inclusive repository for franchise documents, and no federal requirement for all franchisors to file their documents with any federal agency.

[63] Earnings Claims (UFOC Item 19) are voluntary under present U.S. Federal Trade Commission (FTC) regulations. The FTC estimates that 20% of franchisors provide this disclosure of franchised outlet earnings.

To obtain franchise documents, I collected an initial sample of 13 UFOC and franchise agreements from clients of the University of South Carolina Small Business Development Center (SBDC) in Charleston, South Carolina.[64] Researchers have solicited these documents through contacting members of the International Franchise Association (IFA) or by using the list of franchisors in *Entrepreneur* Magazine's Franchise 500®. Although these sources may have yielded additional documents for this study, I found that a larger sample of UFOC and franchise agreements were available for viewing at the South Carolina Secretary of State's Office in Columbia, South Carolina. I requested and subsequently received permission to examine franchise documents at the Secretary of State's Office.

The United States provided fertile ground to study franchising's formal context. One reason is that the U.S. Federal Trade Commission requires franchisors to disclose material facts, detailed information about their franchise offering, and outline specific duties created by the franchise in Uniform Franchise Offering Circulars (UFOC).[65] Another is that the U.S. has the "most developed franchise sector of all advanced industrial societies with many large and long-established franchises" (Stanworth and Curran 1999, p. 331). In contrast, the European Union (EU) has very few franchise-specific laws beyond the civil, commercial, and social laws that typically govern

[64] The author was employed as a Business Consultant at the SBDC in Charleston, South Carolina during this period, and had consulted with clients who agreed to provide these documents. Clients had obtained these documents from franchisors, and had used them in their evaluations of franchise opportunities between June 1999 and September 2000.

[65] The UFOC serves as the single document that complies with both U.S. federal and state requirements governing franchise disclosure. Used by the vast majority of franchisors, the UFOC has become the national industry standard in franchising (FTC 16 CFR 436 p. 57296).

business relationships,[66] although France and Spain require franchisors to disclose material information to prospective franchisees.[67] Franchisors in Europe are generally expected to follow guidelines implemented in the European Code of Ethics,[68] which contain broad provisions of fair behaviour for franchise practitioners.

The franchise, as defined in its UFOC and applicable franchise agreement, attachments, and exhibits define the legal governance structure for franchise relationships in the United States. These documents have previously served as a unit of analysis for comparisons of successful and unsuccessful franchisors (Shane 1995), and I considered them an appropriate unit of analysis for this portion of the study.

4.3.1 UFOC Dataset Description

Designed by the North American Securities Administration Association (NASAA), the UFOC provides a systematic and uniform framework for disclosure of information about individual franchises, in a structure of pre-assigned categorical *Items*. Franchisors are required to follow NASAA guidelines, which provide examples of both descriptive summaries and table outlines. The guidelines not only specify organization of information within a document, but also whether information about the franchise

[66] The European Commission passed two regulations defining the vertical restraints typically used in franchising: (EC) No. 2790/1999 on the application of Article 81(3) of the Treaty of Rome, and (EEC) No. 4087/1988 on the application of Article 85(3) of the Treaty. Available at http://www.eff-franchise.com/legislation.htm.

[67] In 1989, the French government adopted legislation that requires mandatory disclosure for franchises and all agreements that involve a license to use a trademark or logo. "Loi Doubin" was found to lack the clarity and detail of disclosure requirements found in North America (Konigsberg 2001).

[68] The Code of Ethics was first elaborated in 1972 by the European Franchise Federation. The Code includes definitions; guiding principles (which include obligations of both franchisor and franchisee); recruitment, advertising, and disclosure; franchisee selection; and guidelines for the franchise agreement. Available at http://www.eff-franchise.com. A copy is provided in Appendix 1, Table 22.

must be presented in paragraph form as a descriptive summary or in tabular form.[69]

Table 4-1 lists the specified UFOC Items and framework.

Table 4-1: UFOC Items and Format		
FRAMEWORK		**FORMAT**
Item	**Description**	
1	Franchisor, Predecessors, Affiliates	**Summary**
2	Business Experience	**Summary**
3	Litigation	**Summary**
4	Bankruptcy[70]	**Summary**
5	Initial Franchise Fee	**Summary**
6	Other Fees	**Tabular**
7	Initial Investment	**Tabular**
8	Restrictions on Sources of Products	**Summary**
9	Franchisee's Obligations	**Tabular**
10	Financing	**Summary**
11	Franchisor Obligations	**Summary**
12	Territory	**Summary**
13	Trademarks	**Summary**
14	Patents, Copyrights & Proprietary	**Summary**
15	Obligation to Participate	**Summary**
16	Restrictions on What May be Sold	**Summary**
17	Renewal, Termination, Transfer, Dispute Resolution	**Tabular**
18	Public Figures[71]	**Summary**
19	Earnings Claims	**Summary**
20	List of Outlets	**Tabular**
21	Financial Statements	**Summary**
22	Contracts[72]	**Summary**
23	Receipt[73]	**Summary**

4.3.2 UFOC Collection and Sample

To explore uniformity, I looked for similarities and differences among franchises. I examined an initial sample of thirteen UFOC and franchise agreements at the University of South Carolina's Small Business Development Center in Charleston,

[69] A complete set of UFOC Guidelines and reporting requirements is available from the NASAA at http://nasaa.org/nasaa/corpfin/UFOC.doc.
[70] Persons identified in Item 1 or Item 2 who have been involved as a debtor in proceedings under U.S. Bankruptcy Code are required to be disclosed in this Item.
[71] Franchisors must disclose if any public figures are used in marketing or promoting the franchise.
[72] Lists all agreements contained in offering circular and franchise agreement, such as sublease, applicable state riders to agreement, and addendums.
[73] Receipt pages contain franchisor and prospective franchisee copies that acknowledge receipt of UFOC, franchise agreement, and all applicable Exhibits. Receipts pages must be signed and dated by both franchisor and franchisee. These pages assure that disclosure documents were provided to prospective franchisee ten business days before signing agreement or ten days before any payment is made.

South Carolina. I then collected data from an additional 42 documents at the Office of the Secretary of State, in Columbia, South Carolina. Although the State of South Carolina does not legally require franchisors to file a UFOC and franchise agreement, more than 750 documents were on file at this office at the time of this study.[74] The Secretary of State's office staff filed documents in the order in which they were received, using a sequential numbering system. I selected individual franchise documents from the available collection at random during September 2000.

Data collection from sources in South Carolina had both advantages and limitations. On one hand, documents examined from any given franchise were likely to be similar to those found elsewhere in the U.S. In other words, federal requirements to provide UFOC and franchise agreements apply to all 50 U.S. states. Although several states had enacted specific laws to regulate franchise disclosure or conduct, South Carolina had no specific franchise legislation at the time of this study.[75] Generalizability of this portion of the study is limited, as this sample is not assumed to be representative of the population of franchises. In other words, this portion of the study sought to discover if and how franchise documents varied, not how typical the variations are.

The exploratory nature of this portion of the study required that I design a method of data collection and categorization for variables. Using MS Access, Word, and Excel application software, a tabular system was devised to capture relevant data while maintaining integrity of the variables within cases. Transfer from the database to

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[74] At the time of this study, 755 franchise and business opportunity disclosure documents and legal agreements were on file at the Secretary of State's Office.

[75] The 12 U.S. states that require registration are Hawaii, Illinois, Indiana, Maryland, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, and California.

spreadsheet format was done to facilitate conversion into SPSS for further analysis. Of the 23 *Items* contained in each UFOC, data were gathered from 16 Items that appeared relevant to this study.[76]

As described in Section 4.2.1, I initially examined a preliminary sample of 13 UFOC and franchise agreements. These agreements were gathered and examined at the University of South Carolina Small Business Development Center in Charleston, South Carolina. Franchises in this sample represented a variety of industries, including auto repair, hair salons, and quick service restaurants. A summary of the industries represented is contained in Table 4-2.

Table 4-2: Industry Representation of Preliminary UFOC Sample

Quizno's Corporation	Sandwich
Case Handyman Services	Home repair
The Pet Pantry	Pet food delivery
Piggly Wiggly	Grocery
Entrepreneur's Source	Business Services
Tilden Associates	Auto Repair
Décor and You Designers	Home furnishings
Golf Augusta	Retail sporting goods
World Inspection Network	Home inspection service
Great Clips	Hair salon
Little Scientists	Children's training
Party Land	Specialty retail
Entrepreneur's Source (Area Director)	Business Services

To facilitate case comparisons, I designed a method of standardizing the data requirements. Numerical values such as fees and dates were transcribed directly, while contractual obligations and specifications were operationalized as dichotomous or categorical variables.

[76] Business experience of franchisor's officers and directors, pending litigation, previous bankruptcies, trademarks and patents, public figures used in advertising, franchisor's financial statements, number of contracts included in the circular, and the acknowledgement of the receipt of the circular were not included in the data.

4.3.3 UFOC Measures: Preliminary Sample

The 16 UFOC Items examined in the preliminary sample of 13 documents provided data sufficient for measuring more than 100 variables for each franchise.[77] For this sample, I entered data as a text summary of applicable terms under each Item into an MS Word table. An example of the measurement system extracted from Item 9 is provided in Table 4-3 below, while a copy of all the data collected in this preliminary sample is contained in Appendix D.

Table 4-3: Item 9- Financial Reporting Requirements

Financial Reporting	UFOC 1	Weekly; must provide direct on-line access to franchisor; monthly income; annual income statement and balance sheet; audit
	UFOC 2	Franchisor may poll computer for sales, cost, and other financial or marketing data; monthly reports; audit
	UFOC 3	Monthly sales reports; audit
	UFOC 4	Weekly, may be audited without notice
	UFOC 5	Quarterly financial statements; audit
	UFOC 6	Quarterly financial statements; audit
	UFOC 7	Annual financial statements; weekly register reports
	UFOC 8	Submit all financials as specified
	UFOC 9	Must submit gross revenues and sales tax reports monthly, must verify and sign each financial report
	UFOC 10	Access during normal working hours, furnish tax return, may require use of modem.
	UFOC 11	Weekly marketing report; bi-weekly financial report with payment of fees; tax returns as requested
	UFOC 12	Weekly signed financial statements; must keep records for three years after agreement termination
	UFOC 13	Signed weekly sales report; quarterly P&L; annual P&L and balance sheet; all daily records; tax returns

Several points emerged from the initial exploration of this sample. First, determining differences in provisions among franchises were further complicated by differences in phraseology, posing potential codification and comparative analysis problems. For

[77] Item 9, *Franchisee Responsibilities*, contained 23 sub-items, each sub-item had several variables within it. Item 20, *List of Outlets*, contained eleven sub-categories, including the number of franchises that left the system, and the number of units transferred for each of the previous three years. The number of projected new unit openings in the next 12 months was also included in this Item.

example, in Item 8, Restrictions on Sources of Products or Services, a variety of qualification terms were used to describe a number of related and unrelated restrictions. The phrase *must buy solely through approved suppliers*, as found in UFOC 2, is similar but not identical to the requirement in UFOC 8 to *use specified suppliers only, any others must be approved.* A sample of differences found among franchises are illustrated in Table 4-4 below:

Table 4-4: Preliminary Sample UFOC Item 8

Product Specifications	UFOC 1	Required to buy only approved products
	UFOC 2	Must buy solely through approved suppliers
	UFOC 3	Must buy product from franchisor or designee
	UFOC 4	No restrictions on product purchases
	UFOC 5	No product purchases required other than marketing materials
	UFOC 6	No product purchases required other than marketing materials
	UFOC 7	All fixtures, furnishings, software, equipment, and materials specified. No requirements to purchase operating materials
	UFOC 8	Specified suppliers only, any others must be approved
	UFOC 9	Must purchase any logo-bearing equipment from franchisor
	UFOC 10	Must comply with specifications
	UFOC 11	Must purchase only designated supplies, equipment, fixtures
	UFOC 12	Must purchase copyrighted materials from franchisor; other supplies from approved list of vendors
	UFOC 13	Not currently required to purchase any goods, services, supplies or fixtures

To reduce coding errors and to facilitate comparative analysis, a system of measurement using dichotomous and categorical variables was designed.

Second, in order to remain within limits imposed on this study, a need for data reduction became apparent. A focus on Item 9, *Franchisee Responsibilities*, appeared to offer several advantages. Item 9, with its 25 sub-categories, provided a consistent framework within which to gather data for comparative analysis. Specified by U.S. federal law, this framework is consistent among franchises. Within this framework were statements relevant to a study of contractual provisions that may constrain or allow entrepreneurial processes. For example, requirements for pre-opening, restrictions on products and services offered, financial reporting specifications, and monitoring and control requirements are some of the provisions contained within the sub-categories of Item 9. Table 4-5 displays the sub-categories of Item 9.

Table 4-5: Item 9 Sub-Categories

Category	Category Description
a.	Site Selection and Acquisition/ Lease
b.	Pre-Opening Purchases/Leases
c.	Site Development and Other Pre-Opening Requirements
d.	Initial and Ongoing Training
e.	Opening
f.	Fees
g.	Compliance with Standards and Policies/ Operating Manual
h.	Trademarks and Proprietary Information
i.	Restrictions on Products/ Services Offered
j.	Warranty and Customer Service Requirements
k.	Territorial Development and Sales Quota
l.	Ongoing Product/ Service Purchases
m.	Maintenance, Appearance and Remodelling Requirements
n.	Insurance
o.	Advertising
p.	Indemnification
q.	Owner's Participation/ Management/ Staffing
r.	Records and Reports
s.	Inspections and Audits
t.	Transfer
u.	Renewal
v.	Post-Termination Obligations
w.	Non-Competition Covenants
x.	Dispute Resolution
y.	Other

Third, consistent among franchises in the sample, the contents of several UFOC items contained references to accompanying franchise agreements, exhibits, and addendums. In one franchise, for example, seventeen provisions covered renewal, termination, transfer, and dispute resolution. Sixteen of those provisions contained references to various sections of the franchise agreement. In the same franchise, of the 25

Franchisee Responsibilities provisions contained in Item 9, twenty-four referred to sections of the franchise agreement and its addendums. The UFOC and franchise agreement, together with its exhibits, addendums, and attachments, appears be substantively as well as physically bound together. As such, these documents were analyzed collectively. A copy of Item 9 from a franchise is included in Table B21 in Appendix B.

4.3.4 UFOC Measures

As previously stated, I designed a system of dichotomous and categorical codification to facilitate comparative analysis. The following describes how variables for this dataset were constructed. Where financial measures were employed, measurements were performed in U.S. dollars. Contractual provisions related to product and supplier requirements were operationalized as five dichotomous variables: (1) *Sell Only Approved Product*; (2) *Required Minimum Purchase*; (3) Franchisor must *Approve Product Line*; (4) Franchisees are *Limited to Approved Line* of products or services; (5) Franchisee must use *Approved Suppliers Only*. In similar fashion, variables related to operations of franchised outlets were constructed into whether or not the franchisor *Set Hours of Operation*, whether an *Exclusive Territory* was granted with purchase of a franchise, and whether a franchisor set a pre-determined *Sales Quota*.

Several dichotomous variables were constructed to measure aspects of franchise marketing and advertising. *Advertising Required* identified franchises in which franchisees were required to make mandatory contributions to an advertising fund. *Advertising Percentage* differentiated those franchises whose franchisee contributions were based on a percentage of gross revenues from those using alternative methods.

Opening Advertising identified franchises that required franchisees to pay fees for advertising the initial opening of their business. When specified, the required *Opening Advertising Amount* was also measured. *Advertising Approval* identified franchises that require franchisor approval for advertising that franchisees may wish to conduct in their markets.

Owner Full Time identified those franchises in which a franchise owner is required to devote full time efforts to the operation of an outlet. Similarly, *Designate Manager* identified those franchises in which a franchisee may designate a manager to operate the business. In cases where designated managers were permitted, *Approve Manager* identified franchises in which managers must be approved by their respective franchisors.

Provisions that govern outlet monitoring were measured using three dichotomous variables. *Quality Audit* identified those franchises in which a franchisor reserves the right to perform formal audits of its franchised outlets. *Inspect Business* and *Interview Customer* identified those franchises in which a franchisor retains the right to inspect and/or interview customers of a franchised business as a part of its ongoing monitoring program.

Transfer Allowed differentiated those franchises that contractually specified that transfers were permitted within the term of an agreement. Franchises that used a *Fixed Fee* as a basis for calculating *Transfer Fee* were differentiated from those that employed alternative methods of calculation. Similarly, franchises that disclosed *Renewal Terms* and *Renewal Amounts* were measured. *Dispute resolution* was measured as a categorical variable, indicating whether mediation, arbitration, or no specific means of dispute resolution was specified.

Other Business differentiated those franchises in which ownership of another business was specifically allowed during the term of a franchise agreement. Some contract provisions extended restrictions beyond the term of a franchise agreement. *Non-Compete* identified those franchises in which a provision specified that a franchisee may not enter into a competing business after the term of a franchise agreement. For those franchises with specific non-compete clauses, *Non-Compete Years* measures the duration of post-agreement non-competition.

4.4 Secondary Data: Examination of Three Secondary Data Sources

Guided by hypotheses that emerged from the literature review and results of the previous section, I collected additional data from reliable secondary sources, enabling use of more extensive quantitative methods for the second portion of this study. Consistent with studies in corporate entrepreneurship (e.g., (Covin and Miles 1999); (Zahra 1996)), if opportunities for entrepreneurial processes exist within the context of franchising, they may be more evident in growing franchises. With little guidance from the recent literature, I probed these datasets for characteristics that differentiate growing franchises from others.

The dearth of official data relevant to franchising has been noted in the academic literature (e.g., (Lafontaine 1995); (Mehta, Luza et al. 1999)) and in U.S. government reports (e.g., (Stana 2001)).[78] A singular, comprehensive, and official source of data on franchising did not exist at the time of this work. Given the absence of a single comprehensive source of data on franchising, I collected data from three sources used previously in academic studies of franchising. Pilling et al. employed use of multiple datasets in their study of competition among franchised and company-owned units (Pilling, Henson et al. 1995). They concluded that "while increasing the difficulties of comparing results" the approach "significantly increases the insights provided by the research" (p. 185). Therefore, to test the hypotheses, I collected data from three secondary sources: (1) FRANDATA's franchise system *Snapshots*; (2) *Entrepreneur* Magazine's Franchise 500® rankings, as published in its 1997, 1998, 1999, 2000, and 2001 editions; and (3) Source Book Publication's *Bond's Franchising Guide*. Each is described below.

4.4.1 FRANDATA Dataset Description

FRANDATA Corporation is a leading supplier of information to and about the franchising industry. Founded in 1989, FRANDATA maintains a proprietary database of franchise information, compiled from independently verified data gathered from individual UFOC documents.[79] The company maintains an active customer base of over 2,500 franchise concepts - including each of the 100 largest companies involved in franchising. Jambulingham and Nevin concluded, "Extensive research indicated that

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[78] Since the U.S. Department of Commerce canceled it publication *Franchising in the Economy* in 1988, there is no census-type data available from which to calculate growth or survival of franchise systems (Lafontaine and Shaw 1998).

[79] The company posits that its dataset represents the largest private collection of current and archived UFOCs in the world. FRANDATA has relationships with a variety of regulatory and industry agencies, including the U.S. Small Business Administration (SBA), Federal Trade Commission (FTC), North American Securities Administrators Association (NASAA), International Franchise Association (IFA), American Franchisee Association (AFA), and the National Franchise Council (NFC).

FRANDATA's database was the most complete available" (Jambulingham and Nevin 1999, p. 376).

FRANDATA Corporation distributed its database information through customized research reports, and through its four franchise websites: http://www.FranchiseResearch.com , http://www.FranchiseRegistry.com , http://www.FranchiseDocs.com , and http://www.FranchisePlanet.com . The company posited that its FranchisePlanet.com's research section was the single largest source of objective data available about the U.S. franchise industry. Access to more than 1,200 franchise companies was provided through FranchisePlanet's *Snapshots* link.

4.4.2 FRANDATA: Collection and Sample

I collected a random sample of 598 franchise *Snapshots* from FRANDATA through its FranchisePlanet website at http://www.franchiseplanet.com during May and June 2000. To provide a permanent record of data gathered on each franchise, I downloaded each FrachisePlanet *Snapshot* from the website, and stored them on disc as individual HTML files before I entered data into MS Excel spreadsheet, and subsequently transferred the accumulated data to SPSS v. 10 for analysis.

Each *Snapshot* contained a variety of information about each franchise, as summarized in Table 4-6:

Table 4-6: FRANDATA *Snapshot* Dataset Variables	
Contact	Name, Address, Telephone Number
Description	Franchise description
Legal Agreements	Agreements to be signed as conditions of franchise purchase
Programs Offered	Other concepts offered by this franchisor
Business Types	Other business types offered by franchisor
System Size	Number of franchised and company-owned outlets
Initial Payments	Franchise Fee, payment terms, multiple franchise purchase discounts
Initial Investment	Average minimum and maximum cost estimates, with and without real estate
Royalties	Amount and basis of royalty calculation
Advertising	Advertising expenditures required
Exclusive Territory	If offered, parameters of territorial exclusivity
Term/ Renewal	Initial and renewal term of franchise agreement
Transfer	Franchise transfer requirements
Financing	Type of financing (if offered) by franchisor

An example of a FranchisePlanet *Snapshot* obtained through FRANDATA's website from McDonald's Corporation is provided in Appendix E, Table E1.

4.4.3 FRANDATA Measures

Using the difference between the current year (2001) and the year in which the business was formed, *Age* was calculated. In similar fashion, *Experience* was measured, using the current year and the year in which the firm commenced franchising. I considered that firms may use the period of time between start of operations and the start of franchising to refine their concept. Therefore, *Refinement Period* was created by measuring the number of years between a firm's first year of operation and the year which the firm began franchising. *Number of Franchises* and *Number of Company Units* were measured directly for each franchise, and *Size* was calculated as the sum of franchises and company units. *Percent Franchised* was calculated by dividing *Number of Franchises* by *Size*.

Purchase of a franchise may require execution of additional agreements in addition to the franchise agreement. *Number of Agreements* measured the total number of agreements required to be signed as a condition of the franchise purchase.[80] In addition to its original concept, *Other Programs* measured the number of other programs offered by a franchisor.[81] Similarly, in addition to its standard program, franchisors may offer a variety of business types, measured by *Business Types*.[82]

In some concepts, franchise fees vary. Initial franchise fees may be provided in a range, *Fee Low* and *Fee High* measured low and high ranges of franchise fees, expressed in U.S. dollars. *Terms* was measured as a dichotomous variable, differentiating those franchisors who offered payment terms from those who did not.

4.4.4 Entrepreneur Magazine Franchise 500®: Dataset Description

Entrepreneur Magazine began its system of ranking franchises in 1980 with its first Franchise 500® issue. Its ranking system lists only North American franchisors, which must submit UFOC or Alberta Canada disclosure documents before inclusion, and employs an independent CPA firm to audit financial data. Rankings are based on a weighted system established by the magazine. Although details of the system are not disclosed, weighted more heavily are a franchisor's financial strength and stability, the system's growth rate, and the size of a franchise system. Also considered in the ranking are the number of years in business, length of time franchising, start-up costs, amount

[80] Confidentiality agreements, lease agreements, and promissory notes are examples of additional agreements.
[81] A franchisor may offer other programs to become a franchisee in the system. An area development agreement is an example of a program listed in this category.
[82] An example is Pretzel Time's franchise, which offers a cart/kiosk franchise and a co-branded franchise in addition to its standard offering.

of litigation, percentage of terminations, and whether or not the franchisor provides financing for franchisees.

The magazine considers variables used in their rankings to be "objective, quantifiable measures of a franchise operation" (p. 174-175), in part, because subjective elements such as satisfaction or management style are not considered (anonymous 2001). In addition to 500 ranked systems, the 2000 edition of the *Entrepreneur's* Franchise 500® listed 98 non-ranked franchises.[83]

Data from *Entrepreneur* Magazine has been employed in previous academic studies of franchising. Castrogiovanni et al. validated the data, and felt "confident that both the UFOC data obtained to estimate failure rates and the additional *Entrepreneur* data used in this study are accurate" (Castrogiovanni, Justis et al. 1993, p. 107). Shane also used *Entrepreneur's* dataset to study franchisor mortality (Shane and Foo 1998).[84] Lafontaine concluded that *Entrepreneur's* dataset was "the most detailed longitudinal data set on individual franchisors" (p. 15), although she cautioned that it should not be considered representative of the population of franchisors (Lafontaine 1995).

I chose this dataset for several reasons. First, with an estimated 2.2 million readers, *Entrepreneur* Magazine's Franchise 500® ranking system is widely known by franchise researchers, practitioners, and potential franchisees. Second, because responding franchises often included their Franchise 500® ranking in their marketing materials,

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[83] Non-ranked franchise systems included both those companies whose information was verified but fell below the criteria for the 500th system, and those companies who submitted unverifiable data. Hotels and motels, because of much higher typical start-up costs were also excluded from the rankings.
[84] In an earlier study, Shane cited previous work by Lafontaine (1992) and Michael (1993) that concluded the data provided by *Entrepreneur* was "unbiased" (Shane 1996, p. 222).

response bias may be lower than would typically be expected of independent surveys. Exit from *Entrepreneur Magazine's* listing was used as a measure of failure in Shane's study. Third, reliability of data in this dataset may be better than that of other surveys, in part because franchisors are required by the magazine to provide documentation to substantiate their claims. Before publication, data is audited by the magazine.

4.4.5 Entrepreneur Magazine Franchise 500®: Collection and Sample

Access to *Entrepreneur's* Magazine's data was available through either the printed publication, or through the magazine's website at http://www.entrepreneur.com/franchise_zone. I collected data from the January 2000 edition of *Entrepreneur* Magazine's Franchise 500® between September 2000 and January 2001. I included both ranked and unranked franchises, for a total of 598 franchises in this sample.

Table 4-7: *Entrepreneur* Magazine Dataset Variables
Name
Franchise Description
Franchise 500® Rank
Year Began Operations
Year Began Franchising
Number of Franchises 1997
Number of Franchises 1998
Number of Franchises 1999
Number of Company Owned 1997
Number of Company Owned 1998
Number of Company Owned 1999
Franchise Fee (Low)
Franchise Fee (High)
Average Start-up Costs (Low)
Average Start-up Costs (High)
Royalty
Franchisor Financing Available

I transcribed data from the *Entrepreneur* Magazine's 21st Annual Franchise 500® edition, published in January 2000, into an MS Excel spreadsheet, and subsequently transferred the data to SPSS for analysis. Variables provided by the magazine and collected for this portion of the study are presented in Table 4-7.

4.4.6 Entrepreneur Magazine Franchise 500®: Measures

Variables from this dataset were constructed as follows: *Age* was calculated as the difference between the year the franchisor began operations and the current year (2001). *Experience* was calculated in similar fashion, using the year in which the firm began franchising. Consistent with the measurement system used in the previous dataset, I considered that firms may use the period of time between start of operations and the start of franchising to refine their concept. Therefore, *REFINE* was created by measuring the number of years between a firm's first year of operation and the year which the firm began franchising. As described earlier in this section, *Entrepreneur* Magazine considered franchise system size to be one of its most important criteria. Because the magazine did not specify whether company-owned units were included in their measurement, I considered *Size* to be the sum of franchised and company-owned units, calculated for each of the three years provided. To determine if company-owned units had any effects on the other variables, *Franchise Percentage* was calculated, using the quotient of franchised units divided by the total number of units in each of the three years.

Franchise Fee and *Average Start-up Costs* were measured in U.S. dollars, as provided by the magazine. *Royalty,* as provided by the magazine, was listed as either (1) a percentage; (2) a range of percentages; (3) a fixed rate per period of time; or (4) the term "varies". Since a clear majority of franchises in this sample calculated royalty based on a percentage or percentage range, those with fixed rates per period and those listed as "varies" were excluded. Where a range of percentages was listed, the mean value was entered. Ten different types of financing were coded in the magazine's listing.[85] *Financing* was operationalized as a dichotomous variable, indicating whether any form of financial assistance was provided by franchisors.

4.4.7 Source Book Publications: Dataset Description

Data were also gathered from Source Book Publications of Oak Brook, California, publisher of the *Bond's Franchise Guide*. The company posted information from 1,201 franchises on its website, http://www.worldfranchising.com. Source Book obtained information from franchisors using a survey instrument. Mehta et al., in their comparison of franchise data sources, concluded that Source Book Publication's *Bond's Franchise Guide* was a reliable source of information for studies of franchising, and comparable to other widely used sources of franchise information (Mehta, Luza et al. 1999).

Source Book's survey collected data in the broad categories of:

(1) Franchisor Background, including when established, total units and projected new units;
(2) Financial Requirements, including investment and fees
(3) Terms of Contract, including passive ownership and area development agreements
(4) Franchisor Support and Training Provided, including financial assistance; and
(5) Franchisor's Specific Expansion Plans, categorized by U.S., Canada, and overseas.

Although considered reliable, this dataset included only those franchises headquartered in North America, and cannot be considered as representative of the population of firms engaged in franchising. A copy of the Source Book Publication's questionnaire used in their survey is included in Appendix F.

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[85] The ten types of financing categories established by the magazine are: in-house financing; 3rd party financing; accounts receivable financing; equipment financing; franchise fee financing; inventory financing; leasehold improvements financing; payroll financing; start-up cost financing; and working capital financing.

4.4.8 Source Book Publications: Collection and Sample

I collected data from Source Book Publication's website between December 2000 and February 2001. Data were collected from all 1,201 franchises listed on the website. I downloaded individual web pages relevant to each franchise, saved them as HTML files, and later entered the variables into a Microsoft Excel spreadsheet. Subsequently, I transferred the data from Microsoft Excel to SPSS for analysis.

4.4.9 Source Book Publications: Measures

Variables were constructed as follows: Since only those franchises headquartered in North America were included in this dataset, *HQ* was measured using a dichotomous variable to differentiate between Canadian- and U.S.-headquartered franchises. *US, Canada,* and *Int'l* represented the number of outlets located in each market. *SIZE* was calculated for each franchise, as the sum of its U.S., Canadian, and International outlets. *Franchises* and *Company Owned* measured the total number of franchised and company-owned outlets respectively. *PERFRAN* was calculated by dividing the number of *Franchises* by *SIZE.*

Franchisors provided the year in which their firm was *Established*, and the year in which they *Began Franchising*. Since the time between when a firm was founded and when it began franchising may be used to refine the concept, *REFINE* was calculated as the number of years elapsed from when a firm was *Established* and when it *Began Franchising.* From these two dates, *AGE* and *EXP* were calculated, using difference between the present year (2001) and the year *Established* and *Began Franchising* respectively. *TERM* represented the length of a franchise agreement expressed in years.

Franchisors were asked to provide the number of units they project to open in the upcoming twelve months. *PNU* measured the number of projected new units for each franchise.

Several variables related to financial aspects of a franchise were measured. *ILOW* and *IHIGH* represented low average and high average investment costs associated with each franchise, while *FFEE* measured initial franchise fees in thousands of U.S. dollars. *ROYAL* and *ADV* measured royalties and advertising fees, respectively.[86] *EC* was operationalized as a dichotomous variable, indicating whether a franchise made an earnings claim. *FA* was measured as an ordinal variable, indicating whether (0) no financial assistance; (1) indirect financial assistance; (2) direct financial assistance; or (3) both indirect and direct financial assistance were provided by franchisors.

Variables related to operations of a franchise were also measured. *SF* and *ET* were measured as dichotomous variables, indicating whether sub-franchising, and expansion within assigned territories were permitted under a franchise agreement respectively. *PO* was operationalized as a categorical variable, indicating whether passive ownership of a franchised outlet was prohibited, discouraged, or allowed by a franchisor. *AD* served as a dichotomous indicator of whether area director agreements were offered by a franchisor.

[86] These variables were expressed as a percentage of gross sales. Those franchises who used fixed royalty payments were excluded.

Source Book Publications' survey asked franchisors to indicate their plans for growth in the U.S., Canadian, and overseas markets. Three categorical variables were established to measure growth intentions in these markets, expressed as (0) no expansion planned; (1) limited expansion in this market; (2) expansion in all areas of this market. A summary of the variables measured in this dataset are provided in Table 4-8 below.

Table 4-8: Source Book Publications Dataset Variables

HQ	Location of Headquarters	Dichotomous
US	Number of Outlets in U.S.	Nominal
Canada	Number of Outlets in Canada	Nominal
Int'l	Number of Outlets outside NA	Nominal
SIZE	Total Number of Outlets	Nominal
Established	Year in Which Firm Established	Nominal
Began Franchised	Year in Which Firm Began Franchising	Nominal
AGE	Number of Years Since Firm Established	Nominal
EXP	Number of Years of Franchising Experience	Nominal
REFINE	Number of years in Operation Before Franchising Commenced	Nominal
Franchises	Total Number of Franchised Outlets	Nominal
Comp.-Own	Total Number of Company-Owned Outlets	Nominal
PERFRAN	Percentage of Outlets Franchised	Nominal
PNU	Projected New Openings in Next 12 Months	Nominal
ILOW	Average Investment- Low Average	Nominal
IHIGH	Average Investment- High Average	Nominal
FFEE	Franchise Fee	Nominal
ROYAL	Royalty Fees	Nominal
ADV	Advertising Fees	Nominal
EC	Earnings Claim Disclosed	Dichotomous
TERM	Term of Franchise Agreement in Years	Nominal
PO	Passive Ownership	Ordinal
AD	Area Director Agreements Offered	Dichotomous
SF	Sub-Franchising Permitted	Dichotomous
ET	Expansion in Territory Permitted	Dichotomous
FA	Financial Assistance for Franchisees	Ordinal
EXP US	Expansion Intentions in U.S.	Ordinal
EXP CAN	Expansion Intentions in Canada	Ordinal
EXP OS	Expansion Intentions Overseas	Ordinal

4.4.10 Comparative Strengths and Weaknesses of the Datasets

Although each dataset provided information on franchise characteristics, such as number of outlets, year in which operations began, and amount of fees, each provided unique information relevant to this study. FRANDATA's dataset included the number of different concepts, programs, and business types offered by each franchisor. The dataset also included the number of agreements required to be signed as a condition for purchase of a franchise, and whether or not an exclusive territory was offered in conjuction with the purchase. *Entrepreneur* Magazine's dataset included the number of franchised and company-owned outlets operated for the previous three years, providing a longitudinal measure of growth. This dataset has been widely used in studies of franchising by academics and practitioners. Source Book's dataset provided information on the geographic location of each franchisor's outlets, categorized by U.S., Canadian, and international markets. It also included organizational details, such as whether passive ownership, sub-franchising, or area development agreements were offered. The dataset contained details of the franchise agreement not found in other datasets, such as the term of the agreement in years, and whether or not an earnings claim was provided in the agreement. In addition, because this dataset was developed from data collected through a survey of franchisors, it provided information on projected openings as well as the extent and geographic focus of each franchisor's expansion strategy.

While providing valuable insights, FRANDATA and *Entrepreneur* Magazine's datasets were limited to data disclosed in a UFOC and franchise agreement. Although FRANDATA's dataset was derived from a random sample, there is no information on the population of 1,300 franchises from which it was drawn, and access to the data is not possible since the website was removed from service. Data gathered from *Entrepreneur* Magazine was also limited, and firms included in the ranking have been found not to be representative of the population of franchises in previous studies (e.g., (Lafontaine 1995); (Shane 1997)). The Source Book dataset was developed from the population of 1,201 franchises, and contained information not found in other datasets.

Information obtained from this respected source of franchise data also provided a means of examining franchisor strategies and intentions in addition to characteristics and past performance.

4.5 Primary Data: Semi-Structured Interviews

The first two portions of this study focused on franchising's formal context, delimited by its contractual provisions and legal disclosure requirements. Stanworth argued that "consideration of franchisor-franchisee relations solely based at the formal level is misleading" (p. 165), and that "the formal contract was often a poor guide to the world of operational reality" (Stanworth 1995). He cited an example based on work conducted at the University of Westminster in which franchisees reported high levels of independence despite the apparent controls imposed by a franchise contract.

To further examine the operational realm and differences between the formal and informal contexts of franchising, I chose a semi-structured personal interview format. Interviews with six franchise owners and two representatives of a franchisor were conducted. This method was chosen because the exploratory nature of the research problem could best be addressed through in-depth examination and analysis, consistent with the use of qualitative methods (Yin 1989). Personal interviews and other qualitative research methods "have become increasingly important modes of inquiry for the social sciences" (Marshall and Rossman 1989, p. 9), and were considered the best method when dealing with complex research topics (de Vaus 1996). Although the interview methods employed may limit external validity of subsequent analysis, they are consistent with work whose aim is to provide additional perspectives for theory building. At the time of this study, work is still being conducted on propositions toward a general theory of franchising (e.g., (Stanworth and Curran 1999)).

4.5.1 Franchisee Interview- Dataset Description

I conducted semi-structured personal interviews with four present and two former franchisees. These interviews were recorded on audiotape, with the permission of interviewees. Transcripts are provided in Appendices G through L.

4.5.2 Franchisee Interviews- Collection and Sample

The ubiquity of franchising assured that an ample supply of franchisees existed in most U.S. metropolitan areas. To remain within the overall limits of this study while providing insights from a cross-section of franchisees, I chose to limit this section to interviews with six franchise owners. Franchise owners were chosen from an available base in Charleston, South Carolina based on several factors.

First, I selected franchisees from diverse industries, including fast food, business services, and retail. Although I did not intend to get a sample representative of the population of franchisees, the industries selected are ones where franchising has realized considerable success. Second, I chose franchisees with varied levels of experience. The sample included relative newcomers to franchising as well as veterans. It also included two former franchisees, one who recently left the system, and a franchisee whose franchisor ceased operations. Third, specific franchises were chosen because of their growth rates. An area developer from Quizno's, a quick service restaurant franchise, was included in the sample. Quizno's has grown from 400 outlets to in excess of 1,300 outlets in one year's time, and has risen from #46 to #6 in

Entrepreneur Magazine's Franchise 500® ranking, and is presently ranked #8 in the "Top 30 Fastest-Growing Franchises" by the magazine. A franchisee from General Nutrition Centers (GNC) was also selected. Established in 1935, GNC currently ranks #9 in the Franchise 500®, and #17 in the "Top 30 Fastest Growing Franchises." Franchisees and former franchisees in this sample were chosen to provide a diverse sample, while remaining within the required scope of this study. . Semi-structured personal interviews were conducted, during which franchisees were asked open-ended questions.

4.5.3 Franchisee Interview- Measures

Interviewees were asked open-ended questions, designed to provide insights along three main themes: First, to better understand the role of a UFOC and other formal aspects of franchising in actual operations of a business. Interviewees were asked about the role of UFOCs and franchise agreements in their franchise selection process. The second theme is that of franchisor and franchisee relations, and the role of UFOCs and franchise agreements in governing the actual operations of their franchised outlet. Finally, interviewees were asked about how change and adaptation is implemented within their business. They were asked about how they responded to dynamics in their markets, specifically how adaptation to changing customer behaviours and competitive pressures were accomplished. The open-ended questions and clarifying statements were designed to extract subtleties and perceptions expressed by the interviewees. I summarized their responses in text format for presentation.

4.5.4 Franchisor Interviews

Semi-structured interviews with the general counsel and chief financial officer of a rapidly growing franchise were also conducted. This franchisor was chosen based on its rapid growth, and their willingness to participate in this study. This franchise system is owned by two former franchisees, who purchased the original 18 restaurants from the founder. Interviews were conducted in person by the author, at Quizno's corporate headquarters in Denver, Colorado, recorded on audiotape with the permission of the interviewees. Transcripts are provided in Appendices M and N.

4.6 SUMMARY

The aim of this chapter was to describe methods used to collect data for the three analysis sections of this study. The first section followed a content analysis strategy to gather data for comparative analysis from 55 UFOC and franchise agreements. I considered this method suitable, considering the exploratory nature of this section, and the detailed contracts and disclosure documents being analyzed. Next, hypotheses that emerged from the literature were tested, using three datasets created from secondary data. I considered the absence of a single, comprehensive source of data on franchising and availability of different perspectives from the three datasets in this section. Although use of multiple datasets introduced complexity, it provided additional insights. Lastly, because examinations of franchising's formal aspects provided a limited view of the phenomenon, semi-structured interviews were conducted with individuals currently and previously involved in franchising. Interviewees represented both current and former franchisees from a variety of industries, using a method designed to provide levels of comparability and meaningful insights into franchising's operational realm. Interviews with two franchisor representatives were also performed. Analysis of the data collected follows.

5.0 ANALYSIS OF UFOC AND FRANCHISE AGREEMENTS

5.1 Introduction

When contrasted with other organizational forms, franchising appears to create a uniform and highly regimented context, a theoretically unpromising environment for entrepreneurship. The extent and nature of uniformity in franchising's context remains largely unexplored. As presented earlier in this work, assumptions of uniformity may be based, at least in part, on legal agreements and disclosure documents that characterize the formal environment in which franchise relationships exist. One way of testing these assumptions is through systematic examination of Uniform Franchise Offering Circulars (UFOC) and franchise agreements, the official documents that define and govern franchise relationships in the U.S.[87]

5.2 Uniformity in Franchise Documents

In the European Union (EU), very little franchise-specific legislation exists beyond the civil, commercial, and social laws that govern most business relationships in each country.[88] Although France and Spain have laws that govern disclosure to prospective franchisees,[89] franchisors in Europe are generally expected to follow guidelines of fair behaviour for franchise practitioners implemented in the European Code of Ethics.[90]

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[87] UFOC and franchise agreements may also contain attached Exhibits, Addendums, and riders which are also part of the franchise and are included in this analysis.

[88] The European Commission passed two regulations defining the vertical restraints typically used in franchising: (EC) No. 2790/1999 on the application of Article 81(3) of the Treaty of Rome, and (EEC) No. 4087/1988 on the application of Article 85(3) of the Treaty. Available at http://www.eff-franchise.com/legislation.htm.

[89] In 1989, the French government adopted legislation that requires mandatory disclosure for franchises and all agreements that involve a license to use a trademark or logo. "Loi Doubin" was found to lack the clarity and detail of disclosure requirements found in North America (Konigsberg 2001).

[90] The Code of Ethics was first elaborated in 1972 by the European Franchise Federation. The Code includes definitions; guiding principles (which include obligations of both franchisor and franchisee);

In contrast, franchisors in the United States are required by both federal and, in some cases, state laws to make detailed disclosures of material facts about the company offering the franchise, about the franchise being offered, and about specific duties in the relationship created by a franchise.[91] Together with its respective franchise agreement, the UFOC serves as the single document that complies with both U.S. federal and state requirements governing franchise disclosure.[92] Used by a vast majority of franchisors, UFOCs have become a national industry standard in franchising (Commission 1986), are sanctioned by the U.S. Federal Trade Commission (FTC), and were therefore selected for use in this study. A copy of the FTC Franchise Rule that defines the use and disclosure requirements is provided in Appendix C.

Devised by the North American Securities Administration Association (NASAA), the UFOC provides a systematic framework of disclosure, including categorical numbering and labeling.[93] Guidelines and requirements are highly specific, including detailed examples and pre-designated specifications for content and presentation of information. For example, NASAA guidelines specify whether information must be presented in paragraph form as a descriptive summary, or in tabular form, according to pre-designed

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recruitment, advertising, and disclosure; franchisee selection; and guidelines for the franchise agreement. Available at http://www.eff-franchise.com.

[91] As previously described, U.S. Federal Trade Commission (FTC) regulation 16 CFR Part 436, known as the Franchise Rule, requires franchisors to disclose these facts in a prescribed and consistent manner, following either the FTC's Franchise Rule's disclosure layout or Uniform Franchise Offering Circular (UFOC) guidelines.

[92] Amended Franchise Rule- 12/30/93, FTC Matter No. R511003, Federal Register.

[93] "Disclose" means to state all material facts in an accurate and unambiguous manner. Disclose clearly, concisely and in a narrative form that is understandable by a person unfamiliar with the franchise business. For clear and concise disclosure avoid legal antiques and repetitive phrases. When possible, use active, not passive voice. Limit the length and complexity of disclosure through careful organization of information in the disclosure. Avoid technical language and unnecessary detail. Make the format and chronological order consistent within each Item (anonymous 2000).

specifications. A complete set of UFOC requirements is available http://nasaa.org/nasaa/corpfin/UFOC.doc. A copy of requirements for UFOC Items 1 and 2, and a cover page are provided in Appendix O to illustrate the level of detail associated with NASAA's requirements. A copy of NASAA's requirements for Items 9 and 17 are also provided in Appendix O because of their relevance to franchisee obligations and restrictions, aspects germane to this study. As summarized in Table 5.1, UFOCs follow a uniformly prescribed framework of Items and disclosure topics designed to present material facts about a franchise offering and facilitate comparisons among franchises.

Table 5.1 UFOC Item Framework and Format

FRAMEWORK		FORMAT
Item	**Description**	
1	Franchisor, Predecessors, Affiliates	Summary
2	Business Experience	Summary
3	Litigation	Summary
4	Bankruptcy[94]	Summary
5	Initial Franchise Fee	Summary
6	Other Fees	Tabular
7	Initial Investment	Tabular
8	Restrictions on Sources of Products	Summary
9	Franchisee's Obligations	Tabular
10	Financing	Summary
11	Franchisor Obligations	Summary
12	Territory	Summary
13	Trademarks	Summary
14	Patents, Copyrights & Proprietary	Summary
15	Obligation to Participate	Summary
16	Restrictions on What May be Sold	Summary
17	Renewal, Termination, Transfer, Dispute Resolution	Tabular
18	Public Figures[95]	Summary
19	Earnings Claims	Summary
20	List of Outlets	Tabular
21	Financial Statements	Summary
22	Contracts[96]	Summary
23	Receipt[97]	Summary

[94] Persons identified in Item 1 or Item 2 who have been involved as a debtor in proceedings under U.S. Bankruptcy Code are required to be disclosed in this Item.
[95] Franchisors must disclose if any public figures are used in marketing or promoting the franchise.
[96] Lists all agreements contained in offering circular and franchise agreement, such as sublease, applicable state riders to agreement, and addendums.

This section begins by describing the results of an exploratory examination of UFOCs and franchise agreements conducted in two phases. First, complete documentation packages associated with a franchise purchase were examined for uniformity in structure, format and contents. Included were UFOCs, franchise agreements, and all exhibits, addendums, attachments, riders, and appendices. Given the extent of coverage and quantity of documentation, the first analysis was limited in scope to just thirteen franchises. For the second phase of this analysis, a subset of the variables examined in the first phase was selected for a more focused exploration of franchisee responsibilities and restrictions. Documentation from a total of 55 franchises were examined in this second phase.

An analysis of uniformity in the UFOC framework and format is first described, followed by analysis of the sample's contents. Next, the respective franchise agreements are analyzed. An analysis of the entrepreneurial constraints found in both UFOC and franchise agreements follows, specifically focused on franchisee obligations and other areas of opportunity for entrepreneurship within the system. This section concludes with a summary of the results.

5.2.1 Uniformity in Framework and Format: Analysis of 13 UFOC Documents

Consistent with published guidelines, all UFOC documents in this sample complied with NASAA requirements for franchise disclosure. UFOC Items were numbered and

[97] Receipt pages contain franchisor and prospective franchisee copies that acknowledge receipt of UFOC, franchise agreement, and all applicable Exhibits. Receipts pages must be signed and dated by both franchisor and franchisee. These pages assure that disclosure documents were provided to prospective franchisee ten business days before signing agreement or ten days before any payment is made.

categorized as required, and tables within UFOC Items 6, 7, 9, 17, and 20 revealed consistent frameworks of *sub-categories.*[98] For example, tables in Item 9, *Franchisee Obligations*, contained an assigned categorical labeling system similar to the overall UFOC framework with alphabetical ordering. Obligation "a." was titled *Site selection and acquisition/ lease* in each UFOC, and obligation "d." was titled *Initial and ongoing training* in each UFOC examined. Similar in structure, Item 17, *Renewal, Termination, Transfer and Dispute Resolution*, contained ordered and alphabetized categories of provisions, *a* through *w*. Consistent sub-category lettering and descriptive titles among franchises were also found. In each UFOC, Item 20, *List of Outlets*, contained tabular information about the numbers and locations of franchised and company outlets. In summary, this exploratory investigation of UFOC frameworks and formats revealed a consistent and regimented structure of item and subordinate item ordering, and consistent category and sub-category titles in each case examined.

5.2.2 Uniformity in Content: Analysis of 13 UFOC Documents

As described earlier, the first portion of this exploratory study broadly examined contents of 13 UFOCs for uniformity in framework and contents. In this initial sample, content data considered relevant to the overall study were collected from UFOC Items 1, 5, 6, 7, 8, 9, 10, 11, 12, 14, 15, 16, 17, 19, and 20 and categorized into 46 variables. In order to remain within the scale limits imposed on this study, data from Items 2, 3, 4,13, 18, 20, 21, 22, and 23 were not included in this analysis. Table 5.2 presents items and variables examined in this initial portion of the study.

[98] The guidelines state: "Disclose obligations in tabular form. The table should contain a response to each category listed below. Do not change the names of the categories. Fit all obligations within the listed categories."

Table 5.2: Exploratory Examination of Contents in Uniform Franchise Offering Circulars (UFOC)		
ITEM	**VARIABLE**	**COMMENT**
1. Franchisor, Predecessors & Affiliates	• Year corporation founded • Year began franchising	
2. Business Experience		
3. Litigation		
4. Bankruptcy		
5. Initial Franchise Fee	• Franchise fee	
6. Other Fees	• Royalty • Renewal • Transfer • Marketing • Other mandatory fees	Includes fixed fees and those based on a percentage of sales or geographic area.
7. Initial Investment	• Initial investment-Low • Initial Investment- High	May include cost of real estate, expected rent payments and leasehold improvements.
8. Restrictions on Sources of Products or Services	• Product Specifications • Other Restrictions	
9. Franchisee's Obligations	• 12 Variables	25 separate categories. Includes references to UFOC and franchise agreement.
10. Financing	• Financing offered by franchisor	
11. Franchisor Obligations	• Site Selection • Advertising • Training • Other	Lists obligations of services provided by franchisor.
12. Territory	• Territorial Exclusivity	
13. Trademarks and Patents		
14. Patents, Copyrights	• Intellectual Property	
15. Obligation to Participate in Actual Operation	• Level of participation	Includes full-time, part-time or if passive ownership is permitted.
16. Restrictions of what franchisee may sell	• Franchisor products • Other products	
17. Renewal, Termination, Transfer & Dispute Resolution	• Contract term (length) • Renewal terms • Agreement termination by franchisee • Agreement termination by franchisor • Right of refusal • Buy back provision • Transfer fees • Non-compete during agreement • Non-compete after agreement • Dispute resolution	
18. Public Figures		
19. Earnings Claims	• Earnings or sales claims	Optional disclosure
20. List of outlets		
21. Financial Statements of Franchisor		
22. Contracts		
23. Receipt		

Although the framework and format of UFOC documents were found to be consistent and regimented, disclosures *within* the framework varied among franchises in this sample. For example, following identical UFOC frameworks, one franchise provided 17 pages of documentation and 5 exhibits, another used 43 pages and 5 exhibits, while a third franchise used 54 pages and 12 exhibits to meet the same requirements of disclosure about their respective franchises. Another indicator that franchises varied in the extent of disclosure was evident in Item 19, *Earnings Claims.* An earnings claim includes any representations of "actual or potential sales, costs, income or profit," and under U.S. Federal Trade Commission (FTC) guidelines, disclosure of earnings is not mandatory. Three franchises in this sample (23%) provided earnings information under Item 19.[99]

The nature and extent of restrictions and franchisee obligations imposed by each agreement also varied among franchises in this sample, including product selection criteria. For example, nine franchises (70%) had specific product purchasing requirements, stipulating that franchisees purchase materials and supplies exclusively from a franchisor or from a franchisor's designee. Three franchises defined their franchised outlet's hours of operation, and one specified the number of employees that each franchisee must hire. Six franchises required that an owner commit to on-site management of their outlet, while only one permitted passive ownership.[100]

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[99] The U.S. Federal Trade Commission noted that "approximately 20 percent of franchisors choose to make earnings disclosures, and that prospects, in theory, can find franchise systems that voluntarily disclose earnings information" (p. 57309) 16 CFR 436.

[100] Franchises that permit passive ownership have no requirement for an owner's direct participation in the operation of the business.

5.2.3 Summary: Uniformity in Framework, Format, and Contents of UFOC

Franchises in this initial sample exhibited a high degree of uniformity and regimentation in their structure and format, conforming with NASAA's guidelines for UFOC disclosure. The initial sample revealed, however, substantial variations among franchises in the scope and extent of disclosure. Table 5.3 presents a summary of descriptive findings, while Appendix D contains details of this initial exploratory study.

This exploratory sample of 13 UFOC documents, as presented in Table 5.3, represented a diverse group of franchises. Firms varied in age from 3 to 85 years, and had between 3 and 83 years of franchising experience. The average franchise fee was $26,070.00, but standard deviation of the sample (18.0) reflected the fact that one franchise did not assess a franchise fee, while another franchise, *The Entrepreneur's Source,* charged fees that ranged between $50,000 and $100,000.[101] Royalty fees also varied among firms in the sample, both in terms of magnitude and on their basis of calculation. For example, ten franchises (76.9%) assessed royalty fees based on a percentage of gross sales, in amounts that ranged between 2 ¾ and 10 percent. Five of these franchises (50%) had minimum royalty payments that ranged from $250 to $1,000 per week.

[101101] In the case of *Entrepreneur's Source*, an average fee of $75,000 was used to calculate the mean franchise fee.

UFOC	Variable	Mean	SD	Min	Max	Comments
Table 5.3: Summary of Descriptive findings of UFOC Contents From Initial Examination of 13 UFOC Documents						
Item 1	Corporation Founded (age)	21.54	27.95	3	85 yrs.	
	Began Franchising (experience)	15.0	21.41	3	82 yrs.	
Item 5	Initial Franchise Fee	$26,070	18.0	$0	$75,000	
Item 6	Royalty Fees	5.98%	1.81	2.75%	10%	Reflects 10 systems that based royalty on percentage of gross sales.
	Renewal Fees	11.66%	6.83	5%	25%	6 Expressed as percentage of franchise fee; 4 as fixed cost of $1,000; 3 had $0 fees
	Transfer Fees					2 based on percentage of current franchise fee; 3 as fixed fee; 8 as combination
	Marketing Fees					8 as percentage of gross; 3 flat fees; 2 had no ongoing marketing fees
	Other Mandatory Fees					5 had no other fees, 2 had local advertising requirements; 6 had misc. additional fees
Item 7	Initial Investment Low	$82,664	86.90	$15,500	$319,200	
	Initial Investment High	$166,013	184.96	$34,500	$723,600	
Item 8	Product Specifications					9 had specific purchase requirements; 3 required no product purchases
	Other Restrictions					3 set hours of operation; 1 specified number of employees that must be hired
Item 9	a. Site Selection					12 required franchisor approval; 5 would provide assistance
	b. Pre-Opening Purchases					All specified some requirements; 4 required grand openings
	c. Other Pre-Opening Requirements					5 had no additional requirements; 4 required compliance with company standards
	d. Initial and Ongoing Training					12 required franchisee to pay expenses; 22 days maximum, 40 hours minimum
	e. Opening					6 specified maximum time between training and opening
	f. Other Mandatory Fees					3 specified minimum grand opening advertising expenditures.
	i. Other Restrictions					3 set hours of outlet operation
	j. Warranty & Customer Service					7 had none required; 3 referred to operating manual
	l. Product Specifications					4 had no restrictions; 6 required purchases from franchisor or designee
	n. Insurance Required					All required some form of insurance, $3M in liability highest
	r. Financial Reporting					5 specified weekly reports; 2 quarterly; 1 annual
	s. Monitoring and Control					All reserved right to inspect; 7 specified access during working hours
Item 10	Financing Offered					One franchise offered financing assistance
Item 11	Site Selection Assistance					All applicable franchises offered assistance
	Advertising					4 specified advertising as percentage of sales; 5 specified fixed amount
	Training	67.66 hrs	47.74	8 hrs.	176 hrs.	7 required franchisees to pay expenses; 1 did not specify training

	Other					5 required purchase or license of computer and software
Item 12	Territory Exclusivity					11 designated territorial exclusivity, 6 based on demographic, 5 on geographic
Item 14	Intellectual Property					8 claimed rights for ad materials and operations manual
Item 15	Owner's Participation					6 specified owner's full-time commitment; 1 did not require owner participation
Item 16	Restrictions on What may be Sold					6 specified all and only products as authorized; 2 required only that products be related to operation of franchise
	Other Products or Services					8 specifically prohibited other products or services; 1 had no restrictions
Item 17	Contract Length	9.38 yrs.	3.27	0 yrs.	15 yrs.	
	Renewal Terms					7 specified must be in good standing and pay fees
	Termination by Franchisee					6 No provision for franchisee termination of agreement
	Termination by Franchisor with Cause					5 allowed termination only if franchisee is in default; 8 provided list of 'curable' defaults and time to cure before termination
	Right of Refusal					All specified first right of refusal, and right to match offer
	Buy Back Provision					9 specified right but not obligation to buy back; 2 had no buy-back
	Transfer Fees					3 specified percentage of franchise fee; 1 fixed amount; 6 combination fee
	Non-Compete During Agreement					All specified no competing business permitted
	Non-Compete After Agreement					All specified non-compete, 8 specified two-year term, 1 had three year, and 1 had 18 month terms; geography varied from anywhere in U.S. to 5 miles.
	Dispute Resolution					9 specified arbitration, while 3 required mediation; 1 had no clause
Item 19	Earnings Claim					3 provided earnings claims
Item 20	List of Outlets	175	360.47	0	1183	
	Number of Company-Owned	3.92	4.73	0	13	6 had zero company-owned outlets

5.2.4 Uniformity in Franchise Agreements: Framework, Format, and Contents

As stated previously in this chapter, UFOCs, franchise agreements and various exhibits and attachments comprise the official documents of a franchise. In contrast to the regimentation found in UFOCs, franchise agreements are not required to follow a prescribed format or structure. Agreements in this sample followed no apparent numbering, labeling, or categorical framework.

Franchise agreements in this sample differed in length; one agreement consisted of 15 pages, while another spanned 35 pages. The number of addendums and exhibits also differed, with as few as five and as many as 12 separate documents attached to the UFOCs and franchise agreements in this sample. Categorical frameworks also differed; Quizno's agreement contained 23 Sections, while contractual provisions in Pet Pantry's agreement were divided among 11 Sections. Sections within franchise agreements did not follow the same regimentation as found in UFOC documents; *Training* was listed as a separate category, Section 7, in Quizno's franchise agreement, while training information was part of Section 5, *Services to Franchisee* in *Pet Pantry's* agreement.

To illustrate the diversity found in franchise agreements, tables of contents from three franchises were compared, as depicted in Table 5.4.

Table 5.4: Franchise Agreement Tables of Contents			
Section	**Franchise Agreement 1**	**Franchise Agreement 2**	**Franchise Agreement 3**
1	Purpose	Introduction	Parties
2	Grant of Franchise	Grant and Term of Franchise	Recitals
3	Franchised Location and Target Area	Territory	Definitions
4	Initial Franchise Fee	Site of Franchised Business	Grant of Franchise
5	Royalties	Initial Franchise Fee	Services to Franchisee
6	Development of Franchised Location	Royalty Fee	Payments by Franchisee
7	Training	Marketing and Advertising	Obligations of Franchisee
8	Operations Manual	Telephone Numbers and Advertising	Relationship of Parties
9	Development Assistance	Computer maintenance Fee	Transfer of Franchise
10	Operating Assistance	Training	Termination of Franchise
11	Franchisee's Operational Covenants	Operating Requirements	Miscellaneous Provisions
12	Advertising	Operating Assistance	
13	Quality Control	Records and Financial Reports	
14	Marks, Trade Names, Proprietary Interests	Reviews	
15	Reports, Records and Financial Statements	Insurance	
16	Transfer	Books and Records	
17	Term and Renewal	Service Marks	
18	Default and Termination	Default and Termination	
19	Business Relationship	Assignment	
20	Restrictive Covenants	Sale to Third Party	
21	Disputes	Death or Disability	
22	Security Interests	Covenant not to Compete	
23	Miscellaneous Provisions	Remedies and Indemnities	
24		Contract Interpretation; Modification	

Information provided in franchise agreements was presented exclusively in summary format, although the amount of information and content varied among franchises. In some cases, franchise agreements provided information not found in the UFOC, such as information related to contract terms, specific requirements for the grant of a franchise, and definitions of the legal relationship of the parties. Topics addressed in the UFOC, such as fees, transfer, inspections, and training, were also included in various sections of their respective franchise agreements.

5.2.5 Summary of Uniformity in Franchise Agreements

Overall, franchise agreements in this sample did not appear to follow the regimentation and strict framework conventions found in UFOCs. The information contained in franchise agreements was presented exclusively in summary format. Although franchise agreements contained information also found in the attached UFOC, some provisions contained disclosures and specific information not found elsewhere.

5.3 CONSTRAINTS WITHIN FRANCHISING

In the first phase of this study, exploratory examination of thirteen franchise documents found uniformity in structure and format among UFOCs in this sample. It also revealed differences in both the extent of disclosure and nature of restrictions imposed by franchises. Concurrent examination of the sample's respective franchise agreements revealed that (1) franchise agreements and their respective addendums and exhibits contained relevant information not contained in the UFOC; and (2) franchise agreements followed no prescribed structure or format. The second phase of this exploratory study examines the extent to which contractual provisions circumscribe operations of franchised outlets by analyzing 55 UFOC and franchise agreements.

5.3.1 Introduction

The first phase of the study revealed that not all relevant disclosures were made exclusively in a UFOC. Specific terms and details related to fees, for example, were found only in franchise agreements. Therefore, examination of both UFOCs and franchise agreements for each franchise was necessary to complete this phase of the study.

Within a UFOC structure, Item 9, *Franchisee Obligations* provided a useful template for systematic examination and analysis of a larger sample of both UFOC and franchise agreements. Item 9 was selected because it not only provided a uniform structure of sub-items, which included references to provisions in both the UFOC and franchise agreement, but it also focused on franchisee responsibilities and restrictions, germane to this work. In contrast to general franchisee obligations under the Guiding Principles of the European Code of Ethics for Franchising,[102] UFOC Item 9, *Franchisee Obligations*, contains a detailed framework of responsibilities, restrictions, and obligations, with specific references to applicable sections of both UFOC and franchise agreement.[103]

Of the 26 sub-items contained in Item 9, nine were chosen for their particular relevance to this study, delimited also by limits imposed on this document. Data from Item 19, *Earnings Claims,* were also gathered because of its importance to franchisees and because relatively few franchises chose to make this voluntary disclosure. Variables were grouped according to subordinated categories within Item 9. In all, 24 categories of franchisee obligations were listed in Item 9, in sub-item categories *a* through *y* in consistent order, and with uniform category titles. An example of the framework of Item 9 is contained in Table 5.5.

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[102] The Principles state that the obligations of the individual franchisee are: (1) devote its best endeavours to the growth of the franchise business and to the maintenance of the common identity and reputation of the franchise network; (2) supply the Franchisor with verifiable operating data to facilitate the determination of performance and the financial statements necessary for effective management guidance, and allow the Franchisor, and/or its agents, to have access to the individual Franchisee's premises and records at the Franchisor's request and at reasonable times; and (3) not to disclose to third parties the know-how provided by the Franchisor, neither during nor after termination of the agreement (anonymous 2001).

[103] One franchise noted that Item 9 was designed to "help you (franchisee) find more detailed information about your obligations in these agreements and in other items of this offering circular."

Table 5.5: UFOC Item 9 "Franchisee Obligations" Sub-Item Categories		
Category	**Category Description**	**Included in Study**
a.	Site Selection and Acquisition/ Lease	
b.	Pre-Opening Purchases/Leases	
c.	Site Development and Other Pre-Opening Requirements	
d.	Initial and Ongoing Training	
e.	Opening	
f.	Fees	
g.	Compliance with Standards and Policies/ Operating Manual	
h.	Trademarks and Proprietary Information	
i.	Restrictions on Products/ Services Offered	Yes
j.	Warranty and Customer Service Requirements	
k.	Territorial Development and Sales Quota	Yes
l.	Ongoing Product/ Service Purchases	
m.	Maintenance, Appearance and Remodeling Requirements	
n.	Insurance	
o.	Advertising	Yes
p.	Indemnification	
q.	Owner's Participation/ Management/ Staffing	Yes
r.	Records and Reports	
s.	Inspections and Audits	Yes
t.	Transfer	Yes
u.	Renewal	Yes
v.	Post-Termination Obligations	Yes
w.	Non-Competition Covenants	Yes
x.	Dispute Resolution	Yes
y.	Other	

This section begins by examining the relationships among variables within each of the nine sub-items and Item 19. Next, correlation analysis of all variables is presented.

5.3.2 Sub-Item *i*: Restrictions on Products or Services Offered

An ability to adapt products and services for dynamic markets is often cited as a source of competitive advantage for small businesses. Adaptation is also used as an indicator of innovation and other entrepreneurial processes (Jennings and Beaver 1997). Analysis in this section considered the potential for innovative processes and adaptation through initiating change at a local level. These processes are likely to be suppressed when circumscribed by contractual restrictions on products or services offered by a franchised outlet.

Variables considered in this category were derived from *Restrictions on Products/ Services Offered,* Sub-item "i" of UFOC Item 9. A majority of franchises restricted products offered at a franchised outlet to only those approved by franchisors (78.2%). Product purchases were confined exclusively to approved suppliers in 70.9% of sampled franchises. A requirement for franchisees to sell only approved products was significantly associated with both franchisor approval for products or services offered at outlets, and a restriction to sell only an approved line. The extent and scope of franchisor control over franchised outlets' product offerings revealed in this section is consistent with Morgan's predictions of product uniformity among franchised outlets (Morgan and Stoltman 1997).

Table 5.6: Frequencies and Correlations of Restrictions on Products/ Services Offered

	Variable		Frequencies			1	2	3	4	5	6
1	Sell Only Approved Product	Yes	43	78.2%	Corr.	1.000					
		No	12	21.8							
2	Required Min. Purchase	Yes	7	12.7	Corr.	.202	1.000				
		No	48	87.3			-				
3	Franchisor Approve Line	Yes	40	72.7%	Corr.	.566**	.111	1.000			
		No	15	27.3							
4	Limited to Approved Line	Yes	45	81.8	Corr.	.664**	.039	.664**	1.000		
		No	10	18.2							
5	Accepted Suppliers Only	Yes	39	70.9	Corr.	.243	.124	.417**	.425**	1.000	
		No	16	29.1							
6	Franchisor Sets Hrs. of Operation	Yes	10	18.2	Corr.	.135	.244	-.029	-.100	-.009	1.000
		No	45	81.8							

** Significant at >.01 n=55

Although most did not, a minority of franchises (18.2%) prescribed hours of operation for franchised outlets in their agreements. A franchisor's right to set hours of operation was not significantly correlated to any other variables in this category. A summary of frequencies and correlations from sub-item *i* is presented in Table 5.6.

5.3.2.1 Discussion

Maintaining consistency in product and service offerings at a franchised outlet is not only a requirement for meeting customer expectations, but also ensures protection of a franchisor's trademark. Despite widely held assumptions of uniformity, not all franchises in this sample exerted control over all products or services offered at a franchised outlet. Although a majority (78.2%) restricted products offered to only those approved by their franchisor, the remainder had no such requirement.[104] Similarly, a requirement for franchised outlets to offer a limited line of products or seek franchisor approval for product offerings was not uniformly imposed in all franchises. This data suggests that opportunities for customization and adaptation to meet local market demands exists in some franchises. This is consistent with Phan's speculation that franchisees are potentially entrepreneurial because of gaps in their formal agreements (Phan, Butler et al. 1996).

Arguably, franchises that mandated minimum purchase requirements and stipulated hours of operation exerted more control over operations of franchised outlets than those that do not. These requirements have little relationship to trademark protection or quality control, but may be indicative of franchises driven by incremental sales revenues, possibly at the expense of franchisee profits (Birley, Leleux et al. 1997).

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[104] Some franchises use specialized equipment in addition to product specifications to control production. Tastee Freeze, for example, required that franchisees lease a unique and essential pump to regulate the flow of its soft-serve ice cream (Love 1995).

5.3.3 Sub-item *k*: Territorial Development and Sales Quota

Territorial exclusivity not only defines a potential market for a franchised outlet, but also protects an outlet from encroachment by either franchised or company-owned outlets within the same chain. Territorial encroachment is a highly contested issue in franchising (Vincent 1998). When used in conjunction with territorial exclusivity, establishment of a sales quota ensures franchisors of a minimum revenue stream of royalties from a given territory.

More than two-thirds (67.3%) of franchises in this sample defined exclusive territories for franchisees, either based on geographic or demographic boundaries, and more than half (54.1%) of them specified sales quotas. Unexpectedly, a provision for territorial exclusivity was not highly correlated with a requirement to meet a specified sales quota. Overall, a majority of franchises (72.7%) in this sample did not stipulate a sales quota in their UFOC or franchise agreement.

Granting of territorial exclusivity, whether by demographic or geographic means, can be important to a franchisee. A summary of the frequencies derived from sub-item "k." is presented in Table 5.7.

Table 5.7: Territorial Exclusivity and Sales Quota (Sub-Item *k.*)

Variable			Frequencies			1	2
1	Exclusive Territory	Yes	37	67.3%	Corr.	1.000	
		No	18	32.7			
2	Sales Quota	Yes	15	27.3%	Corr.	.253	1.000
		No	40	72.7			

5.3.3.1 Discussion

Territorial exclusivity affords a level of assurance that direct competition is not likely to come from an additional franchised or company-owned outlet of the same concept within a specified market area. Establishment of a protected geographical area that is fair to both franchisees and franchisors is difficult, given rural, metropolitan, and suburban settings (Spinelli 1994). Territorial encroachment is one of the most commonly litigated issues between franchisees and franchisors (Vincent 1998).[105] Granting an exclusive territory prohibits franchisors from selling additional outlets in a given market area, which may adversely affect their ability to grow revenues. Mathewson argued that territorial exclusivity is profitable when franchisee efforts are critical to a venture's success (Mathewson and Winter 1994).

The results from this sample suggest that a majority of franchisors is willing to grant territorial exclusivity without a requirement for franchisees to meet a sales quota. Although the results are not significant, frequencies suggest that a *quid-pro-quo* relationship between a franchisor's grant of an exclusive territory and a franchisee's requirement to meet a sales quota is not apparent in this sample.

5.3.4 Sub-item *o*: Advertising

Success of a branded product or service depends on an ability to effectively market and advertise it (Aaker and Biel 1993) (Bhat and Reddy 1998) (Ha 1998). A majority of franchises in this sample (74.5%) required franchisees to make payment into an advertising fund. Two-thirds of the franchises in this sample based their fees on a percentage of sales or income. In addition to ongoing advertising payments, a minority of franchises in this sample (23.6%) required franchisees to set aside additional funds to promote opening of their outlet. More than one third (36.4%) of franchises required that locally developed advertising be approved by the franchisor, an aspect significantly

[105] Vincent defined territorial encroachment as "...when a franchisor approves a new location, whether company-owned or franchised, which is close enough to an existing location so that the new location draws away some customers from the existing location, resulting in a reduction of sales for the older location" (Vincent 1998, p. 30).

correlated to both mandatory advertising and opening advertising requirements. Table 5.8 presents frequencies and correlations found in sub-item *o*.

Table 5.8: Advertising Frequencies and Correlations (Sub-item *o*.)

	Variable		Frequencies			1	2	3
1	Mandatory Advertising	Yes	41	74.5%	Corr.	1.000		
		No	14	25.5				
2	Opening Advertising	Yes	13	23.6%	Corr.	.129	1.000	
		No	42	76.4				
3	Franchisor Approve Advertising	Yes	20	36.4%	Corr.	.355**	.380**	1.000
		No	35	63.6				

5.3.4.1 Discussion

Large-scale advertising campaigns exert significant influence over consumer product choices (Bucklin 1971). Franchising relies upon advertising to build brand recognition, often used by consumers to determine that a seller's prices are justified by the product's level of quality (Norton). In the U.S. restaurant industry, for example, most brands spent between 2.5% and 5% of sales on media[106] (FFCA 2000). A majority (74.5%) of franchises in this sample required franchisees to contribute toward a brand's advertising expenses.

Less than one-fourth (23.6%) of franchises in this sample required that franchisees pay for grand opening expenses, presumably because franchisor-sponsored advertising has minimized liability of newness typical of non-franchised start-up businesses. There also appears to be appreciable discretion in local marketing, since nearly two-thirds (63.6%) of franchises do not require franchisor approval for local advertising.

5.3.5 Sub-item *q*: Owner's Participation/ Management/ Staffing

In the context of agency theory, ownership of a local outlet by a franchisee theoretically reduces problems of shirking (Meese 1996). A prevalence of multiple outlet ownership

[106] In 1998, McDonald's spent $570.9 million in total measured media advertising (FFCA 2000).

by franchisees was found in previous empirical studies (Kalnins and Lafontaine 1996); (Kaufmann and Dant 1996), which appears to conflict with this theoretical approach. Systems that support ownership of multiple outlets may be more likely to attract prospective franchisees with aspirations of growth and increased responsibility.

In this sample, nearly two-thirds of franchises (63.6%) required that owners provide on-site supervision, while nearly half (49.1%) required both that owners be on-site and devote full time to operations of their franchised outlet. Although 65.5% of franchises allowed franchisees to designate a manager, 60% required franchisor approval for a manager. These findings are summarized in Table 5.9

Table 5.9: Owner's participation, Management and Staffing (sub-item *q*)

Variable			Frequencies			1	2	3	4
1	Owner Required On-Site	Yes	35	63.6%	Corr.	1.000			
		No	20	36.4					
2	Owner Must Devote Full-Time	Yes	27	49.1%	Corr.	.742**	1.000		
		No	28	50.9					
3	Owner May Designate Manager	Yes	36	65.5%	Corr.	.087	.102	1.000	
		No	19	34.5					
4	Franchisor Must Approve Manager	Yes	33	60.0%	Corr.	.000	-.015	.890**	1.000
		No	22	40.0					

5.3.5.1 Discussion

For franchisors, a franchise relationship induces self-direction by owner-manager franchisees in circumstances where central control would be difficult (Stanworth and Curran 1999). However, only half (49.1%) of the franchises in this sample required that owners devote full-time to running their business, while more than one-third (36.4%) did not require an owner's presence on-site. Owners of franchises who are not required to devote full-time efforts or to be on-site will have more opportunities to engage in other business endeavours than those in other systems.

An ability to hire and designate a manager is provided in two-thirds of the franchises in this sample. A majority (60%) of franchises requires franchisor approval of an appointed manager, a provision that may be indicative of higher levels of control by some franchisors in franchised outlet operations.

5.3.6 Sub-item *s*: Inspections and Audits

Although some form of quality control by franchisors is required to guard against claims of trademark abandonment, the extent and manner in which inspections and audits are conducted may be a measure of franchisor control (Dant and Nasr 1998); (Kaufmann and Eroglu 1998). Unexpectedly, 21.8% of franchises in this sample had no specified provision for franchisors to inspect franchised outlets in their UFOC and franchise agreement. Further, 30.9% of franchises did not specify a quality audit. Although in a minority (12.7%), a small group of franchisors formally reserved the right to interview an outlet's customers as a part of their inspection process. Table 5.10 presents a summary of frequencies and correlations among variables related to inspections and audits.

Table 5.10: Inspections and Audits (sub-item *s*)

	Variable		Frequencies			1	2	3
1	Inspect Business	Yes	43	78.2%	Corr.	1.000		
		No	12	21.8				
2	Quality Audit	Yes	38	69.1%	Corr.	.790**	1.000	
		No	17	30.9				
3	Right to Interview Customers	Yes	7	12.7%	Corr.	.202	.255	1.000
		No	48	87.3				

5.3.6.1 Discussion

Random inspections of franchised outlets by franchisors provide assurances that franchisees follow established procedures and standards (Blair 1995). Knight found that as franchisees became more experienced, they began to question their franchisor's standards and policies, as they increasingly believed that success of their outlets was due to their own efforts (Knight 1986). Arguably, the right to interview a franchisee's customers provides franchisors may be considered an incremental level of monitoring over routine inspections and quality audits.

5.3.7 Sub-items *t* and *u*: Transfer and Renewal

One measure of franchisee autonomy cited by Spinelli was a franchisee's ability to transfer ownership or to renew their agreement (Spinelli and Birley 1996). A majority of franchises in this sample (61.8%) based transfer fees on a percentage of franchise fees in effect at the time of transfer. For those 21 franchises that specified fixed transfer fees, amounts ranged from $500 to $7,500 with a mean of $4,119. Terms for renewal were provided by 52.7% of franchises. Fees ranged between $500 and $15,000, with a mean renewal fee of $3,647. Findings in this section are summarized in Table 5.11.

Table 5.11: Transfer and Renewal (sub-items *t* and *u*)

	Variable		Frequencies			1	2	3
1	Transfer Allowed	Yes	43	78.2%	Corr.	1.000		
		No	12	21.8				
2	Fixed Transfer Fee	Yes	21	38.2%	Corr.	-.038	1.000	
		No	34	61.8				
3	Renewal Terms Disclosed	Yes	29	52.7%	Corr.	.382**	-.080	1.000
		No	26	47.3				

	N	Minimum	Maximum	Mean	Std. Error	Std. Deviation
Fixed Fee Amount	21	500.00	7500.00	4119.0476	374.6503	1716.8631
Renewal Amount	17	500.00	15000.00	3647.0588	861.5187	3552.1327

5.3.7.1 Discussion

Franchisors may exert substantial control over franchisees in aspects other than product specifications. For example, Ray Kroc, founder of McDonald's, refused to grant additional franchises to his most successful franchisees primarily because they sold Pepsi Cola as opposed to Coca Cola, contrary to McDonald's policy (Love 1995). Franchisors retain unilateral rights to grant transfers or renewals of franchise agreements during and at the expiration of their term respectively. The wide range of fees associated with transfer and renewal indicates that some franchisors may exert financial penalties in this aspect of franchising, perhaps in an effort to influence franchisee behavior.

Considering financial commitments by franchisees to their outlet(s) and the long term of most franchise agreements, Emerson concluded that legal issues surrounding termination, renewal, and transfer of franchises were among the most controversial in franchise law (Emerson 1998). A failure to disclose renewal terms, as was found in nearly half (47.3%) of franchises in this sample, may help explain part of this legal controversy. Spinelli concluded, "A franchise prospect should be wary of an agreement of an agreement that does not address renewal" (Spinelli 1994, p.368).

5.3.8 Sub-item *v*: Post Termination Obligations

Obligations and restrictions within UFOCs and franchise agreements may extend beyond an agreement's term (Spinelli Jr. and Bygrave 1995). A substantial majority (94.5%) of franchises in this sample had non-compete clauses that prohibited involvement in competing businesses after an agreement's expiration. Periods of non-compete varied between one and five years (mean 2.086; s.d. .138). Five of the franchises in this sample (9.1%) required that managers and/or employees of franchised outlets also sign post-termination non-compete contracts.[107]

5.3.8.1 Discussion

Non-compete clauses, found in most franchise contracts, make it difficult for franchisees to put human capital accumulated within a chain to good use upon termination (p.36) (Lafontaine and Slade 1998). Non-compete clauses potentially restrict competition, and may deprive individuals an ability to earn a living after contract termination. U.S. courts have ruled that non-compete clauses may be enforced only if they are: (1) necessary to protect a legitimate business interest; (2) reasonably limited to time and territory; (3) not unduly restrictive of the person's ability to earn a living; (4) reasonable from a public policy standpoint; and (5) supported by valuable consideration (anonymous 1999). Non-compete clauses may be viewed as an indicator of franchisor control that extends beyond an agreement's term.

5.3.9 Sub-item *x*: Dispute Resolution

Disputes within franchising are prevalent, reported in both academic literature (Spinelli Jr. and Bygrave 1995) and popular press (Harris and France 1997). Procedures for dispute resolution are important considerations for all parties in a franchise (Leblebici and Shalley 1996). Nearly three-quarters of franchises in this sample specified arbitration, mediation, or either method of dispute resolution in their agreements. Of those that specified a method of dispute resolution, 78.9% stipulated arbitration, as indicated in Table 5.12.

[107] The five franchises that required managers and/or employees to sign post-termination non-compete agreements are: (1) Blimpie; (2) Le Print Express; (3) Pizzaria Regina; (4) Worldsites; and (5) Medihealth Solutions.

Table 5.12: Dispute Resolution		
Sub-item x.	Frequency	
Mediation	8	14.5%
Arbitration	30	54.5
Either	3	5.5
None	14	25.5
Total	55	100%

5.3.9.1 Discussion

Ideally, governance structures should give all participants incentives to work together efficiently, and minimize costs of coordination and dispute resolution (Blair 1995). There is a trend in the U.S. toward increased litigation between parties engaged in franchising (Spinelli Jr. and Bygrave 1995), despite a prevalence of mediation and arbitration clauses in franchise agreements. In addition to a prescribed method of dispute resolution, franchisors may employ a judicial forum selection clause, which requires any franchisee litigation to be brought in a franchisor's choice of jurisdiction (Dunham, Darrin Jr. et al. 1998). Inclusion of forum selection clauses in franchise agreements is increasing (Zimmerman 1998).

Baucus et al. concluded that franchisors are likely to become involved in fewer disputes in situations where franchisees have latitude (Baucus, Baucus et al. 1996). More than one fourth (25.5%) of franchises in this sample had not specified a method of dispute resolution. There is at this point, however, no indication that those franchises that do not specify a prescribed dispute resolution method have fewer disputes, or offer greater latitude to their franchisees.

5.3.10 Item 19: Earnings Claim

As explained in the Methodology Section, disclosure of potential earnings, sales, or income is voluntary under current U.S. law, but is a recurring topic in policy debates.

An earnings claim is defined as information "...from which a specific level or range of actual or potential sales, costs, income or profit from franchised or non-franchised units may be easily ascertained" (anonymous 1998). Because of longstanding debates, it has been called "the issue that wouldn't die" (Kolton 1999, p. 48). Although the U.S. Federal Trade Commission estimated that 20% of franchises voluntarily disclosed earnings, (Wieczorek 1999) only 12.7% of franchises in this sample made earnings disclosures.

5.3.10.1 Discussion

In Knight's study of 148 franchisors and 105 franchisees, both sides agreed that government disclosure regulations were required to control "con artists and frauds" operating within franchising (Knight 1986, p. 14). Bates and Bradford cited one study of 282 restaurant franchises where 92 percent of them were earning *less* than profit projections used by franchisors in their promotional literature (Bates and Bradford 1995). As a voluntary item, earnings claim disclosure may be indicative of a more forthcoming or better performing franchise, when compared to those who elect not to provide this information to prospective franchisees.

5.3.11 Correlation of variables

Some variables within sub-items were found to be significantly correlated, such as an owner on-site requirement and obligations for an owner to devote full-time to operation of a franchise in sub-item *q,* and disclosure of renewal terms and permission to transfer a franchise agreement in sub-item *t*. In order to obtain a more complete look at overall terms of a UFOC and franchise agreement, all variables were entered into a correlation matrix. A correlation table is presented in Appendix B, Table B5.

Analysis revealed that several variables in one sub-item were significantly correlated with variables from other sub-items. For example, a requirement to limit products or services offered at a franchise outlet to only approved products was significantly correlated to the granting of exclusive territories (.374), and a right of a franchisor to approve managers selected by a franchisee (.577). A franchisor's right to approve a product line was also correlated to a right to inspect a franchised outlet (.368). This implies that some franchise agreements are more restrictive than others, and that restrictions found in one sub-item may be indicative that restrictions exist in other sub-items as well.

5.4 Summary

This chapter explored franchising's formal context through systematic examination of disclosure and contractual agreements. Widely held assumptions of uniformity could not be supported in this analysis. Shane's assertion that "franchisors actually offer standard contracts" (Shane 1998, p. 703) also could not be supported by this study's empirical findings. This exploratory study revealed that although frameworks for disclosure documents followed a uniformly prescribed format, contents of these documents varied among franchises in the sample. Some franchises were found to exert substantial influence over operations of their franchised outlets, such as those that stipulated hours of operation or reserved the right to interview customers. Contrary to a view that categorizes all franchise agreements as 'tying' contracts, some franchises in this sample did not require that products or supplies be purchased exclusively through a franchisor or their approved suppliers. This analysis suggests that franchisors do not all exert the same level of continuing control over franchised outlets, consistent with some previous studies (e.g., (Adams, Jones et al. 1997)).

6.0 FRANCHISING'S FORMAL CONTEXT AND DIFFERENTIAL PERFORMANCE: AN ANALYSIS OF SECONDARY DATA

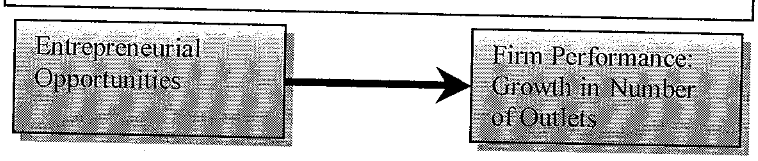
6.1 INTRODUCTION

As described in the Introduction Chapter, the overall purpose of this study is to explore entrepreneurial opportunities within franchising's context. Stanworth observed that franchising's context was comprised of a formal constituent, characterized by contractual agreements and official documents, and an informal one, in which the day-to-day operations of business were conducted (Stanworth 1995). Consistent with Stanworth's approach, this portion of the study builds on the previous section, and continues an examination of franchising's formal context.

The previous section began with an exploration and analysis of fifty-five Uniform Franchise Offering Circulars (UFOC) and franchise agreements. Widely held assumptions of uniformity among firms engaged in franchising were not supported in that analysis, as differences in contractual provisions and organizational complexities were revealed. To the extent that franchising's formal constituent shapes firm behaviour, discontinuities and heterogeneity among firms may be surrogates of potential entrepreneurial opportunities. Further exploration appeared justified.

This section employs contributions from the corporate entrepreneurship literature to test previously developed hypotheses using secondary data sources.

Figure 6.1: Entrepreneurial Opportunities and Firm



A key goal of this section is to further explore relationships between entrepreneurial opportunities and firm performance, measured by growth in number of outlets, as depicted in Figure 6.1.

One approach to explore entrepreneurial opportunities within franchising's context is to examine characteristics that differentiate growing franchises from others. Growth has been widely accepted as an indicator of entrepreneurship (Drucker 1985); (Penrose 1968); (Schumpeter 1934). Growth has been associated with entrepreneurship in small firms (Birley and Westhead 1990); (Carland, Hoy et al. 1984); (Davidsson 1989); (Storey 1987) as well as in large firms (Covin and Miles 1999); (Kanter 1996); (Slevin and Covin 1997). Consistent with corporate venturing (Block and MacMillan 1993); (Guth and Ginsberg 1990), growth among franchising firms is substantially dependent upon creation of new business units. It follows, then, that growth should also serve as an indicator of entrepreneurial opportunities within hybrid organization structures, such as those found in franchising.

Although the Methods Chapter described three datasets used in this portion of the study, this chapter begins with a brief summary of the FRANDATA, *Entrepreneur* Magazine, and Bond's Source Book Publications datasets. Each dataset provided different information relevant to this study. FRANDATA provided extensive information on fees, agreement offerings, and other details not found in other datasets, while Source Book listed each franchise's projected new openings for the next twelve months. In addition, their survey gathered information from franchisors on the extent and geographic location of their expansion plans. Widely used by academics and practitioners, *Entrepreneur* Magazine's dataset provides a link to previous studies of franchising.

Next, descriptive statistics are presented, including a crosstabs analysis that illustrated relationships among variables in the three datasets. To begin testing hypotheses developed in a previous chapter, four measures of franchise growth were operationalized. Correlation and ANOVA analyses follows, testing hypotheses developed in the previous chapter. To determine the extent to which variables obtained from franchising's formal context explain growth, factor analysis and multiple regression analysis are performed. This chapter concludes with a summary of the analyses.

6.2 Dataset Description Summaries

Although detailed descriptions of secondary datasets used in this study are provided in the Methods Chapter, a brief summary of FRANDATA, *Entrepreneur* Magazine's Franchise 500® 2000 Edition, and Source Book Publications datasets is presented in this chapter. Pilling et al. used multiple datasets in their study of competition among franchising firms (Pilling, Henson et al. 1995). The authors argued that although testing hypotheses in separate databases made comparisons of results more difficult, it "significantly increases the insights provided by the research" (p. 185) In the absence of a singular, official source of franchise data,[108] multiple datasets were employed in this portion of the study.

[108] The U.S. Department of Commerce ceased publication of its *Franchising in the Economy* in 1988.

6.2.1 Dataset Description Summary- FRANDATA

Data used in this portion of the study were collected as a random sample of 592 franchises from FRANDATA Corporation's database.[109] FRANDATA maintains an active customer base of over 2,500 franchise concepts - including each of the 100 largest companies involved in franchising. Jambulingham and Nevin concluded, "Extensive research indicated that FRANDATA's database was the most complete available" (p. 376) (Jambulingham and Nevin 1999). FRANDATA distributed information through customized research reports, and through its four websites: FranchiseResearch.com, FranchiseRegistry.com, FranchiseDocs.com, and FranchisePlanet.com. Data for this study were gathered through the FranchisePlanet.com website, promoted by FRANDATA as the single largest source of objective data available about the U.S. franchise industry. A copy of a FRANDATA *Snapshots* web page, the source of information for this dataset, is included in Appendix E, Table E1.

6.2.2 Dataset Description Summary- *Entrepreneur* Magazine Franchise 500®

Since 1980, *Entrepreneur* Magazine has published its Franchise 500® ranking of franchises, providing quantifiable and comparative measures of franchise opportunities. This dataset has been considered as a reliable source of franchise information (Shane 1996). Only franchises who provide Uniform Franchise Offering Circulars (UFOCs) or Alberta Disclosure documents, and whose responses are verified by the magazine are

[109] FRANDATA Corporation is a leading supplier of information to and about the franchising industry. Founded in 1989, FRANDATA developed and maintains a proprietary database, compiled from independently verified data gathered from individual UFOC documents. According to the company, the dataset represents the largest private collection of current and archived UFOCs in the world. FRANDATA has relationships with a variety of regulatory and industry agencies, including the U.S. Small Business Administration (SBA), Federal Trade Commission (FTC), North American Securities Administrators Association (NASAA), International Franchise Association (IFA), American Franchisee Association (AFA), and the National Franchise Council (NFC).

included in *Entrepreneur's* rankings. An independent accounting firm audits all financial data provided by franchisors before publication (p. 196).[110]

In its 2001 edition, *Entrepreneur* Magazine explained that its rankings do not endorse, advertise, or recommend any particular franchise, but rather serve as "a research tool…to compare franchise operations" (anonymous 2001, P. 174). According to the magazine, its Franchise 500® is "the best and most comprehensive rating of franchises in the world," using a system "polished and perfected," with a "formula that accurately identifies today's top franchise opportunities" (p. 174).

In addition to its use by potential franchisees, *Entrepreneur's* Franchise 500® dataset has also been used in academic research. With the demise of the U.S. Department of Commerce's *Franchising in the Economy* in 1988, statistical data on franchising has not been available from official government sources.[111] Castrogiovanni et al. used *Entrepreneur's* data to test the representativeness of their sample in a study of franchisor types (Castrogiovanni, Bennet et al. 1995). Shane also used this data to examine survival and growth of new franchisors (Shane 1996). Exit from *Entrepreneur's* listing served as his dependent variable in a later study of franchisor failure (Shane and Foo 1998). Lafontaine and Shaw compared exit from *Entrepreneur's* listing to exit from the trade publication "Franchise Annual," concluding that exit from *Entrepreneur's* listing accurately reflected exit from

[110] *Entrepreneur* Magazine noted that research for the 2000 Franchise 500® was compiled by Maria Anton Conley, Lee Houston, and Liza Dembiec, with assistance from Bowen Park and Megan Reilly; financial analysis was performed by David R. Juedes, CPA (anonymous 2001, P. 175).

[111] Trade associations, such as the International Franchise Association (IFA) and the American Franchisee Association (AFA), have also become involved in data collection and dissemination on franchising.

franchising (Lafontaine and Shaw 1998). Despite limitations noted by Lafontaine,[112] the *Entrepreneur* Franchise 500® is considered a reliable source of quantitative information on franchising (Shane 1996).

6.2.3 Dataset Description Summary- Source Book Publications

Data for this portion of the study were also gathered from Source Book Publications of Oak Brook, California, publisher of *Bond's Franchise Guide.*[113] In their comparison of three sources of franchise data, Mehta et al. concluded that Source Book Publication's *Bond's Franchise Guide* was a reliable source of information for studies of franchising (Mehta, Luza et al. 1999). The publisher conducted a survey of franchisors for its *Guide*, and published individual responses on their website, at http://www.worldfranchising.com. Source Book's survey collected data in broad categories, as described in Table 6.1:

Table 6.1: Categories of Data in Source Book Dataset

Franchisor Background	Age, Experience, Total number of units, Number of projected new units
Financial Requirements	Average investment costs, Fees
Contract Provisions	Area development, Passive ownership, Sub
Franchisor Support	Financial Assistance, Training
Expansion Plans	Expansion intentions in U.S., Canadian, and overseas markets

A copy of Source Book's questionnaire used in their survey is included in Appendix F.

[112] Lafontaine noted that although the *Entrepreneur* Magazine dataset provided "the most detailed longitudinal data set on individual franchisors," (p. 15) based on a comparison with the U.S. Department of Commerce's *Franchising in the Economy* survey, *Entrepreneur's* data set was not representative of the population of firms engaged in franchising (Lafontaine 1995).

[113] The data, questionnaire, and other information is available at http://www.worldfranchising.com .

6.3 Differences Among Three Franchise Data Sources

This section provides descriptive analyses for FRANDATA, *Entrepreneur* Magazine, and Source Book Publications datasets, followed by an ANOVA comparison of these widely used sources of franchise data. In addition to basic information such as size, fees, and number of years in operation, each source of data gathered different facts from franchising companies relevant to this study. For example, FRANDATA collected the number of different programs and business types offered by franchisors. *Entrepreneur* Magazine's dataset contained larger, more mature systems, and served as a basis of comparison with previous studies of franchising. Source Book's dataset, derived from the publisher's survey of franchisors, not only provided historic measures of growth, but also revealed the number of new outlets projected in the upcoming twelve months and geographic focus of each franchisor's growth strategy. Collectively, these datasets revealed intricacies and complexities among firms engaged in franchising greater than those often presented in the literature.

6.3.1 Descriptive Analysis: FRANDATA

In aggregate, firms in FRANDATA's sample represented 157,518 franchised and 28,771 company-owned outlets, averaging 266.08 franchised and 48.6 company-owned outlets per firm.[114] Subway, the largest firm in the sample, had 11,541 franchised outlets, while Radio Shack had the largest number of company-owned stores with 5,014 outlets. Only 36.3 percent of firms in this sample used franchised outlets exclusively in

[114] As presented in Section 3.3.3 and depicted in Figure 3.3, some firms engaged in franchising simultaneously operate a number of outlets using corporate managers. Company-owned outlets may be used for test marketing of new products or services and/or training. A franchisor may assume temporary ownership of an outlet in cases of franchise default or termination, or it may be a permanent part of a company's strategy and financial asset base. Since there was no practical method of differentiating among strategies, and because company-owned outlets contribute to economies of scale and scope in similar fashion to franchised outlets, they were included in measures of franchise system size.

their organizations, while a majority of firms (63.7%) simultaneously employed combinations of franchised and company-owned outlets, using a "plural" form of organization (Bradach 1997).

On average, firms in this sample had been in business for 21.36 years, had 5.92 years of business experience before they began to offer franchises, and had been franchising for more than 15 years.[115] There were also firms without franchising experience in this sample, as 35 firms (5.9%) currently offered franchises to prospective franchisees, but had not yet reported opening of their first franchised outlet.[116] Exclusive territorial rights were granted by 78.5 percent of the franchises in this sample, while 280 (47.3%) offered financial assistance to franchisees. The majority of franchises in this sample (70.3%) did not offer agreements that covered purchase of multiple outlets, and a similar number (70.4%) did not offer area development agreements. Average franchise fees for firms in this sample ranged between $21,598 and $27,141.

Contractual obligations associated with a franchise purchase varied among firms in this sample. Franchise agreements in this sample had an average term of 10.8 years. Analysis of the 1,969 franchises in FRANDATA's database revealed that although a large percentage had 10-year contract terms, more than half of these franchises had terms covering shorter or longer periods of time, as presented in Table 6.2.

[115] Based on year of incorporation, the five oldest franchises in this sample averaged 87.8 years in business before they began franchising.
[116] FRANDATA and other sources of secondary data utilize UFOC documents as their source of data. Only updated annually, there is likely to be a substantial delay between the opening of an outlet and its inclusion in a UFOC. Firms offering franchises were included in this dataset.

Table 6.2: Term of Franchise Agreements		
Term (yrs)	Count	Percent
N/A	34	1.73%
0-4	90	4.57%
5-9	474	24.07%
10	937	47.59%
11-15	141	7.16%
16-20	266	13.51%
>20	27	1.37%
TOTAL	**1969**	**100.00%**

Source: FRANDATA, obtained at http://www.FranchisePlanet.com .

In addition to franchise agreements and UFOCs, franchisors in this sample required prospective franchisees to sign an average of 3.23 agreements as conditions of their purchase.[117] BAB Systems, Inc., for example, required prospective franchisees to sign 17 separate agreements in order to purchase one of their Big Apple Bagels franchises, including a BAB Operations Supply Agreement, a Fixed Price Purchase Option, a Master Lease Agreement, and a Security Agreement.

Although in a minority, 15.2 percent of franchisors in this sample offered other programs through which potential franchisees could become a part of their system, in addition to their original concept. Baskin Robbins, for example, offered a separate institutional program for schools and universities in addition to its original ice cream store franchise. Institutional program franchisees operate smaller facilities and have lower start-up costs than standard concept franchisees. CKE Enterprises, a fast-food restaurant chain, offered Carl's Jr./ Hardee's dual-concept franchises, as well as Carl's Jr./ Green Burrito franchise programs. These dual concept franchises are evident in the

[117] Dollar Rent-a-Car, International House of Pancakes, Jiffy Lube, and Sterling Vision each required as many as 11 agreements, while Howard Johnson's and Carvel each required 10 agreements to be signed as conditions of purchase.

co-branded outlets as described in Section 3.3.4. Distribution of other programs offered by firms engaged in franchising is presented in Table 6.2.

Table 6.2: FRANDATA-Number of Other Programs to Become Franchisee

		Frequency	Percent	Valid Percent	Cum. Percent
Valid	0	502	84.8	84.8	84.8
	1	65	11.0	11.0	95.8
	2	15	2.5	2.5	98.3
	3	4	.7	.7	99.0
	4	2	.3	.3	99.3
	7	4	.7	.7	100.0
	Total	592	100.0	100.0	

In addition to other programs, some franchises offered additional business types as vehicles for prospective franchisees to enter their franchising system. Dunkin Donuts, for example, offered a Combo Store business, a Conversion Program, and a Cooperative Production Program in addition to their basic type of donut shop franchise. Each franchise is offered under a separate franchise agreement. The distribution of firms offering different business types is presented in Table 6.3 below.

Table 6.3: FRANDATA- Number of Additional Business types

		Frequency	Percent	Valid Percent	Cum Percent
Valid	0	487	82.3	82.3	82.3
	1	90	15.2	15.2	97.5
	2	13	2.2	2.2	99.7
	3	2	.3	.3	100.0
	Total	592	100.0	100.0	

Although a majority of franchises in this sample offered only their core franchise, a sizable minority (17.7 percent) offered additional business types, each under different franchise agreements, with potentially different terms, conditions, and fees.

Appendix B, Table B6 presents means and standard deviations for continuous variables, and frequencies and percentages for dichotomous and categorical variables from this FRANDATA sample dataset.

6.3.2 Descriptive Analysis: *Entrepreneur* Magazine

The *Entrepreneur* Magazine's Franchise 500® sample included 598 ranked and unranked franchises. In aggregate, the sample represented firms with 335,871 total outlets: 289,287 franchised and 46,584 company-owned outlets. With 24,256 franchised outlets, Kumon Math and Reading Centers represented the largest franchise in this sample. On average, firms in this sample had been in existence for 23.42 years, had been franchising for more than 16 years, and had operated for more than seven years before beginning to franchise. Dividing the number of franchised outlets by the total number of outlets in each franchise, a percentage of units franchised was calculated. In aggregate, firms in this sample increased the percentage of total units franchised from 87.47 percent in 1997, to 88.31 percent in 1998, to 88.88 in 1999.

Because franchise fees may vary with different programs or business types, *Entrepreneur's* dataset presented franchise fees as a high and low average.[118] Franchise fees in this sample, ranged from an average low of $20,550 to an average high of $26,070. Average start-up costs, which includes franchise fees ranged from $258,920 to $532,210. Of the 597 franchises in this sample, 404 franchises (67.6%) included some form of financial assistance to prospective franchisees. A summary of the

[118] Franchise fees may differ among franchises offered by the same franchisor. For example, fees may be based on factors such as population or number of households in a franchisee's specific territory. Franchisors may also charge different fees for area director franchises or those that involve other programs or business types, as described in the previous section.

descriptive statistics from *Entrepreneur* Magazine's Franchise 500® dataset is presented in Table 6.4.

Table 6.4: Descriptive Statistics *Entrepreneur* Magazine Dataset Variables						
	Min.	**Max.**	**Mean**	**Std. Dev.**	**Freq.**	**Percent.**
AGE	3	135	23.42	16.29		
EXP	3	75	16.10	10.94		
OPB4F	0	129	7.32	12.60		
F97	1	19720	418.69	1481.83		
F98	1	19667	445.30	1538.91		
F99	1	24256	483.76	1747.14		
C97	0	5433	75.13	457.16		
C98	0	5223	76.30	452.72		
C99	0	5729	77.90	457.84		
PERF97	.69	100.00	87.47	20.31		
PERF98	.88	100.00	88.31	19.26		
PERF99	.90	100.00	88.88	18.28		
FEEL[a]	.00	89.50	20.55	11.48		
FEEH[a]	.00	200.00	26.07	17.08		
STARTLO[a]	1.00	30000.00	258.92	1556.44		
STARTHI[a]	1.80	45000.00	532.21	2692.92		
FIN No=0					193	32.3
Yes=1					404	67.6
[a] In thousands of U.S. dollars; Valid N=572						

Descriptive statistics and correlations for *Entrepreneur* Magazine's dataset are provided in Table B18 of Appendix B.

6.3.3 Descriptive Analysis: Source Book Publications

Source Book Publications provided information on 1,201 North American franchises through their http://www.worldfranchising.com website. This sample was comprised of 1,026 franchises (85.4%) headquartered in the United States, and 175 Canadian-based franchises. In aggregate, franchised outlets in the U.S. accounted for 254,778 of the total (71.5%), while 32,448 outlets were located in Canada (9.1%), and 68,981 (19.4%) were international outlets. Table 6.5 depicts geographic distribution of outlets among firms in this sample.

Table 6.5: Descriptive Statistics Source Book Publications Dataset Variables						
	Min.	**Max.**	**Mean**	**Std. Dev.**	**Freq.**	**Percent.**
NUMUS[a]	0	12627	212.14	749.19		
NUMCA[b]	0	3555	27.04	139.19		
NUMIN[a]	0	12836	57.44	567.48		
SIZE[b]	1	26588	303.95	1265.53		
NFRA[a]	0	20531	260.85	1068.51		
NCOM[a]	0	6057	43.10	300.77		
HQ[a]	Canada				175	14.6%
	U.S.				1026	85.4%

[a]N= 1201; [b]N= 1202

NUMUS= Number of U.S. outlets
NUMCA= Number of Canadian outlets
NUMIN= Number of international outlets
SIZE= Total number of outlets
NFRA= Number of franchised outlets
NCOM= Number of company-owned outlets
HQ= Location of headquarters

On average, franchises in this sample had 303.95 total outlets, 260.85 outlets franchised (81.54 percent) and 43.1 company-owned outlets. Average age of franchisors, as measured by the date a firm was established, was 23.13 years, while the number of years since firms began franchising averaged 15.37 years. The average term of franchise agreements in this sample was 10.88 years.

In pecuniary terms, franchises in this sample charged franchise fees that averaged \$21,900, and required a low and high mean initial investment of between \$242,210 and \$500,130 respectively. Of those franchises that charged royalties based on a percentage of sales, the average royalty was 5.38 percent. Nearly half of the franchises in this sample (46.1%) provided indirect financing support for prospective franchisees, while almost one-third (30.2%) offered franchisees no financial assistance.[119] Earnings claims information, voluntary under current U.S. Federal Trade Commission guidelines, were provided by 26.3 percent of respondents in this sample, consistent with the ratio

[119] A small minority (1.7%) offered both direct and indirect financial assistance.

revealed in Price's study (Price 2000), but higher than a 20 percent estimate provided by the U.S. Federal Trade Commission (Government 1997).

Also revealed though this survey were organizational differences among franchisors. Passive ownership, where a franchise owner need not be an active participant in daily operations of an outlet, were prohibited by only 25.1 percent of franchises in this sample. A majority of franchises in this sample allowed or discouraged passive ownership of their franchised outlets. Area development agreements were offered by more than half of the franchises (51.8%), introducing a layer of supervision and support between owners of franchised outlets and their franchisor.

While a majority of franchises prohibited their franchisees from sub-franchising, 22.1 percent of franchises permitted this practice within a franchisee's designated area. A majority of franchises in this sample (83.1%) permitted expansion by existing franchisees within their territory.[120] Although franchisors in this sample projected to open an average of 33.2 outlets in the upcoming 12 months, a high standard deviation (96.88) indicated that projected growth was not uniformly distributed among franchises. Descriptive statistics for Source Book Publication's dataset are summarized Appendix B, Table B7. Complete descriptive statistics and correlations are provided in Table B19 of Appendix B.

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[120] Collectively measuring subfranchising and area development Kaufmann and Kim found that 57 percent of the franchises in their sample engaged in these practices (Kaufmann and Kim 1995).

6.3.4 Comparison of Datasets

As described in the Introduction section of this chapter, each dataset provided different information relevant to this study. FRANDATA provided extensive information on fees, agreement offerings, and details not found in other datasets. *Entrepreneur* Magazine's data had served as a basis of comparison in previous studies of franchising, and Source Book Publications gathered anticipated growth information, listing projected new openings and geographic expansion strategies.

Lafontaine compared several datasets, including *Entrepreneur* Magazine's and Source Book Publications, to the last official publication of *Franchising in the Economy* (Lafontaine 1995). Building on her work, Mehta et al. compared data from three widely used sources of secondary data on franchising: *Entrepreneur* Magazine, *Franchise Annual*, and Source Book's *Bond's Franchise Guide* (Mehta, Luza et al. 1999). The authors argued that comparisons of quantitative data from widely used sources of franchise information were important for several reasons. First, there is no longer a single, official source of franchise information, and practitioners in franchise selection processes often use these datasets. Second, academics use these datasets for sample frame development as a source for franchisor contact information. Third, these datasets have been used for theory validation, hypothesis development and testing (Shane 1995), and sample validation (e.g., (Castrogiovanni, Justis et al. 1993)). Mehta et al. used ANOVA to examine differences among the three datasets using eight metric variables. The authors concluded that although each dataset included different franchises, there were no significant differences found in their analysis.

Before proceeding with theoretical development and hypothesis testing, the three datasets used in this study were compared using ANOVA to determine if they could be used independently. None of the datasets used in this study were posited as representative of the population of franchises. This comparison was conducted to see if findings developed in one of the datasets could be generalized to the other. Therefore, a logical first step would be to examine the level of relative similarity among the datasets (Trochim 2001).

The three datasets were compared using one-way ANOVA, based on five common variables: total number of units (SIZE), number of years since incorporation (AGE), average franchise fee (FEE), number of franchised outlets (#Franch), and number of company-owned outlets (#Comp.). Table 6.6 below summarizes the findings.

Table 6.6: ANOVA Comparison of Three Datasets

	Descriptives				95% Confidence Interval for Mean		Homogeneity Of Variance		ANOVA	
	Dataset	N	Mean	Std. Dev.	Lower	Upper	Sig.	Levene	F	Sig.
Size	1	583	262.43	675.62	207.47	317.38				
	2	588	432.80	1225.31	333.56	532.05				
	3	1192	294.59	716.12	201.45	282.84				
	Total	2363	294.59	866.36	259.64	329.54	.000	18.179	10.146	.000
Age	1	583	20.90	14.83	19.69	22.10				
	2	588	22.94	15.15	21.72	24.17				
	3	1192	22.69	15.18	21.83	23.55				
	Total	2363	22.31	15.10	21.70	22.92	.986	.014	3.456	.032
Fee	1	583	23560.69	11785.91	22601.99	24519.38				
	2	567	23213.87	11908.64	22231.56	24196.18				
	3	1102	21879.61	11938.93	21173.94	22585.28				
	Total	2252	22650.74	11911.20	22158.53	23142.96	.986	.014	4.659	.010
#Franch.	1	583	217.42	541.64	173.36	261.47				
	2	588	369.38	1039.49	285.19	453.57				
	3	1191	209.24	622.22	173.87	244.61				
	Total	2362	251.12	735.35	221.45	280.79	.000	17.095	10.227	.000
#Comp.	1	583	45.01	269.40	23.09	66.93				
	2	588	63.42	382.67	32.43	94.42				
	3	1191	32.85	217.21	20.50	45.20				
	Total	2362	43.46	279.70	32.18	54.75	.001	7.436	2.366	.094

Dataset 1= FRANDATA; Dataset 2= *Entrepreneur* Magazine; Dataset 3= Source Book Publications

Levene's homogeneity of variance test revealed that equal variance assumptions could not be made for size, number of franchises, and number of company-owned outlets. Post hoc tests using Tamhane and Dunnett T3 multiple comparisons revealed that the FRANDATA and Source Book datasets did not differ in terms of size and number of franchises. Although assumptions of equality in the number of company-owned outlets could not be rejected, ANOVA analysis revealed differences among the three datasets.

This finding is inconsistent with Mehta et al., who found no significant differences among variables between the *Entrepreneur* magazine and Source Book datasets in a similar analysis (Mehta, Luza et al. 1999). The implications of this finding suggest that generalizability of the findings using any given dataset are restricted to firms in that sample.

6.3.5 Crosstabs Analysis of Contractual Provisions and Franchise Characteristics

Franchise agreements have been viewed as long-term relational contracts, with an average term of ten years (Leblebici and Shalley 1996). Comparatively little is known about these agreements and their relationship with firm characteristics or strategy, despite their focal position in franchising. For example, longer-term agreements potentially reduce franchisor income derived from renewal fees, although they potentially add stability to a system by reducing franchisee turnover. Contractual terms may also affect an ability to attract potential franchisees. Franchisees who choose franchising as a lifestyle may be more attracted to franchises with longer-term agreements. Younger, less-proven concepts may be compelled to offer shorter agreements, while larger, more mature franchises may be able to command longer terms, based on their market presence.

Examination of 55 UFOC and franchise agreements conducted earlier in this study revealed substantive differences in franchise agreement provisions. Contractual provisions may serve as indicators of firm behaviour within franchising's context, facilitating comparisons among firms. Comparative studies of firm behaviour formed a basis for development of corporate entrepreneurship theory (Stevenson and Jarillo 1990). This section examines relationships between contract provisions and characteristics of franchising firms. Relationships between these variables and comparative growth among franchising firms follows.

To explore relationships between contractual provisions and franchise characteristics, variables from FRANDATA's dataset were operationalized as binary and ordinal variables.

Table 6.7: Franchise Contractual Provisions and Characteristics (FRANDATA)

Provision		Description	Variable
	DEV	Development agreement offered	binary
	MULTI	Multi-unit agreement offered	binary
	EXCL	Exclusive territory offered	binary
	NUM	Number of agreements	ordinal
	TERM	Agreement term	ordinal
	FIN	Financing offered	ordinal
	BIZTYPE	Number of business types offered	ordinal
	OTHER	Number of other programs offered	ordinal
Characteristic			
	YBF	Years in operation before franchising	ordinal
	NFRA	Number of franchised outlets	ordinal
	NCOM	Number of company-owned outlets	ordinal
	FEEL	Low average franchise fee	ordinal
	FEEH	High average franchise fee	ordinal
	AGE	Number of years since incorporation	ordinal
	EXP	Number of years franchising	ordinal
	SIZE	Number of outlets in system	ordinal
	PERF	Percentage of total outlets franchised	ordinal
	CAGR	Compound average growth rate	ordinal

This dataset provided several measure of franchise contractual provisions, including term of an agreement, a provision for territorial exclusivity, and the number of agreements franchisees are required to sign as a condition of purchase.[121] Variables were operationalized as depicted in Table 6.7.

Crosstabs analysis was performed using SPSS v10 for Windows. Significance level of .05 was adopted, based on an asymptotic distribution assumption. Chi-square, correlations, and Kendall's tau-b statistics were calculated. Tau-b was chosen as a measure of nonparametric association, and served as an indicator of strength and direction for the variables, taking ties into account. Table 6.8 presents significant relationships revealed in this crosstabs analysis.

Table 6.8: Significant Relationships Between Contractual Provisions and Franchise Characteristics: FRANDATA

		Contractual Provisions							
		DEV	MULTI	EXCL	NUM	TERM	FIN	BIZTYPE	OTHER
Franchise Characteristics	YBF				.017				
	NFRA		.001	.000	.000	.000	.000	.003	.000
	NCOM	.000			.000	.004			
	FEEL	.000	.018		.003	.003			
	FEEH	.010			.002	.003			.032
	AGE		.010		.000	.000	.000	.000	.000
	EXP		.029	.014	.001	.000	.000	.001	.000
	SIZE		.004	.000	.000	.012	.000	.000	.000
	PERFRAN	.000			.004				
	CAGR					.012			

Chi-Square tests revealed several significant relationships between contractual provisions and franchise characteristics. Only the term of a franchise agreement, operationalized as an ordinal variable "TERM," was found to have a significant (.045) although weak and negative (tau-b of -.077) relationship with franchise growth, as measured by CAGR. TERM was also significantly associated with larger, more mature franchise systems, and with those charging higher franchise fees. A complete crosstabs analysis of this dataset is presented in Table B8 of Appendix B.

[121] In addition to a franchise agreement, some franchisors require prospective franchisees to sign additional agreements as a condition of franchise purchase. Some franchises also offer other business types and other programs as a means to become franchisees in their system.

Selected contractual provisions were also contained in Source Book Publication's dataset. Similar to FRANDATA, franchisor financial assistance, area development agreements, and term of franchise agreements were disclosed. Different contractual provisions, such as permission to sub-franchise, passive ownership, franchise expansion in territory, and voluntary disclosure of earnings claims were also provided in this dataset. Source Book's dataset supplied several measures of franchise growth, including number of projected new openings anticipated in the next twelve months and geographic areas targeted for expansion. In similar fashion to the previous analysis of FRANDATA's dataset, categorical variables were operationalized to enable a crosstabs analysis. These variables are presented in Table 6.9 below.

Table 6.9: Franchise Contractual Provisions and Characteristics (Source Book)

Provision		Description	Variable
	DEV	Development agreement offered	binary
	SUB	Sub-franchising permitted	binary
	PASS	Passive Ownership permitted	binary
	EXT	Expansion in territory permitted	binary
	FIN	Financing offered	binary
	EC	Earnings claim provided	binary
	TERM	Term of agreement	ordinal
	HQ	US or Canadian headquarters	binary
Characteristic			
	YBF	Years in operation before franchising	ordinal
	NFRA	Number of franchised outlets	ordinal
	NCOM	Number of company-owned outlets	ordinal
	FFEE	Average franchise fee	ordinal
	AGE	Number of years since incorporation	ordinal
	ILOW	Low average initial investment	ordinal
	IHIGH	High average initial investment	ordinal
	EXP	Experience in franchising	ordinal
	SIZE	Number of total outlets	ordinal
	PERF	Percentage of total outlets franchised	ordinal
	GROWTH	Percentage growth projected	ordinal
	CAGR	Compound average growth rate	ordinal
	PNU	Projected new outlet openings	ordinal
	EXPUS	Expansion plans for US market	ordinal
	EXPCAN	Expansion plans for Canadian market	ordinal
	EXPINT	Expansion plans for overseas markets	ordinal

Crosstabs analysis of this dataset using Tau-b measures of association revealed the existence of similar relationships between contractual provisions and franchise firm characteristics as those found in FRANDATA's dataset. Chi-Square analysis revealed significant relationships existed between contractual provisions and characteristics of firms in this dataset, as evident in Table 6.10.

Table 6.10: Significant Relationships Between Contractual Provisions and Franchise Characteristics: Source Book

		Contractual Provisions							
		DEV	**SUB**	**PASS**	**EXT**	**FIN**	**EC**	**TERM**	**HQ**
Franchise Characteristics	YBF		.006						
	NFRA					.000		.000	
	NCOM	.000				.007	.000	.000	
	FFEE	.002	.002				.002	.000	.000
	AGE						.024	.000	
	ILOW	.000	.015			.001	.000	.000	.000
	IHIGH	.000				.004	.001	.000	
	EXP		.017	.027				.000	.000
	SIZE					.008	.032	.000	
	PERF	.000	.001			.000	.029	.004	.019
	GROWTH	.031		.006				.000	.000
	CAGR					.002		.007	
	PNU	.003		.017		.000			.000
	EXPUS			.000	.047	.000			.000
	EXPCAN		.000			.005		.010	.000
	EXPINT	.000	.000	.005		.002			

Although the chi-square analysis indicated that relationships existed among variables, correlation analysis was used to determine the strength and direction of those relationships. Financing provisions were associated with larger firms, both in terms of number of franchised outlets (NFRA= .100) and total number of outlets (SIZE= .073). A negative relationship between franchise agreement term and CAGR (-.067) was also consistent with that found in the FRANDATA dataset. Significant associations between TERM and NFRA (.096), NCOM (.145), AGE (.180), EXP (.173), and SIZE (.113) were comparable to relationships revealed in the FRANDATA analysis. Development agreement provisions were positively associated with number of company-owned outlets. Significant relationships between DEV and NCOM (.129) and PERF (-.111) were revealed, consistent with the FRANDATA sample. A complete crosstabs table from Source Book's dataset is presented in Appendix B, Table B9.

This analysis of Source Book's dataset revealed relationships inconsistent with those found in the previous analysis using FRANDATA's dataset. For example, significant associations between a provision to provide financing and the age and experience of a firm were revealed in the FRANDATA dataset. These relationships were not evident in Source Book's dataset. In addition to an ANOVA comparison performed in section 6.3.4, this section provided further evidence of differences among secondary datasets used in studies of franchising.

6.4 Franchise Growth

Franchising's aggregate growth rates have been a topic of debate among academics and practitioners (c.f. (anonymous 1999); (Lafontaine and Shaw 1998); (Stanworth, Purdy et al. 1997)). Franchising has been considered a powerful means to effect growth (Birley, Leleux et al. 1997), enabling firms to grow at a faster rate than through exclusive use of internal resources. Franchising firms grow by a combination of: (1) increasing same store turnover; and/or (2) opening additional outlets. Bradach concluded that firms engaged in franchising rely heavily on adding new units, because it is difficult to stimulate sales in existing units (Bradach 1998). Hoffman argued that franchising represented the only business strategy in which the creation of new business units is central to its mission (Hoffman and Preble 1993).

Growth, as measured by a change in the number of outlets, has also been found to be a key factor in the survival of firms engaged in franchising. Shane studied the 1983 cohort of new franchisors in the U.S., and found that fewer than one quarter were still franchising ten years later (Shane 1995). His work revealed "surviving new franchisors have continuous growth in franchised outlets over the first ten years of system life" (p.19). Growth in new outlets was one measure used to determine the value of a franchise[122] (Baucus, Baucus et al. 1993), and was used as a dependent variable in Kaufmann and Kim's study of franchise system growth rates (Kaufmann and Kim 1995).

Although new unit development is important, it presents only a partial view of overall growth among firms in franchising. For example, a study of restaurant chains, an industry with a substantial franchise population, illustrated comparative contributions of same store sales and new unit development. Table 6.11 describes historic sources of growth by the 100 largest U.S. restaurant chains. It illustrates the importance of new unit development to overall growth in this industry, but also shows that its contribution to total growth varies over time.[123]

Table 6.11: Top 100 U.S. Restaurant Chains-Sources of Growth

	1995	**1996**	**1997**	**1998**	**1999**
Avg. Unit Sales Increase	2.9%	0.7%	0.8%	1.3%	3.2%
New Unit Development	2.6%	4.5%	4.1%	3.3%	2.2%
Total Growth	5.5%	5.2%	4.9%	4.6%	5.4%

Source: 2000 Chain Restaurant Industry Review & Outlook, Franchise Finance Corporation of America, p. 23 (FFCA 2000).

Table 6.10 illustrates that new unit development was responsible for 40 percent of restaurant chains' total growth in 1999, down from 71.7 percent in 1998 and 83.8 percent in 1997. Availability of data limited measures of growth in this study to changes in the number of units.

[122] Baucus et al. considered the age of the franchise, the market representation, and the growth of total retail outlets compared to the investment made by the franchisee in base fees and royalties to determine the value of the franchise.

[123] An example of relationships between number of franchised and company-owned outlets and sales turnover is provided in Brinker International's annual report. A copy of a relevant page from their report is found in Appendix 1, Figure 3.

To examine franchise growth in this study, four measures were used, reflecting different aspects of the phenomenon. First, franchise growth in number of outlets using compound annual growth rate was calculated. Next, franchise growth as measured by the number of new outlets projected to be opened in the next twelve months was measured. Next, franchise growth expressed as a percentage increase in the number of exiting outlets was calculated. Finally, franchise growth strategy was operationalized. Each is discussed in the following sections.

6.4.1 Franchise Growth: Compound Average Growth Rate

Kaufmann and Kim studied the effects of master franchising on system growth rates using compound average growth rate (CAGR) (Kaufmann and Kim 1995). This measure considers the average increase in number of outlets since the firm began operations.[124]

Examining firms that had been in existence for five or more years, CAGR was calculated for franchises in the three datasets. The 1,169 franchises in Source Book Publications dataset had a mean CAGR of 26.82 percent, those in *Entrepreneur* magazine's dataset averaged 32.94 percent, while FRANDATA's sample yielded a mean of 31.09 percent growth. Results of this comparison are presented in Table 6.12 below.

Table 6.12: Comparison of CAGR in Three Datasets

	N	Min.	Max.	Mean	Std. Dev.
Source Book	1169	0.00	1.93	.2682	.2139
Entrepreneur	591	0.00	1.98	.3294	.2442
FRANDATA	569	0.00	2.27	.3109	.2423

[124] Kaufmann and Kim calculated CAGR= (current number of outlets) $^{1/n}-1$; where n= age of the system in years. The authors noted that CAGR is unstable for new systems, where n is very small (p. 58) (Kaufmann and Kim 1995).

Consistent with Lafontaine's finding (Lafontaine 1995), firms in *Entrepreneur* magazine's dataset represented more mature franchises. Of the 598 firms in the dataset, 591 (98.8 percent) had been in operation for five or more years. Firms in *Entrepreneur* magazine's dataset also had a 6.1 percent higher average CAGR than those included in Source Book Publication's dataset. The magazine's dataset provided a longitudinal look at firms, providing data on number of franchised and company-owned outlets for the previous three-year period. In aggregate, firms in this sample increased their average number of franchised and company-owned outlets by 5.6 percent and 7.7 percent in the 1997-98 and 1998-99 periods respectively, as presented in Table 6.13:

Table 6.13: Mean of Franchised and Company-Owned Outlets & Change in Mean of Outlets Among Firms in 2000 Franchise 500®

	1997 Avg. Outlets	1998 Avg. Outlets	'97 to '98 Change	1999 Avg. Outlets	'98 to '99 Change
Franchised	418.69	445.30	6.4%	483.76	8.6%
Company-Owned	75.13	76.30	1.6%	77.90	2.1%
Total	493.82	521.60	5.6%	561.66	7.7%

6.4.2 Franchise Growth in Projected New Units

Of the three datasets used in this study, only Source Book Publications captured the number of projected openings expected for each franchise. A required disclosure in UFOCs, projected new openings may be a reliable measure of growth.[125] In aggregate terms, respondents to Source Book's survey stated that they intended to add 37,380 new outlets to their systems in the upcoming year. Franchises expected to open an average of 33.2 outlets, with a standard deviation of 96.88.[126] Sixteen franchises in the sample had projected new openings in excess of 300 outlets; Coverall projected an additional 1,782 openings, while Jani-King expected to add 1,500 outlets in the upcoming year.

[125] In the U.S., franchisors are required to officially disclose the number of projected new openings expected in the upcoming 12 months in Item 20 of the UFOC.
[126] N= 1126, Minimum= 0; Maximum =1782.

Subway and Peyron Tax Service each planned to add another 1,000 outlets to their systems.

6.4.3 Franchise Growth Rate

Using the number of projected new openings and the existing number of outlets in each franchise, a ratio of growth was calculated for each franchise. Franchises in this sample had an aggregate installed base of 365,046 units.[127] Given a projected 37,380 new units, franchisors projected an annual increase of 10.23 percent in the number of franchised and company-owned outlets.

In similar fashion, projected growth rates were calculated for each franchise. When calculated for individual firms, a mean growth rate was 58.57 percent was revealed, although a high standard deviation (132.48) indicated wide dispersion of growth rates among firms in this sample. Sixteen franchises that projected to add in excess of 300 units each were removed from the sample, yielding a mean and standard deviation in the number of projected new openings of 24.17 and 34.94 respectively for the 1110 remaining firms. Average growth percentage, recalculated for remaining firms, was virtually unchanged from the original sample at 58.87 percent.

Collectively, franchisors in this sample appeared optimistic in the number of outlets they projected to open in the next year, especially when compared to their historic growth rates. Excluding firms in existence for less than five years, historic growth as measured by CAGR had a mean value of 26.82 percent. Those firms would have to

[127] Notable among those franchises that did not respond to this question was McDonald's, with 26,588 total units.

attain an average 50.01 percent growth rate to achieve the number of new openings projected.

To determine relationships between CAGR, number of projected new outlet openings, and growth rates, a correlation analysis was performed on franchises in the Source Book Sample. The results are presented in Table 6.14.

Table 6.14: Correlation of Measures of Growth

	CAGR	PNU	GROWTH%
CAGR	1.0		
PNU	.315**	1.0	
GROWTH%	.033	.074**	1.0

A weak and statistically insignificant relationship between past growth rates, as measured by CAGR, and projected growth rates of franchises in this sample suggests that past growth rates may be less than reliable indicators of projected future growth.

6.4.4 Franchise Growth: Strategy

Franchising's growth has been studied on a macro level by academics (e.g., (Lafontaine and Shaw 1998) and practitioners (anonymous 1998). Growth has been considered central to franchising's mission (Hoffman and Preble 1993), and a key factor for survival for firms engaged in franchising (Shane 1995). Little is known, however, about similarities and differences in growth strategies among franchising firms.

In this portion of the study, expansion plans of North American franchisors in Source Book Publication's dataset are examined. Geographic expansion focused on three areas: (1) United States; (2) Canada; and (3) Overseas. To determine the extent of expansion within each area, franchisors were asked: (1) In which regions of the U.S. are you actively seeking new franchisees; (2) Are you actively seeking franchisees in

Canada, and if so, which Provinces; and (3) Are you actively seeking franchisees overseas, and if so, in which countries.

To reduce the number of variables to a manageable number, I coded individual responses into ordinal variables, with categories for no expansion, limited expansion, and unlimited expansion in each of three respective geographic areas.[128] Table 6.15 depicts the comparative extent and geographic focus of planned expansion.

Table 6.15: Franchisor Expansion Plans

	U.S.	Canada	Overseas
No Expansion	6.2%	39.9%	56.6%
Limited Expansion	27.0%	8.3%	16.1%
Unlimited Expansion	64.0%	48.5%	25.0%
Missing	2.7%	3.3%	3.9%
Total	100%	100%	100%
N= 1,202			

As displayed in Table 6.14, franchisors in this sample indicated a strong preference for U.S. expansion, with 91 percent of respondents indicating plans to expand on a limited or unlimited basis in this market. By comparison, less than half (41.1 percent) planned expansion in overseas markets. This finding conflicts with Shane's earlier study, which found more than 70 percent of U.S. franchises planned overseas expansion (Shane 1996).

Source Book's dataset was comprised of both Canadian and U.S.-based franchise systems. ANOVA analysis of age, size, and experience failed to produce significant differences between U.S.- and Canadian-based franchises. To control for possible differences in expansion plans, projected new openings were compared using an

[128] Those franchises who indicated an intent to expand were asked whether the expansion was directed toward a specific region or to all regions within the area. The responses were operationalized into a scale where 0= no expansion, 1= regional expansion, and 3= expansion to all regions within the area.

independent samples T-Test. The results, presented below in Table 6.16, indicate significant differences between U.S. and Canadian franchisors in terms of the number of outlets they project to open in the upcoming twelve months.

Table 6.16: ANOVA Comparison of U.S. and Canadian Franchises Projected New Outlets					
	N	Mean	Std. Dev.	F	Sig.
Canadian	166	19.48	52.08		
U.S.	960	35.57	102.49	3.916	.048

In addition to the number of projected new outlets, U.S. and Canadian-based franchises differed in the extent and geographic focus of their expansion plans in the U.S. and Canadian markets. As Table 6.17 depicts, differences in their overseas expansion plans, however, could not be supported in this analysis.

Table 6.17: Comparison of Expansion Plans for U.S. and Canada Headquartered Franchises									
		Headquarters		Chi-Square Test			Symmetric		
		U.S.	Canada	Chi-Square	df.	Exact Sig.[a]	Tau-b	Pearson R Value	Exact Sig.[a]
Expand U.S.[b]	No	7	68						
		0.7%	44.2%						
	Limited	302	22	420.816	2	.000	.282	.398	.000
		29.8%	14.3%						
	Unlimited	705	64						
		69.5%	41.6%						
Expand Canada[c]	No	475	4						
		48.1%	2.3%						
	Limited	55	45	165.008	2	.000	-.251	-.266	.000
		5.6%	26.0%						
	Unlimited	458	124						
		46.4%	71.7%						
Expand Overseas[d]	No	576	104						
		58.9%	60.8%						
	Limited	155	31	1.852	2	.396	.024	.028	.355
		15.8%	18.1%						
	Unlimited	252	36						
		25.6%	21.1%						

[a] Two-tailed.
[b] N valid cases= 1168
[c] N valid cases= 1161
[d] N valid cases= 1154

Despite cultural similarities and geographic proximity, a substantial number of Canadian-based franchises expressed no intent to expand into the U.S. market, while a similar ratio of U.S. franchises also expressed no expansion intentions into Canada. Differences in expansion plans into overseas markets between U.S. and Canadian-based franchises could be supported in this analysis. A closer examination of U.S. and overseas market expansion strategies follows.

6.5 ANOVA: Franchise Provisions and Expansion Strategy

Five provisions in franchise agreements were operationalized into dichotomous variables: (1) Financial assistance; (2) Area development agreements; (3) Passive ownership; (4) Earnings claim, and (5) Sub-franchising. Franchise characteristics were then examined using ANOVA, to discover similarities and differences based on the presence or absence of these five contractual provisions. In addition, ANOVA comparisons using expansion strategies in U.S. and overseas markets were also examined.

6.5.1 ANOVA Financing Provision

A substantial majority of franchisors (67.4 percent) in this sample provided financial assistance to prospective franchisees. Significant differences were revealed between franchisors who did and those who did not. Those who provided financial assistance had a significantly higher percentage of franchised outlets (9.22), and represented franchises with lower average investment requirements (160.6) than those who did not. As a group, they projected an average of 14.64 more new outlet openings than those not offering financing. Franchisors providing financial assistance were also larger, with 25.53 more company-owned outlets, and 40.9 more franchised outlets than those franchisors that did not, although these differences were not statistically significant. Details of the ANOVA comparison are provided in Appendix B, Table B10.

6.5.2 ANOVA Area Development

Area development agreements were offered by slightly more than half (53.34 percent) of the franchises in this sample. Although differences were not statistically significant, those who offered development agreements had, on average, fewer total units (96.24), fewer franchised units (98.49), yet projected to open more new outlets in the upcoming year (7.81). Significant differences between groups were also evident. Franchises in which development agreements were offered had franchise agreements with longer terms (1.58) and higher franchise fees (1.46) than those franchises that did not. Details of this analysis are provided in Appendix B, Table B11.

6.5.3 ANOVA Passive Ownership

Less than one-third (32.5 percent) of franchises in this sample prohibited passive ownership of franchised outlets. Comparison revealed a significant difference in percentage of franchised outlets; those prohibiting passive ownership had a lower ratio of franchised to total outlets (4.52) than those who did not. Although those prohibiting passive ownership had substantially fewer outlets (186.31), fewer franchised outlets (152.82), and projected fewer new outlet openings (3.26), the results were not statistically significant. Details of this analysis is presented in Appendix B, Table B12.

6.5.4 ANOVA Earnings Claim

Unlike other UFOC required disclosures, franchisors that provide earnings claims do so voluntarily. Of the franchises in this sample, a minority (26.3 percent) provided this disclosure. Franchises that disclosed earnings had fewer outlets (82.16), represented franchises with higher average investment requirements (249.76), and had lower compound average growth rates (.05), although differences were not statistically significant. Significant differences were revealed, however, in average growth percentage, franchise fees, and franchise agreement term. On average, franchisors that provided earnings claims projected slower growth (19.41), had higher franchise fees (1.98), and had franchise agreements with longer terms (.85) than those that did not. Details of this analysis is presented in Appendix B, Table B13.

6.5.5 ANOVA Sub-franchising

Less than one-fourth of franchisors in this sample permitted sub-franchising. Although not statistically significant, franchisors that permitted sub-franchising were smaller (32.92), younger (1.08), and projected a greater number of new outlet openings (16.93). Significant differences were revealed in percent of franchised outlets, average investment required, and franchise fees. Those franchises permitting sub-franchising had a higher percentage of franchised to total outlets (7.90), lower average investment requirements (389.41), and had lower franchise fees (2.41) than those who did not. Details of this analysis is presented in Appendix B, Table B14.

6.5.6 ANOVA Firm Strategy in U.S. Market

To explore how franchises with unlimited expansion strategies, those expanding into all regions within an area, and those with no expansion plans differed, ANOVA was performed for U.S. and International areas. Seventeen measures of franchise characteristics were measured, using U.S. expansion plans as the factor variable. One-way ANOVA assumes that all variances are equal, and a Levene test was performed to verify homogeneity of variance among the variables. Table 6.18 depicts the homogeneity of variance test and ANOVA comparison.

Table 6.18: Test of Homogeneity of Variances and ANOVA (U.S. Expansion)

					ANOVA	
	Levene	df1	df2	Sig.	F	sig.
Number of US outlets	6.324	2	1165	0.0019	3.890	0.021
Number of international outlets	1.078	2	1165	0.3405	0.345	0.708
Age of Business	0.067	2	1165	0.9355	6.139	0.002
Experience	1.173	2	1165	0.3099	4.603	0.010
Total outlets	3.597	2	1165	0.0277	1.741	0.176
Number of franchised outlets	4.945	2	1165	0.0073	2.457	0.086
Number of company outlets	2.188	2	1165	0.1126	0.791	0.453
Projected new openings	9.683	2	1096	0.0001	7.182	0.001
Growth Percentage	4.147	2	1096	0.0161	2.790	0.062
Percent of units franchised	10.241	2	1165	0.0000	11.883	0.000
Average Investment Low	3.637	2	1137	0.0266	0.657	0.519
Average investment high	6.768	2	1128	0.0012	1.850	0.158
Franchise Fee	3.348	2	1141	0.0355	6.998	0.001
ROYALTY	0.960	2	1068	0.3831	0.968	0.108
Agreement term	0.801	2	1126	0.4493	8.042	0.000
Years before franchising	1.919	2	1165	0.1473	2.264	0.104
CAGR	6.378	2	1165	0.0018	6.729	0.001

This analysis revealed several significant differences between franchises based on their expansion strategy. The 75 franchises that indicated no expansion plans in the U.S. market had been in operation an average of 26.93 years, while those with a targeted expansion averaged 25.14 years. A majority of franchises in this sample (65.8 percent) planned unlimited expansion in the U.S., these firms averaged 22.07 years in operation. These firms also differed significantly in their number of years of franchising experience, with 18.39 years for those with no expansion plans, 16.05 years for those firms with targeted expansion plans, and 14.78 years for those with unlimited expansion plans. Franchise agreement terms also differed significantly among firms in this sample. Those with no expansion plans had an average 8.78-year term, while those with targeted plans averaged 11.37-years. Franchise agreement terms among firms with unlimited expansion plans averaged 10.59 years.

Levene's test revealed that assumptions of equal variance could not be supported for ten variables in this ANOVA comparison. Post hoc tests using Tamhane's T2, a conservative pairwise comparison based on a T-test, were performed. Pairwise comparisons are presented in Table B15 located in Appendix B. When firms with no expansion intentions were contrasted with those who indicated unlimited expansion, several significant differences emerged. Those with unlimited expansion strategies were larger, with an average of 238 more total outlets, 227 more U.S. outlets, and 57 more international outlets. They also had an average of nearly 210 more franchised outlets, and 29 more company-owned outlets than those firms who planned no expansion. Firms adopting an unlimited expansion strategy had lower average (5.4 percent) franchise fees, but franchise agreement terms that averaged 1.8 years longer. On average, firms with unlimited expansion strategy in the U.S. market had compound average growth rates that were 14.23 percent higher than those with no expansion intentions.

This test revealed that significant differences did not exist between firms with targeted and unlimited expansion strategies in terms of their size. Comparisons in the number of existing outlets in the U.S., number of international outlets, number of franchised outlets, number of company-owned outlets, and total number of outlets failed to produce significant differences. Significant differences were revealed, however, in other characteristics. Firms with unlimited expansion strategies were an average of 3 years younger than those with targeted expansion, they projected an average of 21.28 more outlets to be opened in the upcoming year, and had a 7.77 percent higher ratio of franchised to total units in their system. Firms that indicated an unlimited expansion strategy in this market had an average of 14.36 percent higher CAGR than firms adopting a targeted expansion approach.

6.5.7 ANOVA Firm Strategy in Overseas Market

In similar fashion to the comparison of strategy in the U.S. market, an ANOVA comparison in overseas markets was performed. Overseas markets are likely to present risks and uncertainties to North American franchisors not found in domestic markets. Test of homogeneity of variance and ANOVA are presented in Table 6.19.

Table 6.19: Test of Homogeneity of Variances and ANOVA (Overseas Expansion)

					ANOVA	
	Levene	df1	df2	Sig.	F	sig.
Number of US outlets	33.160	2	1151	0.0000	15.706	0.000
Number of international outlets	14.526	2	1151	0.0000	5.492	0.004
Age of Business	4.732	2	1151	0.0090	1.385	0.251
Experience	3.624	2	1150	0.0270	5.147	0.006
Total outlets	31.263	2	1151	0.0000	14.143	0.000
Number of franchised outlets	38.389	2	1151	0.0000	17.084	0.000
Number of company outlets	5.274	2	1151	0.0053	1.555	0.212
Projected new openings	33.852	2	1111	0.0000	18.873	0.000
Growth Percentage	1.633	2	1111	0.1959	0.929	0.395
Percent of units franchised	35.269	2	1151	0.0000	17.476	0.000
Average Investment Low	2.727	2	1123	0.0658	1.147	0.318
Average investment high	4.002	2	1114	0.0185	1.681	0.187
Franchise Fee	2.501	2	1125	0.0825	3.627	0.027
ROYALTY	0.054	2	1056	0.9474	0.111	0.895
Agreement term	2.528	2	1109	0.0803	1.350	0.260
Years before franchising	0.526	2	1150	0.5912	0.184	0.832
CAGR	13.423	2	1151	0.0000	10.138	0.000

This analysis revealed significant differences among firms in their franchise fees. The 667 firms with no intentions to expand overseas charged an average franchise fee of \$21,274, while those with targeted overseas expansion averaged \$23,768. The 282 firms with unlimited overseas expansion intentions charged an average \$22,670 in franchise fees.

Assumptions of equal variance could not be supported in eleven of seventeen variables in this portion of the study. Pairwise comparisons were conducted using post hoc tests, as in the previous section. Compared to those franchises that indicated no overseas expansion intentions, those firms indicating unlimited expansion were larger, with an average of 472 more total outlets, 290 more U.S. outlets, and 133 more international outlets. Although these firms also had an average of 438 more franchised outlets, and had a 10.24 percent higher ratio of franchised to total outlets, they did not differ significantly in the number of company-owned outlets in their system. On average, firms with unlimited expansion strategies intended to open an average of 42 more outlets in the upcoming twelve months, and had a 20.02 percent higher compound average growth rate than those not adopting an overseas expansion strategy. Pairwise comparisons are presented in Table B16 located in Appendix B.

Only one significant difference emerged between those firms with targeted expansion strategies and those with unlimited expansion in overseas markets. Firms that indicated targeted expansion projected to open an average of 32.62 fewer outlets in the upcoming twelve months than those with unlimited overseas expansion.

To examine the relationship of expansion strategies to franchise characteristics and contract provisions, a non-parametric correlation analysis was performed. Twenty-seven variables were entered in this analysis. Three variables that expressed expansion strategies, EXPUS, EXPCAN, EXPINT were significantly correlated at the .0000 level. Although a number of significant correlations were revealed in this analysis, many of the coefficients were small (less than .100). Significantly associated with expansion strategies in the United States with correlation coefficients greater than .100 were U.S.-

based franchisors (.282) with a higher numbers of U.S. outlets (.208) and international outlets (.184). Expanding franchises had higher numbers of projected new openings (.228). Expanding franchises in this market were also those with lower investment costs (-.145) and (-.123) for their respective average low and high investment. Expanding franchises were associated with the provision for franchisee financing (.146) and those who allowed passive ownership of their outlets (.128).

Similar to those franchises with expansion plans in the U.S., franchises expanding into Canada also were associated with those having higher numbers of international outlets (.288), and those with a higher number of projected new openings (.209). In contrast, those expanding into Canada were associated with a larger number of Canadian outlets (.426), were larger systems overall (.187), had a larger number of franchises (.207), and a higher percentage of franchised outlets (.174). Franchises expanding overseas were also associated with larger systems, with higher numbers of U.S. (.160), Canadian (.219) and international outlets (.491). They were also associated with larger franchises in terms of total size (.199), the number of franchised outlets (.216), the number of projected new openings (.218), and the percent of total outlets franchised (.117). Franchises expanding overseas were also associated with the provision to offer area directorships (.112) and to allow sub-franchising (.155).

Expansion intentions of responding franchises in this sample, for U.S. expansion (.170), Canadian expansion (.160) and overseas expansion (.140) were also significantly (.0000) associated with a franchise's overall compound average growth rate (CAGR).

6.6 CORRELATION ANALYSIS

In order to determine the strength and direction of relationships among variables in this dataset, and to test hypotheses developed in section 3.4.2, correlation analysis using SPSS v.10 for Windows was performed. Kendall's Tau-b was selected, to accommodate the use of non-parametric variables found in this dataset.

A number of significant relationships were revealed. The number of international outlets was positively and significantly associated with AGE (.132), EXP (.240), and number of outlets as measured by SIZE (.362), and NFRA (.376). Longer term franchise agreements were associated with larger and more experienced franchise systems, as measured by NUS (.155), AGE (.137), and EXP(.146), and SIZE(.108). Longer agreements were also related to franchise systems with higher average investment requirements, as measured by AILO (.293) and AIHI (.317). A higher percentage of franchised units (PERF) was associated larger, more experienced systems, as measured by SIZE (.220), NUS (.141), NCAN (.164), NINT (.140), and EXP (.182).

Although the provision to provide financing was significantly correlated to larger systems, weak relationships were evident in SIZE (.069), NFRA (.093), NCOM (-.076), as well as those related to the average low (-.088) and average high (-.076) investment required. A stronger positive relationship was found between the provision to provide financing and royalty fees (ROY= .134). AILO (-.186) and AIHI (-.205), were significantly and negatively associated with ROY. Organizational variables, such as passive ownership, sub-franchising, and area directorships had significant relationships with several franchise characteristics. Area development provisions were associated with NCOM (.132), AILO (.194), AIHI (.198), and longer franchise agreements, as measured by TERM (.174). Sub-franchising was also associated with AD (.266).

6.6.1 Hypotheses Test

Specific hypotheses that emerged from the literature review were developed in section 3.4.2, and are summarized in Table 6.26.

Correlation analysis revealed that a weak (.087) but positive and significant relationship existed between financial assistance to franchisees and a firm's average growth, as measured by CAGR. Also significant was a relationship between financing and the number of projected new outlets (.134). No significant relationship between financing and projected growth percentage of firms in this sample was found. Hypothesis 1b was not supported in this analysis, as a negative and significant relationship was revealed between financing and average investment costs. A summary of these relationships is presented in Table 6.20 below.[129]

Table 6.20: Financial Assistance Correlations

	FIN	CAGR	PNU	GROWTH
FIN	1.0			
CAGR	.087**	1.0		
PNU	.134**	.315**	1.0	
GROWTH	.030	.033	.074	1.0

The second hypothesis examined relationships between three measures of growth and three measures of franchisee-owned networks: area development, sub-franchising, and passive ownership. Significant and positive associations were revealed between number of projected openings, percentage growth, and two network variables; area

[129] For all correlation tables in this section: **= .001.

development and passive ownership. A summary of correlation coefficients is presented in Table 6.21.

Table 6.21: Franchise Network Correlations						
	AD	SF	PO	CAGR	PNU	GROWTH
AD	1.0					
SF	.266**	1.0				
PO	.066**	.025	1.0			
CAGR	.015	.026	.037	1.0		
PNU	.082**	.038	.076**	.315**	1.0	
GROWTH	.061**	.038	.067**	.033	.074**	1.0

Based on this analysis, Hypothesis 2a and 2c were supported using projected measures of growth, but rejected when CAGR was employed as a measure of historic growth. Correlation coefficients indicated, however, that relationships among these variables were weak. Hypothesis 2b could not be supported using the three measures of growth employed in this study.

The third hypothesis tested relationships between growth strategies and franchise networks. Franchise networks, as operationalized by area development, sub-franchising, and passive ownership were positively and significantly associated with franchisors that indicated more aggressive growth strategies overseas markets. In addition to overseas market growth, passive ownership was also significantly correlated with more aggressive growth strategies in the U.S. market. A summary of correlation coefficients is presented in Table 6.22.

Table 6.22: Growth Strategy Correlations						
	AD	SF	PO	EXPUS	EXPCAN	EXPINT
AD	1.0					
SF	.266**	1.0				
PO	.066**	.025	1.0			
EXPUS	-.022	-.014	.128**	1.0		
EXPCAN	.025	.097**	.035	.245**	1.0	
EXPINT	.112**	.155**	.075**	.281**	.502**	1.0

Based on this analysis, Hypotheses 3a, 3b, and 3c were supported for overseas growth strategies. Hypothesis 3b also received support for Canadian expansion, while 3c received support for U.S. expansion.

Part of the third hypothesis tested relationships between percentage of units franchised and the age and franchising experience of franchisors. A positive (.182) and significant relationship between the numbers of years a firm has been franchising and its ratio of franchised to total outlets was revealed. Similar relationships were revealed between the ratio of franchised outlets and growth strategies in the U.S. (.070), Canadian (.174), and overseas (.117) markets, as presented in Table 6.23.

Table 6.23: Franchised Outlet Ratio to Growth and Growth Strategies

	EXP	PERF	CAGR	PNU	GROWTH	EXPUS	EXPCAN	EXPINT
EXP	1.0							
PERF	.182**	1.0						
CAGR	-.219**	.173**	1.0					
PNU	.022	.183**	.315**	1.0				
GROWTH	-.485**	-.113**	.033	.074**	1.0			
EXPUS	-.092**	.070**	.170**	.228**	.105**	1.0		
EXPCAN	.048	.174**	.160**	.209**	-.038	.245**	1.0	
EXPINT	.050**	.017**	.140**	.218**	-.039	.281**	.502**	1.0

The ratio of outlets franchised to total outlets was significantly associated with three measures of growth, and growth strategies in U.S., Canadian, and overseas markets. Its relationship with GROWTH, however, was negative. Hypothesis 3d, therefore, received qualified support. Hypothesis 3e was supported, contrary to ownership redirection theories of franchising.

The fourth hypotheses tested relationships between earnings claim disclosures and measures of growth, franchisor investment risk, and ratio of franchised to total outlets. No significant relationships were revealed between earnings claim disclosures and any of the three measures of growth used in this study, as presented in Table 6.24.

Table 6.24: Earnings Claim Correlations									
	EC	CAGR	PNU	GROW	TERM	FFEE	AILO	AIHI	PERF
EC	1.0								
CAGR	.007	1.0							
PNU	.025	.315**	1.0						
GROW	-.041	.033	.074**	1.0					
TERM	.073**	.007	.021	-.124**	1.0				
FFEE	.065**	-.009	.014	-.071**	.187**	1.0			
AILO	.101**	-.071**	-.011	-.119**	.293**	.429**	1.0		
AIHI	.085**	-.059**	.018	-.147**	.317**	.368**	.740**	1.0	
PERF	-.049**	.173**	.183**	-.113**	-.063**	-.072**	-.152**	-.140**	1.0

Significant relationships were revealed, however, between earnings claims and measures of investment risk such as agreement term, franchise fees, and average investment.

Although a significant relationship between earnings claim disclosure and the ratio of franchised outlets to total outlets was found, direction of the association was negative, contrary to the hypothesized relationship. Hypothesis 4a, therefore, could not be supported. Although hypotheses 4b and 4c were supported, correlation coefficients indicated weak relationships among these variables. Hypothesis 4d was not supported in this analysis. A summary of the hypotheses tested in this section are presented in Table 6.25. A complete correlation table is presented in Table B19 of Appendix B.

No.	Variable	Hypothesized Relationship	Variable	Relationship
1a.	Financial Assistance	+	CAGR	+
			PNU	+
			%GROW	
1b.	Financial Assistance	+	Initial Start-up Costs	-
2a.	Area Development	+	CAGR	
			PNU	+
			%GROW	+
2b.	Sub-Franchising	+	CAGR	
			PNU	
			%GROW	
2c.	Passive Ownership	+	CAGR	
			PNU	+
			%GROW	+
3a.	Area Development	+	Expand US	
			Expand Can.	
			Expand Intl.	+
3b.	Sub-Franchising	+	Expand US	
			Expand Can.	+
			Expand Intl.	+
3c.	Passive Ownership	+	Expand US	+
			Expand Can.	
			Expand Intl.	+
3d.	Percent Franchised Outlets	+	CAGR	+
			PNU	+
			%GROW	-
3e.	Percent Franchised Outlets	-	Franchising Experience	+
4a.	Earnings Claim	+	CAGR	
			PNU	
			%GROW	
4b.	Earnings Claim	+	Franchise Fees	+
4c.	Earnings Claim	+	Agreement Term	+
4d.	Earnings Claim	+	Percent Franchised Outlets	-

Table 6.25: Summary of Hypotheses Tested

6.7 Factor Analysis

Correlation analysis revealed that a substantial number of significant relationships existed among variables in this dataset. To reduce the number of variables to a manageable size, factor analysis was conducted on the Source Book Publication's dataset using SPSS V. 10 for Windows. Varimax orthogonal rotation was selected to aid in interpretation of the factors. Factors with eigenvalues greater than one were extracted, using principal components method.

Eight factors were developed, (1) size; (2) investment; (3) age; (4) experience; (5) organization layers; (6) ownership; (7) financial; and (8) royalty. These eight factors explained a cumulative 69.966 percent of total variance, as presented in Table 6.26.

Table 6.26: Factor Analysis Extraction

	Initial Eigenvalues			Extraction			Rotation		
Component	Total	% of Var.	Cum %	Total	% of Var.	Cum %	Total	% of Var.	Cum %
1	4.962	22.555	22.555	4.962	22.555	22.555	4.758	21.627	21.627
2	2.412	10.964	33.519	2.412	10.964	33.519	2.244	10.198	31.825
3	1.712	7.783	41.302	1.712	7.783	41.302	1.821	8.278	40.103
4	1.534	6.973	48.275	1.534	6.973	48.275	1.539	6.994	47.097
5	1.373	6.239	54.514	1.373	6.239	54.514	1.399	6.357	53.455
6	1.218	5.535	60.049	1.218	5.535	60.049	1.332	6.055	59.510
7	1.124	5.111	65.160	1.124	5.111	65.160	1.199	5.450	64.960
8	1.057	4.805	69.966	1.057	4.805	69.966	1.101	5.006	69.966
9	0.981	4.460	74.426						

Factor analysis reduced the original 22 variables to eight factors, which were saved for use in a regression analysis. A component matrix with correlation coefficients is presented in Table 6.27 below.

Table 6.27: Factor Analysis								
	SIZE	INVEST	AGE	EXP	OWNER	NETW	FIN	TER
Headquarters	0.0056	0.1605	-0.2443	-0.3280	0.5454	0.4148	-0.1103	-0.2529
US outlets	0.9013	-0.0941	-0.0559	-0.0367	0.1350	0.0888	0.0266	-0.0002
Canadian outlets	0.6608	-0.1365	0.1144	0.1541	-0.3047	-0.1446	-0.0574	0.1289
International outlets	0.8848	-0.1807	-0.1532	-0.0882	0.0171	-0.0697	0.0184	-0.0144
Total outlets	0.9737	-0.1439	-0.0851	-0.0418	0.0720	0.0117	0.0188	0.0023
Franchised outlets	0.9448	-0.1616	-0.0628	-0.0024	0.0757	0.0577	0.0140	0.0149
Company outlets	0.8180	-0.0408	-0.1436	-0.1746	0.0392	-0.1595	0.0312	-0.0444
Percent franchised	0.0200	-0.3729	0.2798	0.4619	-0.0395	0.4014	-0.0133	-0.0467
Age	0.3117	0.4455	0.7952	-0.2336	0.0269	0.0697	-0.0204	-0.0117
Experience	0.3756	0.1471	0.5508	0.3858	-0.0437	0.3090	-0.2834	-0.1260
Years before franchising	0.0705	0.4244	0.5182	-0.6069	0.0693	-0.1710	0.2102	0.0903
Avg. Investment Low	0.1499	0.7081	-0.3054	0.2409	-0.0866	0.0388	0.1074	0.2183
Avg. investment high	0.2145	0.7632	-0.2790	0.2536	-0.0566	0.0715	0.0627	0.1472
Franchise Fee	0.1832	0.4651	-0.0545	0.1518	-0.2977	-0.1735	0.1019	0.0640
ROYALTY	0.1317	-0.2676	0.0685	0.0035	-0.1340	-0.0694	0.3859	0.0937
Agreement term	0.2260	0.4647	0.0135	0.3079	0.1523	0.0763	-0.1674	-0.2042
Earnings Claim	0.0050	0.1998	0.0090	0.2201	0.1089	0.0593	0.5835	-0.3777
Passive Ownership	-0.0090	0.0937	-0.1208	0.0023	0.5714	0.1369	0.0095	0.2669
Area Directorships	-0.0156	0.1081	0.0911	0.2586	0.4878	-0.5879	-0.0601	-0.1466
Sub-Franchising	-0.0321	-0.2072	0.2311	0.4248	0.3556	-0.4657	-0.0077	-0.0197
Expand in Territory	-0.0492	-0.0672	0.1204	0.0909	0.2479	0.0635	-0.1356	0.7419
Financial Assistance	-0.0501	-0.2068	0.1691	0.1790	0.1943	0.2372	0.6449	0.1942

SIZE factor consisted of items that measured size of a franchise in terms of number of outlets. In addition to total number of outlets in each system, the number of U.S., Canadian, and international units were also considered. Both franchised and company-owned outlets were included in this factor. INVEST included both high and low average investment required to purchase a franchise, as well as the franchise fee and term of agreement in years. AGE factor included not only number of years that a business had been in operation, but also the number of years that a firm had been franchising. EXP factor included the number of years that a firm had been in operation before franchising, as well as a ratio of franchised outlets to total outlets in the system.

OWNER factor considered location of headquarters and whether passive ownership of franchises were permitted. NETW included variables related to franchise networks, including area directorships and sub-franchising provisions. FIN factor included whether or not a franchisor provided financial assistance to franchisees, whether or not an earnings claim was provided, and the amount of royalty assessed. TER indicated whether expansion in territory was permitted by a franchise agreement.

Factor scores were created and used as independent variables in multiple regression analyses to test their explanatory power using three measures of franchise growth as dependent variables: CAGR, projected new openings, and ratio of projected openings to existing number of outlets. These measures of growth were developed in Section 6.4.

6.8 Multiple Regression Analysis of Franchise Growth

Multiple regression analysis was performed using SPSS v.10. Eight factors developed in the previous section were entered as covariates. Natural logarithms for dependent variables, CAGR (compound average growth rate), PNU (projected new openings) and GROW (projected growth percentage) were computed. Entry of independent variables into each regression model were performed using stepwise selection, with probability of F to enter at $\leq .050$ and probability to remove at $\geq .100$. Collinearity diagnostics revealed no strong intercorellations among independent variables were present, as highest condition values indices did not exceed two.[130]

[130] Condition indices are the square roots of the ratios of the largest eigenvalue to each successive eigenvalue. A condition index greater than 15 indicates a possible problem, and an index greater than 30 suggests a serious problem with collinearity.

6.8.1 Regression Analysis: Compound Average Growth Rate

The first regression model using CAGR as a dependent variable revealed an adjusted R Square of .500, as presented in the model summary in Table 6.28.

Table 6.28: Model Summary and ANOVA, CAGR Regression

Model	R	R Square	Adjusted R Square	Std. Error of Estimate
1	0.682	0.465	0.465	0.472
2	0.694	0.482	0.480	0.465
3	0.704	0.496	0.494	0.458
4[a]	0.708	0.502	0.500	0.456

ANOVA Model 4

	Sum of Squares	df	Mean Square	F	Sig.
Regression	174.501	4	43.625	209.887	.000
Residual	173.141	833	.208		
Total	347.642	837			

[a] Predictors: (Constant), REGR factor score AGE, REGR factor score EXP, REGR factor score FIN, REGR factor score SIZE

As presented in Table 6.28, effects of four of the eight factors were found to have a significant effect on CAGR as a dependent variable: AGE, EXP, FIN, and SIZE. Unstandardized and standardized coefficients, t-values, and p-values are presented in Table 6.29.

Table 6.29: Regression coefficients CAGR as Dependent Variable

	Unstandardized		Standardized		
	B	Std Error	BETA	t	p
Constant	-1.493	0.016		-94.704	0.000
AGE	-0.439	0.016	-0.684	-27.976	0.000
EXP	-0.083	0.016	-0.126	-5.134	0.000
FIN	0.077	0.016	0.120	4.919	0.000
SIZE	0.049	0.015	0.077	3.161	0.002

AGE, comprised of both the number of years in operation and number of years a firm had been engaged in franchising had a comparatively large and negative effect on growth, as measured by CAGR. EXP also was found to have a negative beta, although its influence on the dependent variable was considerably less than AGE.

6.8.2 Regression Analysis: Projected New Outlets

In the same fashion as the previous section, factors were entered into a regression analysis, this time using number of new outlets each franchise projected to open in the upcoming twelve months as a dependent variable. The same model explained substantially less variance in number of projected new outlets than in historic growth, as measured by CAGR. The model summary and ANOVA are presented in Table 6.30.

Table 6.30: Model Summary and ANOVA, Ln_PNU Regression

Model	R	R Square	Adjusted R Square	Std. Error of Estimate
1	.493	.243	.242	.99100
2	.514	.264	.262	.97798
3	.525	.276	.274	.97028
4	.532	.283	.280	.96600
5[a]	.536	.288	.283	.96375

ANOVA Model 5

	Sum of Squares	df	Mean Square	F	Sig.
Regression	311.156	5	62.231	67.000	.000
Residual	770.919	830	.929		
Total	1082.076	835			

[a] Predictors: (Constant), REGR factor score SIZE, REGR factor score FIN, REGR factor score OWNER, REGR factor score EXP, REGR factor score NETW

As presented in Table 6.30, the model produced an adjusted R Square of .283. Predictors also changed from those revealed in the analysis using CAGR as a measure of growth. Although EXP, FIN, and SIZE were also included in this model, AGE did not significantly affect the number of projected new openings.

Table 6.31: Regression coefficients Ln_PNU as Dependent Variable

	Unstandardized		Standardized		
	B	Std Error	BETA	t	p
Constant	2.660	.033		79.433	.000
SIZE	1.088	.069	.469	15.726	.000
FIN	.166	.034	.144	4.924	.000
OWNER	.128	.033	.113	3.849	.000
EXP	.100	.034	.087	2.921	.004
NETW	7.387E-02	.066	.065	2.211	.027

Included in this model that were not present in the previous one were OWNER and NETW, measures related to passive ownership and franchise networks. Coefficients are presented in Table 6.31. As presented in Table 6.31, SIZE has a comparatively large effect on the number of projected new outlets. Both FIN and OWNER also had significant effects on the dependent variable, albeit to a lesser extent. EXP and NETW, although significant, had small beta values.

6.8.3 Regression Analysis: Projected Growth Percentage

In similar fashion to the previous two regression analyses, this regression analysis used the ratio of projected new outlets and current number of outlets to measure the projected growth percentage of firms in the sample. A model summary and ANOVA are presented in Table 6.32.

Table 6.32: Model Summary and ANOVA, GROWTH Percentage Regression

Model	R	R Square	Adjusted R Square	Std. Error of Estimate
1	.531	.282	.281	.97296
2	.560	.313	.312	.95195
3	.578	.334	.332	.93799
4	.594	.352	.349	.92560
5	.604	.365	.361	.91715
6	.612	.375	.370	.91062
7[a]	.617	.381	.376	.90668

ANOVA Model 7

	Sum of Squares	df	Mean Square	F	Sig.
Regression	406.185	7	58.026	70.586	.000
Residual	660.118	803	.822		
Total	1066.303	810			

[a] Predictors: (Constant), REGR factor score EXP, REGR factor score AGE, REGR factor score SIZE, REGR factor score INVEST, REGR factor score OWNER, REGR factor score TER, REGR facor score NETW.

This model produced an adjusted R Square of .376 with seven of the eight factors in the model. Only FIN did not produce a significant effect on this dependent variable, although beta coefficients for NETW and TER were comparatively small, as summarized in Table 6.33.

Table 6.33: Regression coefficients GROWTH percentage as Dependent Variable					
	Unstandardized		Standardized		
	B	Std Error	BETA	t	p
Constant	3.131	.032		97.747	.000
EXP	-.580	.033	-.493	-17.421	.000
AGE	-.200	.032	-.174	-6.260	.000
SIZE	-.382	.066	-.166	-5.792	.000
INVEST	-.164	.036	-.128	-4.578	.000
OWNER	.130	.032	.114	4.105	.000
TER	.119	.033	.101	3.597	.000
NETW	9.058E-02	.032	.079	2.828	.005

As presented in Table 6.33, EXP, AGE, and SIZE all had negative beta coefficients, indicating that larger, more experienced franchises had lower growth rates than younger, smaller franchises.

6.9 SUMMARY

This portion of the study examined differences in contractual provisions and characteristics of firms engaged in franchising. In the absence of a single, comprehensive source of franchising data, three secondary datasets were employed. This section focused on the formal constituent of franchising's context, using contractual provisions, firm characteristics, and growth as its variables. In concert with a corporate entrepreneurship theme, measures of venturing were operationalized, using creation of franchised outlets as a basis for comparison.

Although the three datasets provided unique and valuable insights on contractual provisions, ANOVA comparison revealed differences between FRANDATA, *Entrepreneur* Magazine, and Source Book datasets. This finding is contrary to a previous study that compared the latter two sources of franchise data. Crosstabs analysis of FRANDATA and Source Book datasets also revealed relationships between contractual provisions, such as financing and length of a franchise agreement, and franchise characteristics, such as age, size, and fees.

Because Source Book's dataset provided several indicators of future franchise growth, such as the number of projected new openings, and expansion intentions in U.S. and overseas markets, further analysis focused on this dataset exclusively. Correlation analysis using 27 variables revealed numerous significant relationships among the variables. In order to reduce the number of variables to a manageable number, a factor analysis was performed.

Emerging from factor analysis were eight constructs, which served as independent variables for a multiple regression analysis. Dependent variables were formed using three measures of franchise growth: (1) compound average growth rate (CAGR); (2) Number of projected new outlets expected in the next twelve months; and (3) Growth percentage as measured by a ratio of projected new outlets to the current total outlets.

The explanatory power of the regression model varied among dependent variables. Although an R-squared value of .500 was attained using CAGR as a dependent variable, the model lost much of its predictive power with future measures of franchise growth. It explained only 28.3 percent of the variance in the number of projected new outlets, and 37.6 percent of the ratio of openings to total outlets. Discussion of these and other findings is presented in the final chapter of this study.

7.0 FRANCHISING'S OPERATIONAL CONTEXT: A CASE STUDY OF FRANCHISEES AND FRANCHISOR

> For while systematic data create the foundation for our theories, it is the anecdotal data that enable us to do the building. Theory building seems to require rich description, the richness that comes from anecdote. We uncover all kinds of relationships in our hard data, but it is only through the use of this soft data that we are able to explain them. Henry Mintzberg (1979)

7.1 Introduction

Previous sections of this work examined disclosure and contractual provisions associated with franchising. Although franchisors are required by federal law to comply with the format of disclosure, contents of these documents were found to differ among franchising firms. Next, characteristics that differentiated growing franchises from others were examined, using data obtained from secondary sources. Although differences among franchises were revealed in these two previous sections, disclosure and contractual provisions of franchising and the datasets derived from them represent only a partial view of the phenomenon.

Using two in-depth and closely linked research projects conducted at the University of Westminster, Stanworth examined relations between franchisors and franchisees (Stanworth 1995). Contractual provisions were compared with data gathered through surveys and interviews with franchisors and franchisees. Despite restrictive contractual provisions that appeared "to closely circumscribe the franchisee's freedom of action as a businessman," relatively high levels of independence among franchisees were discovered. Based on these seemingly conflicting findings, Stanworth concluded that:

> …at the formal level, relations between the franchisor and franchisee might be described as dependently one-sided since the contract is drawn up on a virtually non-negotiable basis by the franchisor and put to the franchisee on a take-it-or-leave-it basis. But the findings also hint strongly that consideration of franchisor-franchisee relations solely at the formal level is misleading…(that suggests) an operational realm in franchisor-franchisee relations which is not necessarily revealed by an analysis of contractual relations. (p. 165)

This portion of the study examines franchising's operational realm. In broad terms, it examines the role of disclosure and contractual agreements in the franchise selection process and daily operations of franchised businesses. To explore the subtleties, perceptions, and dynamics within franchising's context, a case study approach was chosen. Case study research was defined by Yin as a method of empirical inquiry that investigates a contemporary phenomenon within its real life context; when boundaries between phenomenon and context are not clearly evident (Yin 1989). As a research strategy, it focuses on "understanding the dynamics present within single settings" (Eisenhardt 1989, p. 534). Case study has been considered an ideal methodology when a holistic, in-depth investigation is needed (Tellis 1997). Case study results were also found to facilitate an understanding of complex real-life situations (Soy 1996).

Eight individuals were chosen to participate in this portion of the study. Cases were selected from a population of U.S. franchises with operations in the states of North and South Carolina. In addition to four active franchise owners, two former franchisees were also interviewed. One former franchisee left his system voluntarily, while the other was part of a system in which the franchisor declared bankruptcy. In order to gain additional perspective on the UFOC and its role in a franchised business, the chief financial officer, and general counsel representing a fast growing franchise were also interviewed. The number of cases chosen for analysis is consistent with Eisenhardt's observation, that while there is no ideal number of cases, a number between 4 and 10 cases usually works well (Eisenhardt 1989, p. 545).

Franchisees were chosen purposefully; representing diverse industries, male and female ownership, and varied lengths of time in franchising. This selection process is consistent with Pettigrew's approach, which suggests that given the number of cases that can usually be studied, it makes sense to choose cases such as extreme situations and polar types in which the process of interest is "transparently observable" (Pettigrew (1988), quoted in (Eisenhardt 1989). This franchisor was chosen because of its success and rapid growth in the competitive, quick service restaurant industry. Franchise owner interviews took place in South Carolina, while interviews with the franchisor's representatives took place at their corporate headquarters in Denver, Colorado.

Semi-structured interviews were chosen as the method of data collection for this section. Open-ended questions were primarily used to expand the depth of data gathering, as recommended by Yin (Yin 1989). First, this approach enabled interviewees to reveal individual perspectives on the daily operations of their franchised businesses. Second, it afforded interviewees an opportunity to provide additional insights on operational aspects of franchising. Given that the aims of this section are to explore individual perceptions in a real life context, the advantages of additional insights and perceptions appeared to outweigh the disadvantages of potential bias, incomplete recollections, and potential reflexivity associated with this methodology (Tellis 1997). All interviews were conducted in person by the author, and recorded on audiotape with the consent of all interviewees.

This chapter is structured as follows. First, within-case analysis is performed on six present and former franchise owners. Next, a cross-case analysis is conducted to search for patterns among interviewees in the sample. Following the franchise owner's section, interviews with two franchisor representatives are presented. Lastly, a summary of the findings is provided.

7.2 Within Case Analysis of Present and Former Franchisees

Tellis observed that analysis of case studies is one of the least developed aspects of the methodology (Tellis 1997). Within-case analysis allows unique patterns of each case to emerge before generalizing patterns (Eisenhardt 1989, p. 540). This section follows an explanation-building analytic strategy, one of the possible techniques presented by Yin (Yin 1994). Line number references to transcripts are included where interviewees are quoted. Complete transcripts of the interviews are provided in Appendices G through L.

7.2.1 Franchise Owner A

> "...it was about 90 million pages. I don't think we ever even read it"
> Evelyn Perry, Muzak franchisee

Franchise A is a Muzak franchise, which provides music via satellite to commercial customers, such as restaurants, offices, and grocery stores. This company began with a patented process of transmitting background music over telephone lines in the 1920s. It now boasts 250,000 subscribers and 80 million listeners, delivering its programming through a network of 60 satellites. The company changed hands from the Wrather Corporation in 1957, to the TelePrompter Corporation in 1972, to Westinghouse Corporation in 1981. Muzak LLC is presently headquartered in Fort Mill, South Carolina.[131]

Evelyn is a Muzak franchisee, located in Charleston, South Carolina. She and her husband purchased this franchise in 1984 from an existing franchise owner. Muzak

[131] Information obtained from Muzak LLC website at http://www.muzak.com/corp/default.asp.

franchises are geographically exclusive, and at the time of her purchase, "the only way to get into the franchise community was to be the son or daughter of an existing owner, or to buy one from somebody"{23}. Although this franchisor could also convert one of its company-owned territories into a franchised territory, it had not done so in the recent past. Evelyn did not evaluate any other franchises before purchasing this franchise, because her husband worked for Westinghouse (the parent company), and was familiar with this franchisor and its technology. The couple believed that franchises other than Muzak did not fit their vision. Although they were not specifically looking to own a business, "we knew that we did not want to work for someone else forever"{43}.

When asked about her experience with the receipt and review of Muzak's UFOC and franchise documents, Evelyn recalled that it "was about 90 million pages"{52} and confessed, "I don't think we ever even read it"{53}. She stated that she had spoken with other franchisees and learned there was no room in the franchise agreement to negotiate, that it was "a take-it-or-leave-it contract"{55}. Her husband had worked for the parent corporation for more than two years before they purchased their franchise, and had good friends in this business, some of whom were franchisees. When asked if most of her information about this franchise came from other franchisees, she replied "Absolutely"{67}. In her discussions with other Muzak franchisees, Evelyn found that the franchisor provided quality products and services, made its delivery commitments, and that overall, franchisees were enjoying their expected levels of sales and profits.

Next, the role of disclosure and contractual agreements in the daily operations of her franchised business were discussed. Evelyn noted that a previous "battle with corporate," revealed "we have no protection under those documents" and that "there is very little in the way of laws that protect franchisees at all"{73}. She stated that the Muzak franchisees use a trade association lawyer, who formerly represented her franchisor, as their counsel in these matters. In her opinion, Muzak's franchise agreement was "far less stringent than most franchise agreements"{100}. An example is that although she started with just her franchise, her company now provides a variety of video and audio products and services in addition to Muzak offerings. By recognizing market needs and using technical and marketing resources available to her in her family business, she has broadened her product and service offerings and increased her firm's revenues. Ownership of a complementary business is not prohibited in her franchise agreement, and revenues from products or services outside of Muzak services are not subject to royalty payments to her franchisor.

When asked if an ability to use discretion and to adapt to changing market needs was important to her, she replied "You bet"{154}. She noted, however, that in some respects she is unable to meet the needs of some customers because of her franchise relationship. An example of this was cited, when her franchisor began offering an "advertising on-hold" product; she was prohibited from selling her customers a lower-priced competitive product. Although those products were not part of her original agreement, they were introduced by her franchisor as amendments to her agreement, with terms negotiated by the trade association on behalf of all franchisees. She noted that the influence of her trade group was declining, however, as the ratio of franchised outlets to total outlets had declined from 80 percent to approximately 40 percent. "Corporate is trying to buy more of them up" she noted, but "there are some large franchisees with several territories who are not about to sell"{197}. Despite the ten-year term of her franchise agreement, numerous addendums have been added through the years, which substantively changed the scope and provisions of her agreement.

The importance of adaptation was noted in Evelyn's assessment of the competitive landscape. She observed that with proliferation of satellite technology, her present and future competitors are no longer limited to a specific geography, resulting in "much more competition than we had before"{249}. Most of her competitors are equipment dealers; she noted that Muzak is the only franchised business in this field.

In Evelyn's opinion, her franchise arrangement provides several competitive advantages. First, her ten-year agreement provides assurance to her and her customers of ongoing support. "With a dealership," she noted, "the vendor can pull its product tomorrow morning. Although he may have more leeway to go to other competitive products, he can lose them in a heartbeat"{271}. Next, she opined that a "brotherhood or sisterhood" exists in her franchise community, citing it as a "major reason why we were successful, especially in the beginning"{276}. She attributed this relationship to a geographic exclusivity provision, which means that franchisees were not competing with each other. When asked if her business would change significantly should the territorial exclusivity provision be eliminated, she replied "Oh, yes"{321}.

7.2.2 Franchise Owner B

> "I'm not the entrepreneurial type that can just go and make it for themselves."
> Susan Swavely, Budget Blinds franchisee

Franchise B is a Budget Blinds franchise, which offers customers guaranteed lowest prices on name brand window blinds, shades and coverings. Founded in 1992, Budget Blinds reports that it is the largest and fastest growing window-covering company of its kind in the U.S., with local service in over 1,200 cities and 37 states.[132] Susan is a Budget Blinds franchise owner with operations in Mt. Pleasant, South Carolina.

Prior to her franchise purchase, Susan worked with her husband, Steve, who owned another franchise, the Entrepreneur's Source. Susan's role was to follow-up with people who indicated an interest in services offered by the franchise, and set up appointments for them to meet with her husband. Susan's interest in becoming a franchisee began while working with other prospective franchisees. "It got me kind of interested in the idea of owning a business," she said {21}.

She explained that the business she purchased did not happen as the result of a systematic search, but rather as serendipity. While attending a gymnastics meet with her daughter, an opportunity to purchase a franchise was discussed with a friend. Susan recalled that "The more we talked about it, the more I thought, well, maybe I could do this" {30}. At the time, her husband was unsure of his business, and she was unsure of her role in his business. She spoke with her husband, who "did the due diligence thing for me, and explained it to me, and discussed it with me" {35}. She then called the franchisor's corporate headquarters, and received the UFOC and franchise documents.

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[132] Information obtained through company's website, available at http://www.budget-blinds.com/who/who.html.

Because the price of a new Budget Blinds franchise is based on number of households in a given geographic area, the value of this franchise had increased considerably during her friend's two and one-half years as franchisee. Appreciation in value was not the result of substantial increases in her revenue, but because the number of households in her territory had grown considerably. Sue's friend had purchased this franchise from a previous owner, who had the territory for nine months. Despite asking twice the price she had paid for the franchise, the asking price seemed fair to Susan, because it was comparable to that of a new franchise. She paid a small transfer fee, and after a brief interview, received franchisor approval for the transfer of ownership.

Although she had a couple of ideas before exploring this opportunity, Susan admitted that she "truly did not look at any other one {franchise} besides this" {74}. When asked about the primary reason for her choosing this particular franchise, she cited flexibility. Although the potential to make money was part of her decision process, "Being a mom is first, and I needed something that would let me work from home. I set my own schedule" {79}. Flexibility in product offerings was also discussed. When asked about other products or services not currently offered by her franchise, yet not expressly prohibited by her agreement, she noted that reflective window film was the only thing that came to mind. Other products or services needed by her customers had not been identified as of yet. By her choice, she has chosen to follow the rest of the franchisees in her company, remaining focused exclusively on window treatments.

Because of the competitive nature of her business, and her company's strategy of guaranteed low pricing, cost of products obtained from her franchisor is crucial to

Susan's profitability. She stated that "We have great prices, but it is still hard to compete with somebody, an individual who has maybe two shops and they manufacture their own (products)" {116}. Susan has the ability to sell at or even below cost in order to close a sale. Her franchisor is paid royalties based on a percentage of gross sales. She said that she did not perceive a conflict between her franchisor's interests in increasing sales and her compensation, which is based on post-royalty profits, because she has discretion over pricing of her products and services. She noted that she does, however, sense a conflict "...when I try to tell them (the franchisor) that price is an issue (with my potential customers), and they tell me: no, it isn't" {144}. Her franchisor believes that customers will purchase based on value and not price, and has repeatedly communicated a targeted 70 percent gross profit margin to its franchisees. Susan's husband observed that because her customers *are* predominantly price sensitive, if Susan priced her products to achieve a 70 percent profit, she would lose customers and "she would be out of business" {146}.

As a part of a fast-growing franchise, Susan attributed the growth in part to the aggressive marketing efforts of her franchisor in attracting prospective franchisees. Existing franchisees are paid a referral fee for new franchisee prospects. She rated her corporate support as "wonderful," and the five men that own the business as "wonderful guys" {166}. What she liked most about her franchisor was their approach of "Here's what worked in the past...and we can just follow it. It was a guideline, and I needed that. I'm not the entrepreneurial type that can just go and make it for themselves" {168}. Unlike many other franchises that specify what products or services may be offered, this franchise does not restrict her product purchases, and she is able to offer products from any vendor. Susan could purchase products from a local vendor, never report it in her royalty report, and her franchisor would not be aware of it. This discretionary power is not found in all franchise agreements. Despite her ability to choose any supplier, Susan chooses to purchase a majority of her products from her franchisor, because of the quality and value she receives.

Susan noted substantive differences between contractual requirements found in her franchise agreement and in the manner in which her business actually operates on a daily basis. For example, her franchise agreement stipulates that all franchisees must purchase or lease a van that meets specific requirements in size, color, and appearance. This van must be painted with the franchisor's logo boldly displayed. Susan presently operates her business using her personal vehicle, because she cannot afford the cost of a new van at this point in time. "If they (the franchisor) ask me, of course I'll tell them that I don't have one yet. But they're not going to say…well, then you cannot be a franchisee" {190}. Located more than 2,150 miles from her franchisor's office in San Diego California, Susan's franchise may not be visited often by her franchisor. When she told one of the corporate owners that she could not yet afford the van as specified in the contractual agreement, he replied, "How often do we get to South Carolina?"{201}. In effect, the geographic separation between this franchisor and Susan's territory made monitoring difficult, and this franchisor selectively enforced this contractual obligation. Susan noted that the previous owner of this franchise also opted not to purchase a van during the more than two years that she owned this franchise.

Royalty payments to her franchisor are made monthly, using a computerized system in which customers, sales, and profit margins on products are reported. This franchise does not provide an earnings claim under Item 19 in the UFOC, nor does it employ the use of area directors in its organization. There is only one company-owned outlet in this system, located adjacent to the corporate headquarters in San Diego.

Susan attributed the positive, upbeat, and optimistic personalities of the owners as the major reason for success of this franchise system. The franchisor does not "micro-manage" but rather provides support when asked. "They (the franchisor) will spend time with you…and say here's the things that we think will help you with your business. They're real people. And they are truly interested in us succeeding" {271}. When asked if she felt constrained by the terms of her agreement, Susan replied "Absolutely not" {303}. Both she and her husband noted that their relationship with this franchisor and the wording in her UFOC are in "sharp, sharp contrast" to one another {309}. The last time they looked at their agreement was when they purchased her business, 21 months before this interview. When asked if they believed that they made a good decision when they purchased the franchise, Susan replied, "Overall, it has been good for us, and we're glad we did it" {348}.

7.2.3 Franchise Owner C

> "They (franchise agreements) are always written to the franchisor's advantage. But this is one of the best ones I've seen."
>
> Attorney advising Joan Lukehart, GNC franchisee

Franchise C is a General Nutrition Center (GNC) franchise, offering vitamins, herbs, and diet supplements through franchised and company-owned retail locations across the country. The company was founded in 1935, and now boasts more than 4,000 stores in all 50 states and 20 foreign countries. In recent years, GNC acquired Health and Diet Centre stores based in London, and has developed a comprehensive web site for marketing its products. It formed strategic relationships with Rite Aid Corporation to open 1,500 GNC stores within Rite Aid's pharmacies within three years. The company also merged with Netherlands-based Royal Numico N.V., a nutrition research firm.

Joan and Howard own a GNC franchise in Mount Pleasant, South Carolina. Howard was furloughed from his corporate middle management job in the early 1990s, and Joan was vying for an education superintendent's position in Pennsylvania. Howard spent eighteen months researching various franchise opportunities at libraries and at the Small Business Development Center near their home in Pittsburgh, Pennsylvania. Together, they attended some franchise fairs, looking at concepts that included a tool distributor and mobile check cashing service. GNC caught their eye, partially because at the time it was the top-ranked franchise in *Entrepreneur* Magazine, and it was headquartered in their hometown of Pittsburgh. Joan also stated "We had an interest in nutrition and supplements, and had been a customer of GNC for a long time" {17}. The couple chose a franchise over a non-franchised business because "We always thought we needed the support" {110}.

Their initial plan called for Joan to find a job somewhere, and Howard would then purchase a franchise in a nearby location. After several job interviews, the couple agreed to look for a franchise in an area where they could eventually retire. They met with a GNC franchise director and found that a store was being planned for Hilton Head, South Carolina. By the time the couple investigated the opportunity someone else purchased the franchise. GNC suggested an alternative, a new location in Mount Pleasant, South Carolina. After visiting the site and touring the area, they decided to purchase this new franchise.

Joan recalled that she took the UFOC to a family friend who was also an attorney, who said, "...well, you know they are always written to the franchisor's advantage. But this is one of the better ones I've analyzed" {45}. The couple did not review the UFOC documents from any other franchise, but rather relied on secondary sources of information. When it came to purchasing a franchise, Joan considered herself and her husband as "total neophytes" {47}. Although her friends and family expressed trepidation over their decision, Joan was convinced: "I've always though that if you work hard and learn, you can be successful" {50}.

Now in business for nearly eight years, Joan believes that the role of a UFOC and franchise agreement is one that exists in the background. Joan's franchisor has revised its agreement several times since she purchased her franchise, and she is aware that new GNC franchisees are operating under more restrictive agreements than one she signed. She cited examples of newly instituted lease negotiation fees and requirements of franchisees to participate in co-op local advertising as examples found in new agreements that did not apply to her franchise. Her experience suggested that advertising paid for by franchisees had benefits that accrued disproportionately to company-owned stores. She has followed a targeted marketing approach, one that reached only her potential customers.

In some cases, perceived value of franchisor support may diminish after an initial start-up of a franchised outlet. Joan believed that not only did her franchisor provide support when asked, but also supported her business in areas such as new product development and market research. The company's merger with Royal Numico N.V. provides her with competitive advantages in her market. "We get products that other companies don't have, because they are proprietary" {117}. She buys most, but not all products offered at her store from her franchisor, and is satisfied with product quality and order response time. Her franchise agreement requires that she pay royalties on every item sold at her store, and she cannot introduce a product without approval of her franchisor. Joan noted that restrictions on product offerings also protected franchisees, by reducing the likelihood of a customer's adverse reaction to one of her products.

Joan cited an example where she was unable to quickly respond to a change in her customer's demands. Promoted as a natural sleep aid, *Melatonin* was widely distributed among independent health food and vitamin retailers. Joan recalled, "Other stores had it…and we could have sold bushels…but GNC wanted to do studies on it" {162}. She attributed the delay to her company's desire for safety, and their search to determine a safe dosage. Although a comparatively short opportunity was missed, she felt that adverse publicity about *Melatonin* made her company's conservative approach beneficial in the long run.

Howard and Joan are presently faced with three concerns. First, although the area in which their business is located has grown considerably, for the first time in eight years, they have not increased sales from previous year's levels. One reason may be the opening of a new discount vitamin retailer less than two miles from their store. Vitamins are the biggest part of their business. Referring to the new competition she stated "We don't know if that's a factor or not" {201}. Another franchisee reported to Joan that when this competitor entered her market in North Carolina, it had not had any effect on sales at her store. Joan suggested that it also might be time for "a fresh look at our market, and what we're doing" {204}.

Another concern is that they are nearing the end of their franchise agreement. She described her feelings as "unsettled" {238}. It is likely that Joan and Howard will have to sign a new franchise agreement at the time of renewal, one that is different from the one they signed eight years ago. New GNC franchisees operate under a more restrictive agreement, as described earlier.

Her biggest concern, however, is her franchisor's ability to open competing GNC stores in nearby areas. Their franchise agreement gives existing franchisees 'first right of refusal' should her franchisor choose to open a store in close proximity to an existing outlet. When asked if they would purchase a second store if an offer were extended today, Joan replied "Probably not…because of our age" {251}. She believes that a second store would likely serve some of her already existing customers, resulting in twice the worries without twice the income. Should Joan and Howard pass on the offer to purchase a second store in the area, it is likely that the value of their existing franchise would diminish should they decide to sell and retire.

7.2.4 Franchise Owner D

> "Steve, if everything goes as we hope it will, you'll sign this thing, put it in the drawer and never need it."
>
> Entrepreneur's Source Franchisor

Franchise D is the Entrepreneur's Source, a coaching and consulting service that provides self-employment options, franchising information, education, and training. The company also assists franchisors find qualified and motivated candidates through its process of matching potential franchisee skills and behaviors with the requirements of specific franchise ownership. Steven Swavely, Ph.D. was the first franchisee of this company. Steve owned the Entrepreneur Source franchise in Charleston, South Carolina for two and one-half years before leaving the system at the end of 2000.

Before purchasing the Entrepreneur's Source franchise, Steve considered only a limited number of franchises, including an internet provider and other businesses that could be operated out of his home. He stated "I really only looked at things that I thought I might have an interest in" {8}. At the time, he based his decision on two principal criteria: the enjoyment received through his anticipated role in the business and its earnings potential. Noting his extensive education, experience, and background, "I looked at how could I use those skills to springboard me into business" {18}.

As a franchisee, Steve's role in The Entrepreneur's Source was helping potential franchisees "identify franchises that would be a good fit for them" {25}. His personal experience with the franchise selection process, with thousands of franchise opportunities available, generated his initial appeal for this concept. He recalled that "...when I got hooked up with the Entrepreneur's Source, I thought, now here's a system that makes a lot of sense, in terms of how you go about looking for a franchise. I was experiencing the problem that this business would solve" {29}.

Because he was the first franchisee in the Entrepreneur's Source, Steve actually joined the company before they began franchising. Set up as a "provider," he initially signed a two-page contract that was basically a non-compete clause. "What we actually did is probably illegal from the FTC's (U.S. Federal Trade Commission) point. The thing that made it illegal, in retrospect, is that they made me put up a $25,000 performance deposit" {39}. Three months after joining the company, he was given an option to become a franchisee or to remain under the performance agreement. After reviewing the UFOC, Steve decided to become a franchisee.

Given Steve's experience in assisting prospective franchisees through a franchise evaluation process, he gained first-hand experience with UFOC reviews. "They're (the UFOC documents) very intimidating. I would say that the majority of people I worked with never read the UFOC. I know that from the questions they would ask me, or questions about the terms that I would ask them. Generally, I would say that 90 percent or more never read it" {56}. When asked about the role of the documents in the daily operation of his franchise, he noted that "in terms of running my business, very little. I had an attorney look at it...after I signed that UFOC it went into the drawer and I never saw it again until I decided to exit the franchise" {64}. In Steve's judgment, his experience with franchise documents is typical of other franchisees. "It's a formality, because it's the law," he observed {77}. He noted that strict enforcement of the terms was not a part of his franchise relationship, citing his non-compliance with the franchise's specific requirements to maintain certain office space and signage.

Like most of the franchisees he worked with, Steve had discussions with his franchisor's representatives before receiving the UFOC and franchise agreement. "They start talking about the opportunity, what's involved with being a franchisee. Relationships are formed," he recalled {84}. Prospective franchisees are then presented with a UFOC. "The experience of seeing the terms in the UFOC is 'WOW,' this is so different from what's been happening in our conversations" {86}. He referred to his discussion with his prospective franchisor before presentation of a UFOC as "...a conversation among friends" {87}. After receiving from the franchisor what he called a "shockingly detailed" UFOC, one that included specific hours of operation for his business, he suggested it was "like two whole and separate people" {91}. When Steve relayed his impressions to the CEO of the company, he was told, "Well, we do that because that's what our attorneys tell us we need to do. Steve, if everything goes as we hope it will, you'll sign this thing, put it in the drawer and never need it. If you and I have a disagreement, that's when we use it" {93}.

Steve noted that his company did not force compliance with a number of specific terms contained in his agreement. The agreement did constrain him, however, in his ability to serve his customers and generate additional revenues. He noted that the company had "…a very narrow focus on the service they were going to provide" {104}. He suggested that his franchisor had a vision, and the CEO would not allow his franchisees to deviate from that vision. When asked about the flexibility of services Steve could provide to his customers, the CEO stated "This is the service we are going to provide, and you're expected to provide that service, nothing else" {107}. Although his franchisor appeared not to care about the details of Steve's operation, such as the signage and hours of operation, "When it came down to how do you earn your money, the big picture, they were pretty specific about what I could and could not do" {109}. Steve cited his franchisor's unwillingness to allow him to generate additional revenues through additional services as one of his reasons for leaving the system. When he told his franchisor that he was leaving, the CEO conceded to his request, but imposed such high royalties on additional services that it was unfeasible.

At the time of his departure, Steve had seven and one-half years left on his ten-year franchise agreement. He faced a dilemma that required him to choose between services his customers desired and he was qualified to provide, and the contractual obligations and provisions of his franchise agreement. This franchisor had been experiencing high attrition among franchisees, and was concerned about reporting this outlet closure in their UFOC. Because of this, Steve was able to negotiate a favorable exist strategy with his franchisor. "Technically, when I walked away, the company did not owe me a dime," he said {146}. His terms of separation were different from those outlined in the UFOC.

Steve compared his own franchise purchase experience with his recommendations to his clients. "I think I made the mistake that I told all my clients not to make," he said. "I went into something that I had some experience with, and some knowledge and comfort level with. I would tell my clients, don't just look at what the business does, look at the business itself" {168}. Steve advises prospective franchisees to talk to both current and former franchisees, those that are successful and those that got out of franchising, asking them to describe their typical day while a member of a franchise. He suggests reviewing the UFOC and franchise agreement with an attorney.

7.2.5 Franchise Owner E

> "People believed they were going to be able to live off their business within a year"
> Heidi Kunzel, former MaxCare franchisee

Franchise E is no longer a franchise. MaxCare and its parent company, The Maxim Group, a floor covering retailer based in Kennesaw, Georgia, filed for Chapter 11 bankruptcy protection in 2000. The parent company had been embroiled in several lawsuits, including a class action filing in May of 1999, alleging that company executives misinformed shareholders about their earnings during 1998. The company's share price fell from $25 per share in January to $4 per share in September 1999 after re-stating a previously reported $3 million loss to a revised $17 million loss. The suit also alleged that company insiders took advantage of inflated share prices to sell more than $25 million of their own holdings in the company before reporting the actual loss.[133] The Maxim Group operated several franchises, including Flooring America, Georgia Carpet Outlets, and MaxCare Professional Cleaning Systems. Heidi was a MaxCare franchisee in Charleston, South Carolina. She and her husband Seth continue to operate under the MaxCare name, after buying themselves out of their franchise agreement at the end of 2000.

She recalled that the investigation of possible unlawful activities by the chairman of her parent corporation became known before problems in the MaxCare division were evident. At the time, there were potential buyers for the MaxCare division, but she speculated, "…when they (potential buyers) did their homework and saw what a mess the financials were in…and the negativity of many of the franchisees, they said whoa…we don't need this" {17}.

Originally, the couple decided to purchase this franchise as a partnership venture with Seth's sister and her husband, who were already in the carpet business under the same parent corporation. Seth and his sister went to Atlanta, Georgia and toured the

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[133] Information obtained through *CFO Magazine*, available at http://www.cfo.com/printarticle/1,4580,0|83|AD|1391,00.html.

facilities, receiving what Heidi termed as a "cheerleading session" {28}. The trip had sufficient impact on Seth to begin their process of exploring a family move to Charleston, South Carolina from suburban New York City. Heidi recalled that Seth's parents operated a family business in New Jersey for decades, and her father recently sold his business. She never dreamed of owning her own business, but noted, "At least we have it in our blood" {40}. The couple did not set out to start a business, nor did they set out to buy a franchise. They did not evaluate alternative franchises, rather "the opportunity was presented...we thought it made a heck of a lot of sense" {41}.

Heidi considers herself and her husband to be "totally out of the mould for franchisees" {52}. Seth is an attorney, and she worked as a human resources administrator in a law firm. They read the UFOC and franchise agreement documents, reviewed them with their attorney, identified and asked specific questions before signing the agreement five months after receiving it. In retrospect, she considered the lack of enforcement of UFOC provisions to be more of a problem than the provisions themselves. She cited an example where the couple was awarded "Franchise of the Year" at MaxCare's annual meeting. She discovered at that meeting that "...we were one of a handful of franchises that was up to date with our fees" {74}. Other franchisees were not able to pay their bills, "so they didn't pay the franchisor" {77}.

Just before the bankruptcy, the franchisor began enforcing its collection of fees. Although Heidi noted that "No one wants to see somebody lose their life's savings...it (enforcement) should have happened a year before, at least" {80}. Reporting requirements and quality control were also irregularly enforced. She noted that although there was periodic telephone contact, her franchisor had not visited her territory during her first year of operation. She learned that other franchisees received two or three visits per year from franchisor's representatives, and discovered that franchisees most often visited were those financed by her franchisor. She observed, "Of course they visited them three or four times a year...they (the franchisor) had a lot at stake" {104}.

Despite inconsistent quality control and sporadic enforcement of fee collections, MaxCare did assert control over their franchised outlet operations. Heidi cited an example where her largest carpet-cleaning client asked her to also provide upholstery and drapery cleaning. These additional services presented an opportunity to increase her revenues and profits. Providing these services also prevented loss of her carpet-cleaning service to competitors capable of meeting all of this customer's requirements. MaxCare initially refused Heidi and Seth's request to provide upholstery and drapery cleaning services. Only after the couple performed all the research and purchased the equipment did the franchisor agree to make an exception for them. Heidi was required to pay royalties on revenues from these additional cleaning services. She noted that an ability to adapt and customize their business was an important consideration to the couple when they purchased the franchise.

Initially, Heidi ordered all materials and supplies directly through her franchsor, or her franchisor's designated supplier. She recalled having a problem ordering a specific cleaning solution from a supplier, who told her "...it was not on the MaxCare list (of approved products)" {152}. Heidi explained that she did not "...give a damn if it's not on the MaxCare list" and concluded "To go outside the mould, you have to make a lot of noise" {152}. Since termination of her franchise agreement at the end of 2000, she has used the same suppliers for some of her needs, but is working with other former MaxCare franchisees to find other sources of supply, especially for printed materials. "The printer who was doing the MaxCare stuff was stiffed by the parent organization for tens of thousands of dollars. They (the printers) wanted us (the former franchisees) as a group to sign an agreement and take over some of the remaining debt. Of course, we weren't willing to do that…so he (the printer) burned all the goods he could not sell at clearance" {165}. At its height, there were 74 MaxCare franchise territories; by the end of 2000 there were forty. Some individuals bought themselves out of their franchise agreement for a fraction of what they owed in unpaid fees, vehicle lease payments, and territory fees to their parent organization.

In her opinion, although MaxCare was led by an industry expert, the individual did not have franchising experience. MaxCare also did not maintain a company-owned outlet, "widely believed by franchisees and ex-franchisees that the lack of a corporate model was key in the downfall" {204}. Although MaxCare did not provide an official earnings claim under Item 19 of the UFOC, Heidi believed that her franchisor over-promised sales and profit potential of the business "…people believed that they were going to be able to live off their business after a year" {207}.

Nearly one year after termination of her franchise agreement, her MaxCare outlet remains a viable business in Charleston, South Carolina. When Heidi was asked if she believed that her business was better off today than it was before her franchise agreement was terminated, she said "Hell, yes" {230}. She had gained the technical expertise required to operate her business from her franchisor in the first year of operations, "…and now we don't have to pay any fees…and that's really beautiful"

{237}. She recalled, "There were all these fabulous plans laid out for us…which I totally believed. This was not what we signed on for" {263}. Seth reminder her that they received the best of what the franchisor had to offer, they have a viable business, and they do not have to pay fees anymore. Heidi believed that their business is and will continue to be profitable without the support and purchasing power of a franchisor behind them.

7.2.6 Franchise Owner F

> "From what I can tell, there are not a lot of ideas that *bubble up* from the field"
> Jarrod Brooks, Quizno's Area Director

Franchise F is Quizno's Classic Subs. The company was founded in 1981, and began franchising restaurants primarily in the Denver, Colorado area. In 1987, father and son Dick and Rick Schaden purchased their first Quizno's franchise in nearby Boulder, Colorado. Over the next four years, they bought two additional franchises. In January 1991, the Schadens purchased the entire chain of 18 restaurants from its founders, and now have more than 1,300 outlets operational in 40 U.S. states, Puerto Rico, Japan, Canada, the United Kingdom, Central America, and Australia.[134]

Jarrod is a Quizno's area director franchisee, responsible for franchise development in a 65 county exclusive territory, covering parts of North Carolina, South Carolina and Georgia. His responsibilities include marketing Quizno's franchises to prospective franchisees, assisting franchisees with site selection and lease negotiations, and performing quality assurance inspections of operating franchises within his territory.

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[134] Information obtained through company website at http://www.quiznos.com.

Jarrod's decision to purchase a Quizno's area director franchise was based on his "comfort level with the chain" {6}. His father has owned a Quizno's outlet for more than three years, and his area development purchase decision was one based on an "insider's view," not one based on external research {13}. In legal terms, the area development franchise is owned by Zita, Incorporated, a South Carolina Corporation, jointly owned by Jarrod and his father, who share responsibilities for operations of a franchised outlet and area development duties. The previous area developer in this territory was terminated by his franchisor for non-compliance with terms of the development agreement. Rights to this area had been reclaimed by the franchisor after termination.

Quizno's UFOC discloses four cases of pending litigation, all of which are area developers. Jarrod observed that each case involved "very blatant area director misbehavior" and "almost always have something to do with monetary damages" {62}. He noted that three separate UFOC documents and franchise agreements exist in Quizno's system: franchisee unit; area development; and master franchises for international development.

Purchase of this area development franchise involved a different UFOC review process than that of the franchise unit purchase. Jarrod and his father realized that "its not negotiable anyway," but noted that they "had a level of trust with the people who were making the decisions" {78}. Their experience with this franchisor led to a feeling that "everybody was going to be reasonable, and that in the event that something arose, we would be worked with…as opposed to being held to the letter of the law of the UFOC"

{83}. Although his UFOC contains "dozens of ways to lose your rights," Jarrod noted that his franchisor "has taken a consultative approach…coaching franchisees to do things right rather than summarily citing chapter and verse, terminating agreements left and right" {91}.

Jarrod described examples where Quizno's had demonstrated this consultative approach in their relations with problem franchisees. He cited instances where his franchisor had provided technical assistance, "trying to coach and re-train…even going to the point of monetary help with marketing and food purchasing" {114}. Jarrod noted that his franchisor terminated franchise agreements of these problem franchisees "only after things reached a pretty dire situation…and that was only to protect the brand" {124}.

One of his area development responsibilities is reviewing and discussing UFOCs with prospective franchisees. When asked to describe how prospective franchisees use a UFOC, Jarrod offered, "My perception is that they don't read the UFOC, and have no intention of ever reading it" {131}. He described the document as "…very intimidating. Its one or two inches thick…and every page is full of legalese" {133}. Jarrod coaches prospective franchisees through a UFOC review process, explaining that the document is written in a restrictive manner for everyone's protection.

Unlike a majority of franchises, Quizno's has elected to make voluntary earnings claim disclosure in Item 19 of the UFOC. Jarrod considers this disclosure helpful in selling franchises, since his closest competitors do not make formal earnings claims. He noted that a marketing advantage is created because Quizno's same store sales and earnings have been better than that of their competitors. Jarrod stated that financial disclosures in franchising are regulated, and the U.S. Federal Trade Commission "doesn't let people in my position make a lot of monetary (claims) or give a lot of monetary advice on average sales or cost of goods" {168}. He believed that his job would be more difficult if Quizno's did not provide an earnings claim in their UFOC. Prospective franchisees are also encouraged to contact existing franchisees for sales, income, and other information. Lists of existing franchisees are contained in each UFOC.

Although Quizno's currently provides an earnings claim in their UFOC, Jarrod speculated that changes in the competitive landscape in his industry may affect this disclosure. He noted that "Typically, we come out…and I think most franchises come out with a new UFOC every year" {183}. Although most changes are minor, he recalled that Quizno's issued a new UFOC when they increased royalty fees from six to seven percent two years ago. Jarrod suggested that recent improvements in same store sales by Subway, a substantial competitor in the sandwich industry, may prompt them to begin making an earnings claim in their next UFOC issue.

In addition to marketing franchises, area development agreements require Jarrod to perform quality inspections of existing outlets. Despite his legal status as a franchisee, Jarrod's inspections of franchised outlets are duties normally assumed to be associated with a franchisor. He described his role as a facilitator, between unit franchisees and his franchisor, one that requires "a delicate balance" {226}. Although he is contractually obligated to marketing franchises, assisting with outlet openings, and performing quality inspections, Jarrod sees his role in much broader terms. He does note, however, that his compensation is based on sales at franchise outlets in his area, making it "in my best interests to do what I can to help them (franchisees) grow sales and to help them stay profitable" {240}.

Quizno's is one of the fastest growing franchises in the United States. Jarrod recalled that Quizno's was initially "very product-focused," becoming scientific only after opening 1,000 outlets. The franchise was founded around a product with "flavor mastery" {257}, and a core concept of oven toasted sandwiches that provided a competitive advantage in the marketplace. Jarrod attributes his franchisor's early success to "almost dumb luck" {256}. Quizno's has since employed market research to help them identify new product offerings and address potential customer objections. Jarrod believes that his franchisor is "doing what we do a little smarter now," and concluded that "the more scientific you get, you're able to make more qualified decisions that help your chain grow" {274}. In addition to product development, Quizno's has paid attention to their business model. "We seem to be very unit-level economic focused. We spend a lot of time thinking about what we can do to drive franchisee-level sales and profitability," he observed {277}.

The topic of innovation and adaptation within his franchise system was discussed. Jarrod observed, "From what I can tell, there are not a lot of ideas that *bubble up* from the field" {289}. Quizno's introduces three or four new sandwiches each year. After extensive market testing, his company has reasonable assurance of acceptance before introducing a new product in all of its outlets. A mechanism does exist within the Quizno's system for franchisees to submit ideas for product additions and enhancements. Franchisees must submit details of the new product, including suppliera and samples. Jarrod believes that more ideas do not come from the field because so many come from his franchisor. He noted that some franchisees "actually complain about how much we change menu items" {308}. Quizno's new products introduce change at the franchise outlet level. Jarrod concluded "…when you're in an environment that doesn't seem to get very stale, that kind of keeps franchisees focused on managing what's coming down, not necessarily innovating" {309}. Innovation at the franchisee level within Quizno's is limited to those that involve marketing and promotion of the product.

Quizno's provides financial assistance to prospective franchisees through relationships established with third-party lenders. "The effect of that (relationship) is to mitigate or soften the underwriting requirements that franchisees may face at a normal commercial lender" {437}. Lenders familiar with Quizno's operations have assurances that if operated according to the franchisor's standards, franchisee profits should be sufficient to repay the debt. Other financial assistance provided by this franchisor include equipment and supplier discounts.

7.3 Cross Case Analysis

Eisenhardt posited that the key to good cross-case comparison is counteracting the tendencies to reach premature and false conclusions resulting from information-processing biases (Eisenhardt 1989). She suggested a tactic of selecting "categories or dimensions, and then to look for within-group similarities coupled with intergroup differences" (p. 540). Eisenhardt concluded that cross-case tactics enhance the probability of capturing novel findings that may exist in the data. Categories for cross-case comparisons emerged from these interviews, which are presented under separate headings.

7.3.1 Franchise Motivation and Selection Process

Interviewees revealed different motivations and evaluation criteria in their franchise selection processes. Evelyn and Heidi selected their franchises to take advantage of specific opportunities in specific locations. Evelyn's husband had worked for the parent organization and they knew several people already a part of the franchise system, while Heidi's sister-in-law was in a related business. Steve based his decision on his technical ability and the job content presented by franchise ownership. His investment in his education and experience within the field led him to choose a franchise based on the technical aspects of the business. In contrast, Susan's primary selection criterion was flexibility. She had no knowledge of the technical aspects of the business prior to purchase of the franchise.

Joan and Howard chose their franchise in part because they were customers, in part because their franchisor's headquarters was located near their home, and in part because Howard had lost his job. While the other franchisees were "pulled" into the opportunity of a franchise, Howard was "pushed" by his loss of employment. Jarrod also had considerable familiarity with his franchisor's concept, although it was from a different perspective. He was actively involved in the selection process and ongoing operations of his father's franchised outlet before he purchased an area development franchise from the same franchisor. Evelyn, Heidi, and Jarrod purchased their franchises without evaluating other opportunities. These franchise purchases each involved the opportunity to work with family members. Steve and Susan evaluated a limited number of franchises before choosing their respective businesses. Joan and Howard chose their franchise after limited evaluations of other franchises using secondary data.

7.3.2 Role of UFOC and Franchise Agreement in Selection Process

In the U.S., federal law requires franchisors to disclose material facts about a franchise to prospective franchisees before purchase. UFOCs are designed to play a central role in a formal disclosure process from franchisors to prospective franchisees. Their role in the selection process appeared to differ among interviewees.

Heidi and her husband evaluated and questioned their franchisor about provisions in their agreement over a five-month period. Although they were unable to negotiate any contractual provisions, they felt as though all of their questions had been answered. Despite the fact that Heidi's husband was a practicing attorney, they had their franchise agreement reviewed by another attorney before signing it. At the other extreme, Evelyn recalled that her UFOC "was about 90 million pages," and confessed, "I don't think we ever even read it"{53}. For her and her husband, the franchise was a good fit with their future plans, and the UFOC review was little more than a formality.

Although Joan and Howard had decided that their franchise decision was a sound one, they asked an attorney to review the franchise documents prior to their purchase. Steve, Susan, and Jarrod each performed their own evaluations of the franchise documents, and did not seek legal advice before purchasing their franchise.

7.3.3 Role of UFOC and Franchise Agreement in Daily Operations

Interviewees agreed that contractual provisions in their UFOCs and franchise agreements had little to do with daily operations of their franchised businesses. In Evelyn's franchise system, a trade association attorney, one who formerly worked for her franchisor, negotiates on behalf of all franchisees in her system. Although new revisions to her agreement affect her business operations through new products or services, the cohort of franchisees must approve these revisions before implementation.

In Jarrod's role as area developer, his contractual responsibilities include little more than marketing franchises to prospective franchisees, active participation in store openings, and periodic quality inspections of franchised outlets. Because his compensation is both directly and indirectly affected by sales at franchised outlets in his territory, he assumes duties beyond those prescribed in an effort to enhance store-level sales and profits. Jarrod's contractual agreement with his franchisor provides little more than a set of minimum responsibilities in his view, not an all-encompassing job description.

Perhaps the most apparent discrepancy between the contractual obligations and the daily operations of a franchised business is evident in Susan's franchise. In violation of contractual provisions, Susan operates her business using her personal vehicle, with the knowledge of her franchisor. Selective enforcement of contractual provisions was also evident in Steve's franchise, where hours of operation and signage requirements were not enforced, but service offerings were strictly monitored. Steve summarized the role of franchise documents in the daily operations of the business, recalling that his franchisor told him that as long as things were going well, the documents would not play a part in their relationship.

7.3.4 Flexibility and Adaptation

Flexibility and opportunities for adaptation were more evident in some franchised businesses than in others. Unlike many other franchise owners, Evelyn's franchise did not prohibit simultaneous ownership of another related business. Although she is prohibited from offering products that directly compete with her franchisor's products, she has built a sales and service offering a full line of audio and electronics to complement her franchised business. In his role as area developer, Jarrod has considerable latitude and discretion in his duties, accountable only for an agreed upon number of new outlets sold and opened on an annual basis. Susan also has a degree of latitude in the products and services offered through her franchise. She is not limited to exclusive use of her franchisor's product offerings, and is free to purchase materials to meet her customer's needs.

Joan, however, has less discretion over product offerings at her retail outlet, in part because of liability issues associated with the nutritional supplements she sells. She was not able to take advantage of short-term market opportunities for one supplement because of her franchisor's concerns for safety. Joan's competitors did not exercise the same level of caution, and reaped substantial rewards. In Steve's case, his franchisor's unwillingness to allow discretion in service offerings resulted in termination of his franchise agreement. He was prohibited from offering additional services that would enhance his profitability and improve his cash flow despite his qualifications and expertise. In similar fashion, Heidi was initially prohibited from offering ancillary services to her customer, only receiving permission to do so after agreeing to pay royalties to her franchisor. In Steve's case, an inability to offer additional services was a primary consideration in his decision to leave the system.

7.3.5 Franchisor Control over Franchise Outlet Operations

Franchisor control over operations of an outlet was manifest in several different ways. Although her franchisor allowed franchisees to operate related businesses, Muzak exerted substantial influence over her outlet's operation through negotiation of national agreements on behalf of all franchisees. Evelyn noted that although agreements with large accounts provided her with sales tools, they were deeply discounted, and not profitable.

Despite specific contractual provisions in UFOCs, franchisor control was often used in the discretionary and selective enforcement of agreement terms in several cases. In Susan's case, the requirement to purchase a van represented a substantial expense for her emerging franchise. By not enforcing the contractual requirement to purchase a van, Susan's franchisor improved her profitability in the early months of operation, and appeared to improve the working relationship between them. In contrast, selective enforcement of quality standards and royalty payment collections by Heidi's franchisor were contributors to the demise of the system. In Steve's case, the requirements for office space and signage were not enforced. Jarrod's franchisor exercised restraint in enforcing contractual provisions, only terminating agreements when other options were exhausted. Selective enforcement helps to explain a detachment between franchising's formal context and its operational realm.

7.3.6 Franchise Owner Interviews: Additional Insights

In addition to topics that covered research questions, franchise owners provided other valuable insights into the daily operations of franchised businesses. First, as Heidi's case illustrated, bankruptcy by her franchisor did not necessarily result in a simultaneous failure of all franchisees. Her business and the businesses of 40 former franchisees continued without franchisor support, capitalizing on the technical training and brand awareness built while a franchisee without continued royalty payments. Second, although viewed as long-term contracts, franchisors revise UFOCs and franchise agreements periodically. Provisions contained in one edition may or may not be present in subsequent editions, and franchisees in the same system may be operating under different contractual provisions. Third, unit franchisees, area developers, and master franchisees within the same franchise system may operate under different contractual agreements. Despite their legal position of franchisee, area developers assume roles of marketing and quality assurance, roles more similar to that of franchisors than unit-level franchisees.

7.4 Franchisor Representatives Interviews

Franchise agreements and UFOCs are widely accepted as adhesion contracts; non-negotiable, presented on a take-it-or-leave-it basis (Brown 1985). Drafted by franchisors and their attorneys, these documents define the franchise relationship in detail, designed specifically to ensure that franchisees adhere to their terms (Falbe and Dandridge 1992).

Lafontaine and Shaw observed that theories of franchise contracting are "fundamentally static," and do not incorporate the dynamic phenomena "that could produce systematic changes in contract terms over time" (Lafontaine and Shaw 1999, p. 1043). The authors argued that franchisors learn during the process of franchising, which should affect the terms of their agreements. Fees may be modified to attract additional franchisees, and technology changes such as the Internet may require additional provisions to be written into franchise contracts. These issues, Lafontaine and Shaw concluded, have not been addressed in the theoretical literature.

To explore the formulation process of UFOC and franchise agreement provisions, and to complement the perspective offered by franchisees, interviews were conducted with representatives of a franchisor. The chief financial officer and general counsel of Quizno's Corporation were selected for interviews. This franchise represents one of the fastest growing firms in the quick service restaurant business, a highly competitive industry. Personal interviews were conducted at Quizno's corporate headquarters in Denver, Colorado in September, 2001.

7.4.1 Franchisor Representative A

> "The only time we look at the franchise agreement is when there is a problem."
> Patrick Meyers

Patrick E. Meyers has been Vice President and General Counsel for Quizno's Corporation since its incorporation in October 2000. He has held similar positions with Quizno's since January 1997. Previously, Mr. Meyers was one of Quizno's Directors (from 1993 to 1997). Before becoming general counsel, Mr. Meyers was an attorney at the Denver, Colorado law firm of Moye, Giles, O'Keefe, Vermeire & Gorrell from September 1991 to January 1997.

Mr. Meyers described the UFOC and franchise agreement process as an evolutionary one. "Typically, when a franchisor is just starting out, its going to go to a franchise lawyer and use basically whatever form that franchise lawyer is comfortable with...and that's basically what we did" {6}. Quizno's present franchise agreement is "a compilation between what some lawyers thought was good and what I thought was good" {12}. In his opinion, all franchise agreements are going to have the "standard boiler plate stuff" {23} in them, such as licensing the trademark, dispute resolution, covenants not to compete, and confidentiality provisions. Differences among agreements will be driven by the industry and "the philosophy of the franchisor's legal counsel" {32}.

He explained, "I tend to have a philosophy of having a very tough franchise agreement. The reason is that as long as the system is working…as long as we are working well with the franchisee and the franchisee is complying with system standards, we never look at the franchise agreement- we never worry about it. The only time we look at the franchise agreement is when there is a problem. And so…I want it to be as enforceable and tough as possible" {35}. The philosophy of an agreement is communicated in the language of a franchise agreement and UFOC. Noting the difference between UFOCs and franchise agreements "…the UFOC has to describe all those things in plain English, as opposed to the franchise agreement which do not have to be written in plain English. Its easier to look at the UFOC to figure out what the franchise agreement is saying" {51}.

Contract term and dispute resolution provisions were reviewed. The decision of a fifteen-year agreement term dated back to the late 1980s, before Mr. Meyers joined the firm. Although he did not think that fifteen years was the norm for restaurants, he did not consider the difference between ten and fifteen years to be significant. He noted that Quizno's non-traditional agreements, such as those used in airport locations, have a five-year term. In dispute resolution, Quizno's franchisees waive their rights to a jury trial, as a condition of the agreement. Dispute resolution provisions "come from my philosophy" {75} Meyers stated. "I do not want the company to be put before a jury…because I do not like the jury dynamic. When you have a small mom-and-pop operator…and a large corporation on the other side…that particular dynamic is not a good one for franchisors" {76}. He added that he also tries to avoid arbitration as well, preferring instead to be before a judge.

Unlike a majority of franchisors, Quizno's elected to make an earnings claim in Item 19 of their UFOC. Meyers stated, "For one reason, the first question that comes up in a franchise sale is the prospect saying *How much money am I going to make?* It's very difficult to put a sales person in the position of saying *I can't tell you anything, I can't share any number with you, at all"* {110}. He believed there would be a tendency for sales people to "cross the line" if no earnings claim were provided, noting that the largest number of enforcement cases handled by the U.S. Federal Trade Commission were related to earnings. Meyers is undecided, however on whether earnings claims should be a mandatory disclosure for all franchises.

Asked to comment on pending franchise legislation, known as the Coble-Conyers Act, Meyers offered the following: "The problem with Coble-Conyers, at least in the forms that it has been introduced, is…that it is very draconian, and would make franchising very difficult. The missing concept in Coble-Conyers is that, I believe, it comes from a philosophical position that franchisors are inherently unfair to franchisees, and over-reaching. I don't believe that that's true" {169}. The bill also misses what Meyers believes is true: "…that franchisors, in order to protect all of the franchisees…have an inherent reason to enforce system standards" {175}. Poor cleanliness in one store hurts other operators, and the bill would make it difficult and time consuming to correct these types of problems. He concluded "Coble-Conyers approaches things from a standpoint that we're out there beating on people just for the sake of beating on them" {182}.

According to Meyers, Quizno's made some decisions in the past that were not necessarily popular with their franchisees. They began to automatically debit franchisee accounts for royalty payments, as opposed to letting them pay by check. Meyers recalled, "That was not a popular decision...but I'll tell you what...it was the best decision we ever made" {189}. The company also changed the Point of Sale (POS) system in all their stores. Although this change is expensive for franchisees to implement, "it's the right thing to do for the system" {197}. He suggests that a focus on franchisee profitability minimizes disputes between franchisors and franchisees. "If a franchisee is making money, you won't have a dispute. If a franchisor loses sight of unit profitability...and the units start to lose money...you're going to have disputes all day long" {217}.

Franchisors are required to disclose pending litigation in Item 3 of their UFOC. Meyers opined that the amount of litigation may be an indicator of the comparative harmony or discord with any given system, but cautioned that "Some franchisors will take the position that it's not material because, even if they have theoretically material claims, their system is so large that one piece of litigation is not material" {240}. When asked about the legal environment of the future, Meyers did not believe that franchise associations and codes of ethics, such as those found in Australia, would play an important part in the U.S., unless they are mandated. He also believes that more states will shift away from regulation, especially when business opportunities (those businesses that require less than $5,000 investment) are differentiated from franchises. He believes that more and more countries overseas will continue to adopt franchise regulation "Whether it's a code of ethics, or registration process, or disclosure process, or a myriad..."{281}.

7.4.2 Franchisor Representative B

> "A franchisee will work 12 hours a day, seven days a week and he'll love it. Our paid people would never do that, no matter how hard we try."
> John Gallivan

John L. Gallivan is Chief Financial Officer, Treasurer, and Assistant Secretary of the Quizno's Corporation. Mr. Gallivan has been Treasurer and Chief Financial Officer, and a Director since incorporation in October 2000. He held similar positions with the company since April 1994. From 1979 through March 1994, he was a director and executive vice president of Grease Monkey International, Inc., located in Denver, Colorado, a franchisor and operator of quick oil change centers.

With extensive franchising experience in two different industries, Gallivan noted that both shared the same finance problem: "...sourcing competitive financing for our franchisees to be able to purchase the franchise and start up the business" {12}. He concluded, "You have to have those financing sources available to continue to grow, irrespective of how good your product is" {20}. Growing franchisors encounter potential problems with lenders because of the manner in which franchise fees appear on their accounting statements. For all stores that have not yet opened, non-refundable franchise fees are entered into an account called 'deferred franchise revenue,' a liability on the balance sheet. Gallivan stated, "When we show the financial statements to bankers, we say this amount is not a debt…we do not owe that money…but it's also not recognizable as income; it's there in limbo" {42}.

Similar to non-franchised businesses, start-up franchises often have cash-flow problems. Gallivan recalled "The first years were difficult…we were very, very earnings conscious…we pinched pennies, until we started making money regularly" {55}. Quizno's recent successes and growth have not substantially changes their financial strategy. He noted "We still pinch pennies…we still run this thing by the budget" {64}. Gallivan believes that many young franchises lack the financial discipline to develop and adhere to a budget. He credits Quizno's CEO for his complete support of their financial management process.

As noted earlier in this section, Quizno's CEO is a former franchisee, who "knows what it is like to be a franchisee and what it takes to make money in this business" {100}. This could explain the company's focus on franchisee profitability. Although some firms measure their success by the number of franchises sold, Gallivan offered "When we get them open, we've got to make them profitable…and that's when we know we're successful" {114}.

Unlike other franchises that begin by exploiting new market opportunities, Quizno's entered a competitive market with large, established competitors. Gallivan mused "I don't think anybody would ever sit around and say *Boy, I think it would be a good idea to get in the quick service restaurant business, and compete against Subway with 13,000 units, Blimpie with 5,000 units and every other person in the world…*" {122}. The company targets customers who value premium ingredients, and does not compete directly for the more price conscious customers likely to patronize their competitors. Quizno's same store sales are higher than that of their competitors, a fact that Gallivan believes should be important to prospective franchisees. "If the franchisee is doing their job, they will do those kinds of comparisons. I'm not sure that the majority of them actually do that much due diligence…but the ones that do will choose Quizno's" {155}.

The company used its company stores to establish a business model by which franchisees could benchmark their unit profitability. Each day, the company accumulates sales and cost data from each of its 1,300 outlets. Data is split by area, and data from all stores are faxed back to every store for comparison. Outlets with higher costs would then call better performing storeowners to see what that owner was doing differently. Gallivan noted that the process created peer pressure and competition among franchisees. He cited the major reason for low profitability at franchised outlets is the franchisee's failure to control costs, and labor management is "the most important thing" {213}.

Gallivan suggested several ways to compare franchise opportunities using UFOC disclosures. He would first look at earnings. If a franchise did not provide an earnings claim, he recommends getting information from existing franchisees. He would also look at the amount of litigation, noting that a surge in legal problems could be an indication that the system is in trouble. Next, he would look at the background of the management team. Experience in service management could be an indicator of an ability to provide service to franchisees. Lastly, he advises a review of the franchisor's financial statements. Well-capitalized franchisors "spend their time building a good system...not all their time trying to raise money to pay the bills" {263}.

Quizno's bases its fees and royalties on industry norms. Gallivan noted that franchisees often combine royalties and national advertising fees together as a payment to a franchisor. He noted that advertising fees are placed in a trust account and spent exclusively on advertising, where franchisees get the real benefit of combining their money to purchase advertising they could not afford on their own. The company looks at individual store economics, what the franchisor brings in terms of reduced costs of food, insurance, and other items. Quizno's solved the time-consuming problem of collecting royalties by requiring weekly automatic debiting of franchisee accounts as a condition of franchise purchase. Gallivan noted that he used to spend half of his time calling franchisees, reminding them to submit their royalty payments before implementation of the automatic debit provision.

Despite this franchise system's growth, this franchisor must deal with problem franchisees. Gallivan offered, "...we like our franchisees...you get to know them...and you meet them at gatherings. Sometimes we struggle...one gets in trouble and they are losing money, then they are out of money {362}. He noted that it is human nature to pull together all the resources of the firm to try to help this person, to make things work, and to help get his loan paid. Despite the temptation, Gallivan noted that focusing the company's limited resources on one-thirteen-hundredth of the company may not be in the best interest of the entire system. "As hard as it is to let this one unit fail, you've got to let it fail" {373}.

The role of company-owned outlets in Quizno's franchising system was discussed. Although company-owned outlets may be more profitable in some systems, they are not in this system. Gallivan observed, "Company stores do create cash flow, good cash flow for us. But not necessarily profits after depreciation and amortization" {385}. In this system, company-owned outlets provide places to experiment with new ideas, training facilities for new employees, and facilities in which to bring prospective franchisees. He noted that given comparatively low sales volume and tight margins of their system, a mistake in a company-owned outlet has a tremendous impact on profits, much more so than in higher margin casual dining restaurants. Larger restaurants are also better able to afford on-site, professional general managers than quick service restaurants, which are better suited to owner-operators.

Noting a difference in work habits between franchisees and managers, Gallivan stated, "A franchisee will work 12 hours a day, seven days a week and he'll love it. Our paid people would never do that, no matter how hard we try" {399}. Power of ownership was evident in the conversion of 18 company-owned stores in Denver to four limited partnerships; joint ventures between Quizno's and former managers of the stores. These former managers, now compensated on a percentage of unit profits, are more motivated to improve overall performance in their outlets. Gallivan noted that the biggest challenges faced by his company are remaining consistently profitable and finding good people. He believes the greatest risk faced by his firm is that of obtaining credit for franchisees in need of start-up capital.

The ability to adapt and change in response to market dynamics is considered important at Quizno's. Gallivan noted that Dairy Queen, one of the biggest franchisors in the country during the 1960s, "lost their system...they lost their niche...because they just did not have the mechanics in place to upgrade or change their image and keep up with the times" {461}. He noted that many franchisees ran their business for 20 years, extracted all they could from the business, and allowed the chain to become dirty and dilapidated. The main reason cited was the lack of a specific requirement for franchisees to make upgrades. He noted that this requirement is especially important in the food service business, where customers expect operators to "keep that image new all the time" {473}.

Achieving growth through a limited number of new offerings while remaining focused on their core competency is the strategy outlined at Quizno's. Unlike other franchisors that have grown through acquisition of other chains, Gallivan stated that Quizno's acquisitions are primarily real estate acquisitions. He noted that negotiations and due diligence make acquisitions more time consuming than growing their chain through current methods. Quizno's is currently opening a new store, on average, every 16 hours.

7.4.3 Franchisor Representatives Summary

Interviews with Mr. Meyers and Mr. Gallivan revealed several aspects of franchisor-franchisee relations germane to this study. First, UFOC and franchise agreements evolve over time. As franchisors gain experience, franchise documents are likely to reflect their business philosophy, as opposed to merely meeting the legal requirements of disclosure. Competitive pressures in the marketplace for franchise fees and royalties are also likely to influence contractual provisions as a franchise matures. Second, both representatives believed that most prospective franchisees do not perform adequate due diligence. They confirmed opinions revealed by franchise owners that a majority do not read UFOCs and franchise agreements before making a franchise purchase. Third, supporting opinions expressed by franchise owners, franchise documents are primarily used in the event of a dispute between franchisor and franchisee.

7.5 Summary

This portion of the study focused on the operational realm of franchising. Semi-structured interviews were chosen to explore subtleties, perceptions, and dynamics. Four current franchise owners were selected, representing a variety of industries. Two former franchise owners were also interviewed: one who voluntarily left the franchise system, while the other continued in business after her franchisor ceased operations after bankruptcy.

To provide additional insights into franchising's operational realm, interviews with the general counsel and chief financial officer of a franchisor were performed. This franchisor represents one of the fastest growing systems in North America, with operations in several overseas markets as well as those in the U.S. and Canada. These interviews revealed aspects of the formulation and enforcement of franchise contract provisions, bridging the operational and formal realms of franchising.

Cross-case comparison of current and former franchisees revealed that individuals purchased their franchise for different reasons. Some were attracted to the type of business, some to the location in which the business opportunity was presented. Some evaluated other opportunities, while others considered the franchise they purchased exclusively. The role of the UFOC in their selection process also differed; some performing detailed evaluations while others viewed it as a legal formality. Both existing and former franchisees agreed, however, that the UFOC and franchise agreement played little or no part in the daily operations of their business. Franchise documents were examined by the former franchisees only when separation from their franchisor became imminent.

8.0 DISCUSSION

"Strategic alliances and partnerships are like marriages…" (DeRose 1994, p. 182)

8.1 INTRODUCTION

The overall purpose of this study was to explore entrepreneurial opportunities within franchising's formal and operational contexts. It began with an exploration of franchising's formal context using primary data gathered from UFOC and franchise agreements, and continued with an examination of contractual provisions using secondary data sources. Although insightful, these assessments provided only a partial view of the phenomenon. In order to present a more comprehensive study, an examination of franchising's operational realm was performed, using semi-structured interviews with present and former franchise owners and key representatives of a franchisor.

Although opportunity exploitation is most often associated with the quick decision-making, simple administrative structures, and flexible operations found in small firms (Baldwin 1995), a number of large firms have exhibited entrepreneurial behaviour within their organizations (e.g., (Kanter 1997); (Covin and Miles 1999) enabling them to rapidly adapt to changing market demands (Jennings and Beaver 1997). Large firms typically adopt flexible organization structures to enable quick response to dynamic changes in the market. Although generally considered a hybrid organizational form (Shane 1996), franchising creates a formally structured hierarchy, one in which franchisors retain legal authority and operational control of franchisees through detailed contractual provisions. When compared to non-franchised firms, franchising organizations appear mechanistic, with goals to produce the same product repeatedly, and whose human "machines" comply with the rules as designed (Morgan 1997). In contrast to innovation and adaptation, franchising's underpinnings are replication, standardization, and conformity, creating a theoretically unpromising context for entrepreneurial opportunities and behaviours. Entrepreneurial behaviours, such as innovation and adaptation, have been considered inherently illegitimate in these and other highly structured organizations (Kirzner 1979). Franchising's success, when viewed from a societal or individual firm level, appears to create exceptions to established constructs linking entrepreneurship with firm performance in both small and large firms.

No longer considered a exclusively as small firm phenomenon, entrepreneurial opportunities and processes have been found within corporate organizations, and have been linked to firm performance (Kanter 1996); (Kanter 1997). Corporate entrepreneurship has recently become a topic of discussion among both practitioners and academics (Sharma and Chrisman 1999). Once viewed as an oxymoron, (Stevenson and Jarillo 1990) corporate entrepreneurship has been legitimatised by growth in the field of firm-level entrepreneurship research (Zahra, Jennings et al. 1999). Corporate entrepreneurship (CE) has been linked to profitability, survival, and growth (Zahra 1996), the pursuit of competitive advantage (Covin and Miles 1999), improved firm performance[135] (Peters and Waterman Jr. 1982), value creation (Vozikis, Bruton et al. 1999), and organizational adaptation and renewal in firms (Falbe, Dandridge et al. 1998).

[135] Dess observed that the literature generally supports a notion that corporate entrepreneurship is related to performance, but the relationship may not be immediately apparent. (Dess, Lumpkin et al. 1999)

When franchising firms open new outlets, they enter new markets and create new revenue streams, arguably meeting criteria generally accepted for venturing. Although comparative measures of entrepreneurial orientation have been developed, and shown to be linked to improved firm performance in large firms (Covin and Miles 1999), constructs developed in corporate entrepreneurship have not yet been applied to studies linking entrepreneurial orientation to performance within franchising's context.

8.2 Review of This Study

Previous research in franchising relied extensively on agency, resource constraint, ownership redirection, and other borrowed theories. Franchising has also been studied merely as a form of contracting, licensing, or distribution, although these approaches have been considered too narrowly focused. Research in franchising has generally been concentrated in three major categories. The first examined aggregate data on franchising, including its contributions to overall economic development, and comparative success and failure rates. The second category included studies that focused on success, failure, satisfaction levels, and characteristics of individual franchisees. The third contained research primarily focused on franchisors, including studies of why firms chose franchising as an organizational form. This study falls primarily into the second category.

One criticism of earlier theoretical approaches to studies of franchising is that they often ignored much of the complexity and dynamics revealed in empirical studies. Those that narrowly focused on contracting aspects or the principal and agent relationship created by a franchise were unable to explain many of the complexities found in empirical studies, such as multi-unit ownership, and simulataneous use of both franchised and company-owned outlets. Some franchise researchers have called for additional theoretical development using more supple approaches, ones that link strategies and performance. Consistent with that theme, this study pursued four primary objectives:

1. To explore franchising's formal context, examining the nature and extent of homogeneity in its disclosure and contractual provisions.
2. To examine relationships between firm characteristics, contractual provisions, growth, and growth strategies among firms engaged in franchising.
3. To test the ability of characteristics and contractual provisions found in franchising's formal context to predict measures of firm growth.
4. To examine relationships between franchising's formal context and its operational realm, exploring the role of disclosure and contractual agreements in franchise selection processes and daily operations of franchised businesses.

On the surface, franchised businesses appear to operate in a homogeneous and regimented environment, circumscribed by contractual provisions in detailed, long-term agreements. Innovation, creativity, adaptation, and risk-taking, widely accepted indicators of entrepreneurship, are not likely to be found in organizations whose underpinnings are replication, standardization, and strict adherence to detailed policies and procedures. Franchising's success and socio-economic impact, despite apparent regimentation and uniformity, creates a paradox with widely accepted paradigms of entrepreneurship. Although potential discretion and adaptation was posited in the literature, little or no empirical evidence was found to support its existence. The nature and extent of entrepreneurial opportunities within franchising remained an area largely unexplored.

Entrepreneurship research has identified characteristics and behaviours as contributors to success in both small and large firms. As an academic discipline, entrepreneurship has progressed beyond exclusive use of borrowed theories and broadened its scope past the mere birth of small firms. Corporate entrepreneurship research has found that behaviours and strategies considered entrepreneurial among individuals were also desirable in large firms. Empirical studies of large firms have linked performance with entrepreneurial behaviours, strategies, and organic organization structures. Widely accepted indicators of corporate entrepreneurship are: (1) strategic renewal within an organization; and (2) corporate venturing through creation of new units within the same organization. Research in corporate entrepreneurship has legitimized studies of entrepreneurial behaviour using a firm as the unit of analysis, and has developed entrepreneurial orientation constructs that serve as a basis of comparison among firms.

Although substantial advances have been made in establishing links between entrepreneurship and performance in both small and large firms, entrepreneurship's association with performance among franchised firms is less well developed. Comparative neglect is especially apparent when franchising's socio-economic impact is considered. One explanation is that franchising does not conveniently fit within previously established limits of any academic discipline. Another may be that franchising has often been positioned in somewhat of a theoretical abyss; midway between market and hierarchy, and half-way between corporate employment and independent entrepreneurship.

This study's overall scope included explorations within franchising's formal context, as defined by its disclosure documents and contractual provisions; and examinations within its operational realm, one in which daily operations of franchised businesses are conducted. This study began by testing assumptions of uniformity within franchising's formal context, focusing on areas that affect cooperation and franchisee discretion in the operations of their businesses. After an exploratory study, provisions most likely to affect franchise owners were gathered from disclosure and contractual documents. In all, 24 variables that governed or defined franchisee responsibilities were operationalized from a sample of 55 UFOC documents and franchise agreements. Regimented disclosure requirements imposed on franchisors in the United States not only provided fertile ground for this study, but also a logical framework for categorizing contractual provisions. Although subjects were coded exclusively by the author, a binary system indicating an absence or presence of specific contractual provisions was devised to reduce error and ambiguity.

Analysis of this sample revealed differences among franchises, and areas where franchisees were not completely circumscribed by contractual provisions. For example, examined collectively, franchise agreements are often viewed as 'tying' agreements, which violate anti-competitive laws in many countries. In contrast to this generalization, nearly one-third of franchises in this sample did not require franchisees to purchase supplies directly or through sources specified by the franchisor. Additionally, more than 63 percent of franchisors did not require approval of local advertising, providing discretion in local marketing to franchisees. Contrary to a stereotypical image of a franchisee as an owner-manager of a single outlet, less than half of franchises in this sample (49.1 percent) required that owners devote full time to operations of their business. Based on analysis of data collected in this sample, assumptions of uniformity and homogeneity could not be supported. Franchising does not appear to create a uniformly constrained context in which entrepreneurial processes are likely to be most apparent.

The next section of this study expanded analysis of franchising's formal context, examining relationships between franchise characteristics, contractual provisions, and measures of firm performance. In the absence of an official source of franchise data, facts were gathered from three independent sources. The first dataset was developed from facts obtained through a random sample of 592 franchises posted on FRANDATA's FranchisePlanet website.[136] The second gathered data from 598 franchises published in *Entrepreneur* Magazine's 2000 Edition of its Franchise 500®. The third dataset was constructed with facts from 1,201 North American franchises obtained through Source Book Publications, publishers of *Bond's Franchise Guide.*[137] These sources were selected because each were found to be reliable in previous studies of franchising, because they contained information on contractual provisions and franchise characteristics, and because they contained information on historical growth, projected growth, and expansion strategies. The quantity of data and number of franchises operationalized in these datasets enabled use of quantitative methods of analysis, including factor analysis and multiple regressions.

Analysis of these datasets revealed contractual and organizational complexities among firms not always considered in studies of franchising. For example, in FRANDATA's sample, more than 63 percent of firms employed both company-owned and franchised outlets in their systems. Only a minority of firms in this sample used franchising exclusively as a means of expansion. In addition, some franchises offered different programs and businesses within their systems. More than 15 percent offered other programs, such as conversion programs and co-branding, while 17 percent of franchises

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[136] FRANDATA's FranchisePlanet website was available at http://www.franchiseplanet.com. The website was shut down in the Fall of 2000.
[137] Source Book Publication's franchise website is found at http://www.worldfranchising.com.

in this sample offered other business types, such as kiosks and express stores in addition to their basic franchise concept. This suggests that all franchised outlets within a concept or system may not necessarily require the same investment, fees, or operational responsibilities.

A dataset was built using franchisor responses to a survey conducted by Source Book Publications, publishers of *Bond's Franchise Guide*. It contained a number of franchise characteristics, such as the year in which a company began operations, number of outlets, and fees. This dataset also provided indicators of past performance and future growth plans, such as the number of projected new openings in the next twelve months, including the geographic focus of each franchisor's expansion plans. Analysis of this sample revealed that franchises differed in measures of organizational complexity. Area development agreements were offered by 51.8 percent of franchises in Source Book's sample. Area developers assume roles commonly associated with franchisors, such as franchise marketing and quality control of franchised outlets. Contractual provisions also varied among franchises. In this sample, more than two-thirds of franchises (67.4 percent) provided financial assistance to franchisees, while 26.3 percent voluntarily disclosed earnings and/or average sales to prospective franchisees.[138]

Using Source Book's dataset, three measures of growth were operationalized: (1) compound average growth rate (CAGR);[139] (2) projected growth in number of new outlets in the upcoming twelve month period; and (3) ratio of projected new units to

[138] This finding contradicts a previous study by Mehta et al. In this study, differences were revealed in an ANOVA comparison of the three datasets, delimiting to only those firms within each dataset.
[139] CAGR= (current number of outlets) $^{1/n}$ –1; where n= age of the system in years.

total number of outlets. In aggregate, firms in this sample represented 365,046 franchised and company-owned outlets, and projected to open an additional 37,380 new outlets in the upcoming twelve-month period, an increase of 10.23 percent over their current base. A few firms in this sample had disproportionate influences on the total; four franchise concepts planned to add in excess of 1,000 outlets each in the upcoming year.

Twenty-seven variables operationalized in Source Book's dataset were reduced to a manageable number through factor analysis. Emerging from this analysis were eight factors, which served as inputs into a multiple regression analysis, using three measures of franchise growth as dependent variables. The model produced an R-square value of .500 using CAGR as the dependent variable, .367 for the percentage growth based on projected new openings, and .283 using the actual number of projected new openings. This model was clearly better at predicting CAGR, an historic measure of growth, and less effective at predicting future measures of growth.

The first two sections of this study focused entirely on franchising's formal context. The third section concentrated on franchising's operational realm. Semi-structured, personal interviews were performed with six franchise owners, two of whom recently terminated agreements with their respective franchisors. Franchise owners were chosen to represent a diverse sample of industry and franchise experience. In addition to franchise owners, personal interviews with the general counsel and chief financial officer of a rapidly growing franchisor were conducted. Within-case analysis was performed on all interviewees. A cross-case comparison was performed for present and former franchisees, comparing the role of disclosure documents in their franchise selection process, and in daily operations of their franchised businesses. Interviews with franchisor representatives provided insights on franchise document creation and evolution, as well as underlying justification behind some contractual provisions. All interviews were done in person by the author, audiotape recorded with permission from interviewees, and transcribed.

8.3 Discussion and Implications

This section discusses the findings and implications of this study. It addresses the initial research questions, followed by a review of the hypotheses tested, and concludes with the examination of franchising's operational context.

8.3.1 Research Question of Homogeneity

The first research questions examined homogeneity within franchising's context, as presented in Chapter 5 of this study. This study revealed differences among franchise provisions, organizational structures, and concept offerings among firms in the sample.

Regimented disclosure frameworks characterized UFOCs in this sample, while contractual provisions and disclosures contained within this framework varied considerably among franchises. Franchise agreements varied in length from 15 to 35 pages, each with between 5 and 12 separate addendums and exhibits. Some franchises contained contractual provisions that explicitly circumscribed franchisee autonomy, such as those that specified minimum hours of operation or restricted products or services offered at franchised outlets, while others restricted suppliers, typical of 'tying' agreements. Other franchises were found to have less stringent provisions. Although strict quality control, trademark and/or brand protection, and replication of franchisor standards are frequently assumed tenets of franchising, more than 20 percent of franchises in this sample did not include provisions to control product specifications at a franchised outlet level.

Organizational complexity and diversity among franchising firms were also revealed in this portion of the study. Most franchise concepts simultaneously included company-owned and franchised outlets in their system. Organizational hierarchies, such as area development, sub-franchising, and master franchising agreements were also revealed. Although collectively considered franchisees, area developers and master franchisees may assume responsibilities for franchise sales and quality assurance, roles often associated with franchisors. Area developers and master franchisees sign different disclosure and franchise agreements from owners of franchised outlets, with different fees, terms, and provisions. Combined with a prevalence of multi-unit ownership revealed in previous studies, organizational hierarchies introduce complexity in what is often viewed as a simple, dyadic relationship between franchisors and franchisees.

Additionally, some franchisors offered a portfolio of franchises, including different business types and different programs to prospective franchisees, which may or may not be covered by the same franchise agreement. Different business types, such as kiosks, are likely to have different franchise fees, equipment and staffing requirements, and total start-up costs from other franchises within the same system. Some franchisors offered other programs, such as conversion programs and co-branded outlets, which required additional agreements to be signed as a condition of franchise purchase. Shane's assertion that "franchisors actually offer standard contracts" (Shane 1998, p. 703) did not appear to apply when organizational hierarchies and differences among franchise concept offerings were considered.

8.3.2 Hypotheses Tested Using Secondary Sources of Data

In addition to broad research questions, several specific hypotheses emerged from the literature review, as presented in Section 3.4. Details of hypotheses tested in this study were presented in Chapter 6, and a summary of these findings is provided in Table 8.1. Table 8.1 provides references to correlation tables in Chapter 6, and identifies directions of significant relationships revealed in the analysis.

Table 8.1: Summary of Specific Hypotheses Tested

No.	Variable	Hypothesized Relationship	Variable	Relationship Revealed	Table
1a.	Financial Assistance	+	CAGR	+	6.20
			PNU	+	6.20
			%GROW		6.20
1b.	Financial Assistance	+	Initial Start-up Costs	-	6.20
2a.	Area Development	+	CAGR		6.21
			PNU	+	6.21
			%GROW	+	6.21
2b.	Sub-Franchising	+	CAGR		6.21
			PNU		6.21
			%GROW		6.21
2c.	Passive Ownership	+	CAGR		6.21
			PNU	+	6.21
			%GROW	+	6.21
3a.	Area Development	+	Expand US		6.22
			Expand Can.		6.22
			Expand Intl.	+	6.22
3b.	Sub-Franchising	+	Expand US		6.22
			Expand Can.	+	6.22
			Expand Intl.	+	6.22
3c.	Passive Ownership	+	Expand US	+	6.22
			Expand Can.		6.22
			Expand Intl.	+	6.22
3d.	Percent Franchised Outlets	+	CAGR	+	6.23
			PNU	+	6.23
			%GROW	-	6.23
3e.	Percent Franchised Outlets	-	Franchising Experience	+	6.23
4a.	Earnings Claim	+	CAGR		6.24
			PNU		6.24
			%GROW		6.24
4b.	Earnings Claim	+	Franchise Fees	+	6.24
4c.	Earnings Claim	+	Agreement Term	+	6.24
4d.	Earnings Claim	+	Percent Franchised Outlets	-	6.24

As summarized in Table 8.1, positive and significant relationships were revealed between financial assistance provisions in a franchise agreement, a firm's average growth rate (as measured by CAGR), and the number of new outlets projected to be opened in the next twelve months. Although a positive relationship between financing provisions and projected growth percentage was also revealed, its coefficient was small and not statistically significant. Contrary to Hypothesis 1b, financial assistance provisions were negatively associated with average investment costs, indicating that franchisor assistance with financing is more likely to be found in smaller, less capital-intensive franchise concepts. This finding suggests that potential franchisees may face differing capital constraints dependent on the average investment cost associated with a franchise purchase.

The second group of hypotheses examined relationships between three measures of growth and three measures of franchisee-owned networks: area development, sub-franchising, and passive ownership. Significant and positive associations were revealed between number of projected openings, percentage growth, and two franchise network variables; area development and passive ownership. Based on this analysis, Hypothesis 2a and 2c were supported using projected measures of growth, but could not be supported using CAGR as a measure of historic growth. Correlation coefficients indicated, however, that relationships among these variables were weak. This finding conflicts with an earlier study by Kaufmann and Kim which used CAGR as its measure of growth (Kaufmann and Kim 1995). One reason for the discrepancy may be associated with differences in the two datasets used for the studies. Hypothesis 2b could not be supported using any of the three measures of growth employed in this study.

The third group of hypotheses tested relationships between growth strategies and franchise networks. Franchise networks, as operationalized by area development, sub-franchising, and passive ownership were positively and significantly associated with franchisors that indicated more aggressive growth strategies overseas markets. In addition to overseas market growth, passive ownership was also significantly correlated with more aggressive growth strategies in the U.S. market. Based on this analysis, Hypotheses 3a, 3b, and 3c were supported for overseas growth strategies. Hypothesis 3b also received support for Canadian expansion, while 3c received support for U.S. expansion strategies. Also tested in this group of hypotheses were relationships between percentage of units franchised and the age and franchising experience of franchisors. A positive and significant relationship between the numbers of years a firm has been franchising and its ratio of franchised to total outlets was revealed. Similar relationships were revealed between the ratio of franchised outlets and growth strategies in the U.S., Canadian, and overseas markets. Based on this analysis, the ratio of outlets franchised to total outlets was significantly associated with three measures of growth and the growth strategies in U.S., Canadian, and overseas markets. Its relationship with GROWTH, however, was negative. Hypothesis 3d, therefore, received qualified support. Hypothesis 3e was supported, contrary to ownership redirection theories of franchising.

The fourth group of hypotheses tested relationships between earnings claim disclosures and measures of growth, franchisor investment risk, and ratio of franchised to total outlets. No significant relationships were revealed between earnings claim disclosures and any of the three measures of growth used in this study. Significant relationships were revealed, however, between earnings claims and measures of investment risk such as agreement term, franchise fees, and average investment. A significant relationship between disclosure of an earnings claim and the ratio of franchised outlets to total outlets was found, but direction of the association was negative, contrary to the hypothesized relationship. Hypothesis 4a, therefore, could not be supported. Although Hypotheses 4b and 4c were supported, correlation coefficients indicated weak relationships among these variables. Hypothesis 4d was not supported in this analysis. This analysis supported a view that franchisors that disclose earnings information face greater investment risk, and mitigate their increased risk through higher fees and contractual provisions.

8.3.3 Formal Context Variables and Growth- Factor Analysis and Multiple Regression

In broad terms, this section of the study examined the extent to which franchise characteristics and contractual provisions explained differential performance among franchising firms. Data were gathered from facts obtained through Source Book's website, operationalized into 24 variables. Factor analysis was employed to reduce the variables to a manageable number, as detailed in Chapter 6, Section 6.7. Eight of the nine factors that emerged from this analysis had eigenvalues greater than 1.0, which were saved for input into a multiple regression analysis using SPSS v 10.0.

Firm performance was operationalized using three measures of franchise growth: CAGR, ratio of projected new outlets to present number of outlets, and the number of projected outlets.[140] Each dependent variable presented a different view of franchise growth, although each had limitations. Growth, as measured by CAGR, ignored those units that transferred ownership, either between franchisees or between franchisors and franchisees. CAGR is also an unstable measure for firms in existence for less than five years. Measures of growth based on number of projected new openings ignored franchised outlets that ceased operations, or are acquired by franchisors. Because of instability in CAGR, this portion of the study compared only those firms in operation for five or more years.

Factor analysis revealed eight constructs with significant effects, although between-subjects analysis revealed that effects differed among dependent variables. The subsequent multiple regression model had adjusted R square of .500 for CAGR, .376 for ratio of projected openings to current number of outlets, and .283 for number of projected openings. Regression analysis for these three dependent variables is presented in Table 6.28, 6.32, and 6.30 respectively. The model exhibited limited predictive power in projected growth of franchises, but explained half the variance in the historic growth as measured by CAGR. Multiple regression analysis was described in detail in Chapter 6, Section 6.8.

This finding suggests that firm characteristics and contractual provisions explain only a portion of differential performance among franchising firms. Another finding is that the effects of firm characteristics and contractual provisions differs depending on the measure of growth used. The model had its greatest predictive power on historic

[140] Aggregate measures of growth were not included because they ignored substantial differences among the firms in this sample. A comparatively small number of firms exerted substantial influence on some growth numbers. For example, in the Source Book sample, less than two percent of the firms accounted for nearly ten percent of the total number of projected new outlets.

measures of growth, and was less effective using predicted measures of growth. Since prospective franchisees are likely to be more interested in future performance, this study suggests that measures found in the disclosure documents and datasets derived from them are less than effective predictors of future franchise performance.

8.3.4 Operational Realm

Analysis of franchising's formal context provided only a partial view of the phenomenon. To examine franchising's operational realm, data were collected through semi-structured interviews with franchise owners and franchisor representatives. Although several areas were explored in these interviews, their focus was on daily operations of a franchised business, and the role of disclosure and franchise documents in franchise selection processes. Analysis of these interviews is presented in Chapter 7, and transcripts of interviews are provided in Appendices G through N.

First, interviews with both franchisees and representatives of a franchisor revealed that UFOCs and franchise agreements are periodically modified. Implications of this finding suggest that within a given franchise system or concept, established franchisees may be operating under different contractual provisions than those who recently purchased a franchise. Some franchisors reserve the right to make material changes to contractual provisions during an agreement term. Items such as royalty fees or mandatory purchases, changes that simultaneously affect all franchisees in their system, may affect all franchisees, not just those entering the system. Contractual modifications become especially evident at the time of contract renewal, as existing franchise owners must now agree to provisions found in the current agreement.

Since UFOCs and franchise agreements evolve over time, presence or absence of a contractual provision does not necessarily mean that it was included in a previous edition, nor can assurances be provided that will be found in subsequent editions. In addition, at any given point in time, a franchisor may offer more than one franchise using different franchise agreements. Area developers and master franchisees operate under different agreements than owners of franchised outlets, which have different provisions, fees, and contractual obligations. In other words, many different agreements may simultaneously be in effect between a franchisor and franchisees within the same system.

Second, franchisee interviews conducted in this study revealed that UFOC and contractual provisions had little or no influence on daily operations of a franchised business. In one case, a franchisee was not required to purchase an expensive piece of equipment by her franchisor, despite a contractual requirement to do so. In another case, a franchisee was permitted to perform cleaning services specifically prohibited by provisions in her agreement. Although the franchise agreement specifically stated that non-payment of royalties would result in termination of the franchise, one franchisee noted that his franchisor provided marketing and financial assistance to a franchisee that had fallen behind in royalty payments for several months. Termination of this franchise agreement by the franchisor resulted only after exhaustive efforts to improve this franchisee's profitability failed. Although franchisors retain substantial power through provisions in their franchise agreements, selective enforcement of contractual provisions explains some of the potential differences between formal and operational contexts of franchising.

As a contractual relationship between franchisors and franchisees, bound by general business and franchise-specific regulations, it may be assumed that the formal context of franchising defines the boundaries within which daily operations take place. As depicted in Figure 3.6, franchising's formal context defined boundaries through restrictions, obligations, retained franchisor authority, and other provisional aspects of the agreement. The results of this study suggest, however, that selective or discretionary enforcement of contractual provisions by franchisors places franchising's operational realm partially within and partially outside the defined formal context, as depicted in Figure 8.1.

Figure 8.1 Franchising's Formal Context and Operational Realm

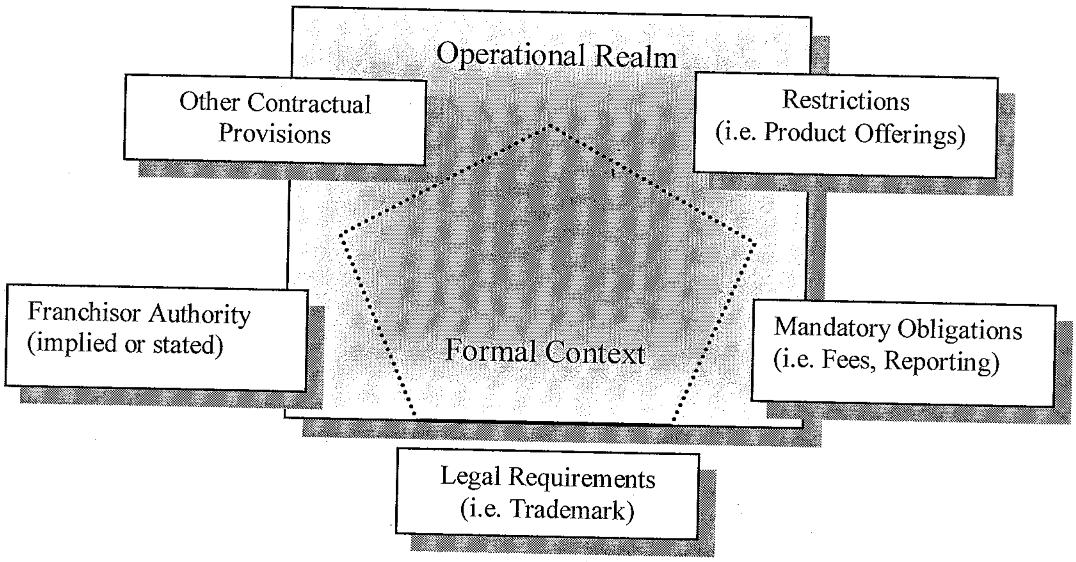

Figure 8.1 illustrates that a franchisor's discretionary authority, as evidenced by selective enforcement of contractual provisions, allows franchise owners to operate outside formal boundaries defined by their franchise agreements, as illustrated by the dashed lines. Enforcement of specific contractual provisions may change over time, and may or may not be uniformly applied to all franchise owners at any given point in time. Although selective enforcement may involve financial or non-financial

provisions, franchisors may be less likely, however, to allow operational discretion in areas related to trademark or brand protection, or those that violate franchise regulatory requirements. A solid line on the formal context boundary of legal requirements indicates that this aspect of enforcement is less likely to be selectively enforced.

Third, this potion of the study revealed that many prospective franchise owners do not read disclosure documents nor do they use them for comparative evaluation in a franchise selection processes. Some franchisees selected a specific franchise because it represented an opportunity to employ their technical skills. For others, purchase of a franchised business coincided with relocation to a more desirable area in which to live or subsequently retire. Despite a legal requirement to be written in "plain English," some viewed disclosure documents as "legalese," merely part of the formality associated with a franchise purchase. One former franchisee noted that language used in these documents stood in stark contrast to the casual and friendly dialogues most prospective franchisees have with franchisors before purchase. Only two franchise owners in this sample evaluated alternative opportunities, examining UFOC documents from several franchises before making their purchase.

Lastly, interviews with present and former franchise owners revealed two aspects of failure not always considered in previous studies of franchising. In the case of MaxCare, the franchisor ceased operations and is no longer franchising. Despite bankruptcy of this franchisor, more than half of the former franchisees are still operating their businesses. Although widely considered as economically dependent, failure of a franchisor does not always result in failure of all franchisee's businesses. In the Muzak franchise, this franchisor is not currently offering franchises for sale.

Although Muzak has embarked on a program to buy back its franchised territories, it is continuing to support existing franchisees through national sales efforts and investments in technology. Studies that examined franchise failures often included firms that are no longer franchising as an indicator of failure (e.g., (Shane 1995); (Shane 1998)). Because Muzak is no longer offering franchises, this franchise would likely be included in a cohort of franchise failures, despite its long and continuing history of business success for both this franchisor and existing franchisees.

8.4 Compatibility of Findings in the Literature

The author's interpretation of this study's findings is compatible with previous findings in the literature. Phan et al's 1996 article posited that potential for entrepreneurship by franchisees existed because of the incomplete nature of franchise agreements (Phan, Butler et al. 1996). The authors argued that franchisors would attempt to modify franchise agreements over time in an effort to protect their interests. In contrast, Lafontaine and Shaw found "a great deal of persistence in franchise contract terms within firms" (Lafontaine and Shaw 1999, p. 1042). They concluded that franchisors make changes in various fees every few years and that there was "significant heterogeneity across firms in the frequency with which they change the terms of their contracts" (p. 1049). Through interviews with franchisees and representatives of a franchisor, this study found that franchisors make periodic revisions to their UFOC and franchise agreements, not only in terms of fees but also in other contractual provisions. A franchise agreement is likely to evolve over time, as experience is gained, additional outlets are opened, and as a franchisor adds new programs or business types. Some agreement changes may affect all franchisees in a chain, while others only affect new franchisees and renewals.

Earlier studies of franchising firms by Bradach revealed a *plural* organization form, one in which franchised and company-owned outlets exist simultaneously within the same firm (Bradach 1997); (Bradach 1998). His case studies described how control and innovation processes in plural organizations mitigate weaknesses and enhance organizational performance. This study found more than two-thirds of the 1,201 franchise firms in one sample simultaneously employed both franchised and company-owned outlets in their organizations. A positive and significant relationship between the ratio of franchised to total outlets and measures of firm growth was revealed in this study.

Shane and Hoy offered the notion of a franchise as an entrepreneurial venture, arguing that creation of franchise networks was consistent with entrepreneurial acts (Shane and Hoy 1996). An example of franchise networks are those created through multi-unit ownership by franchisees, a phenomenon prevalent in Kalnin and Lafontaine's empirical study of the fast food industry (Kalnins and Lafontaine 1996). This study found a prevalence of other types of franchise networks, created through area development agreements, sub-franchising provisions, and passive ownership structures among firms in this sample. A significant relationship between the projected growth and presence of these networks was also revealed in this study. A discrepancy between the findings of this study and that of Kaufmann and Kim's study of master franchising and growth (Kaufmann and Kim 1995) suggests that area development, master franchising, and sub-franchising represent differing strategies, and should be considered separately.

Frignani referred to disclosure requirements in the United States as "particularly dense and complex" (Frignani 1995). Despite comprehensive franchise laws that require extensive disclosure by franchisors, disclosure of sales or earnings information to prospective franchisees is voluntary under present U.S. law. In Price's analysis of 278 franchise documents, 26 percent of her sample made voluntary earnings claims disclosures (Price 2000). She hypothesized that franchisors who made this voluntary disclosure would compensate for higher investment risk associated with this disclosure by charging higher fees. Consistent with Price's study, 26 percent of 1,201 franchises in this study's sample provided voluntary earnings claims. This study also provided further support for Price's conclusion that disclosure of earnings increases investment risk for franchisors, as significant relationships between earnings claims disclosure and franchise fees and average investment were revealed. Augmenting Price's work, this study found a significant relationship between earnings claim disclosure and the average length of a franchise agreement, reflective of the increased investment risk faced by franchisors making earnings disclosure.

The findings of this study are compatible with Stanworth and Curran's work toward a sociological model of franchising (Stanworth and Curran 1999). Contrary to ownership redirection theory,[141] the authors argued that franchising is a "relatively permanent and genuine {organization} form, rather than temporary and likely to lapse into a vertically-integrated hierarchical organization" (p. 333). This study revealed a positive

[141] Dant, Paswan, and Stanworth noted: "The ownership redirection thesis in franchising points to the premise that franchising and franchisees may simply be short-term, early stage, development feature in the growth patterns of certain service-oriented businesses in Western (and increasingly global) economics. Once financial, human capital and local market intelligence resources are no longer at a premium, the (now former) franchisor will prefer to adopt more conventional growth strategies (e.g., opening company branches) in order to meet future challenges and the needs for future growth (Dant, Paswan et al. 1996, p. 48)

relationship between the ratio of franchised to total units, and two measures of longevity: the number of years a firm had been in existence, and the number of years it had been franchising. In other words, firms in this sample did not reduce the ratio of franchised to total units over time, preferring to adopt more traditional expansion strategies through increased use of company-owned outlets. Contrary to an ownership redirection thesis, an interview with the chief financial officer of a franchise revealed that company-owned stores are not always more profitable for franchisors once depreciation and amortization are considered. Stanworth and Curran also posited that franchising will be common when strategies of rapid market penetration over a wide geographic area were employed. This study found that more aggressive expansion strategies in U.S., Canadian, and overseas markets were associated with firms that had a higher ratio of franchised to total outlets.

8.5 Methodological Implications

Data collection and analysis revealed a number of methodological issues relevant to this and future studies of franchising. Among them were organizational complexity, data availability, and unit of analysis consistency.

8.5.1 Organizational complexity

What appeared on the surface to be a simple, dyadic relationship between franchisors and owner-operator franchisees, is actually one complicated by various forms of organizational hierarchies and structures. Organizational complexities were not always considered in studies where relationships or contracting were considered exclusively as dyadic associations among franchisors and franchisees (e.g., (Larson 1992); (Manaresi 1993); (Morrison 1997); (Spinelli Jr. and Birley 1997)). This study revealed a large number of franchises utilize area development agreements, master franchising agreements, passive ownership, and sub-franchising in their systems, each of which creates organizational complexities that must be considered in studies of franchising at an individual or firm level.

Although collectively considered franchisees, area developers, master franchisees, and owners of multiple outlets, and passive owners within the same franchise system have different roles and responsibilities that were not always considered in studies of franchisee performance, satisfaction, competence, or performance (e.g., (Brown and Dev 1997); (Fenwick and Strombom 1998); (Knight 1986); (Shane 1998)). In some cases, ownership and management duties of a franchised outlet may be separate. Relationships between different franchisees and their common franchisor may differ based, at least in part, on their position within the hierarchy. Additionally, owner-managers' relationships with franchisors may be influenced by their relationship with an area developer or master franchisee, who often assume duties most commonly associated with a franchisor.

Franchising, often assumed to be a collective group of individual owner-managers and a single franchisor, is an organizational form comprised of networks of partnerships and corporations. Franchisees may be area developers, master-franchisees, passive owners, and/or multi-outlet owners. Some franchisee corporations, particularly in the restaurant industry, are international firms operating hundreds of outlets. In addition to multi-unit ownership by franchisees, other programs and business types often operate within the same franchise concept, while co-branded outlets and multi-concept offerings by franchisors are becoming increasingly popular. This and other empirical studies have revealed complexity and dynamic interactions beyond those explained by franchising's role as a simple marketing channel or a relational contract between independent parties. These considerations are especially important to consider when surveys of franchisees are conducted.

8.5.2 Data Collection and Analysis

Data availability problems typically associated with studies of franchising were also encountered during this study. UFOC and franchise agreement documents are not readily available to the public, and only thirteen of fifty U.S. states currently require registration of franchises (Price 2000). In registration states, national franchises and those with no operations within the state are exempted from registration requirements (Bercovitz 1999). In the U.S., there is no single repository of documents containing the population of franchises. Whether through survey (e.g., (Castrogiovanni, Justis et al. 1993)) or examination of franchise documents at government offices, obtaining representative samples of UFOC and franchise agreements has been problematic in this and other studies of franchising.

UFOCs and franchise agreements were found to contain a substantial amount of information. The regimented framework provided a complete and reproducible format for comparisons and cross-case analysis, however, the language used in these documents required subjective and interpretive judgment to be exercised. To reduce codification errors in data collection from these lengthy documents, dichotomous variables were used to indicate a presence or absence of certain contractual requirements. Although this system worked well for codification, it limited the number and type of analysis options available once data had been collected.

In the absence of an official data source on franchising, this study constructed datasets from facts accumulated by independent publishers and other commercial organizations. Although considered reliable in previous studies of franchising (Lafontaine 1995); (Mehta, Luza et al. 1999), data derived from these secondary sources imposed limitations on this study. First, contrary to previous findings by Mehta, et al., this study found differences among sources of franchise information, restricting the findings obtained in any one sample exclusively to firms within that sample. Second, datasets derived from these sources change over time, as firms included in one year's publication may be omitted from the next year's edition. This was especially evident in *Entrepreneur* Magazine's dataset, as revealed in a study by Clarkin, et al. (Clarkin, Hasbrouck et al. 2002). Their findings support a view that the cohort of franchises appearing in one year's publication may not be representative of those firms that appeared in previous years or ones likely to appear in subsequent editions.

Third, despite using comparatively large datasets, normal distributions were not evident, presenting challenges with data screening. Outliers in firm characteristics such as size, age, and measures of growth introduced potential distortion in the quantitative analyses. A relatively small number of large firms, such as McDonald's and Subway, often appeared as outliers in the data, and their inclusion or exclusion from a dataset had substantial effects on some measures. Use of CAGR as a measure of growth also imposed limitations on this study, as it was considered unstable for firms less than five years old. Firms less than five years old are often the fastest growing firms when measured on a percentage basis, and have been found in previous studies to be most likely to fail (Bates 1997); (Shane and Foo 1998).

Larger datasets obtained from secondary sources enabled a variety of quantitative analysis tools, although these datasets often ignored organizational complexity revealed in more fine-grained studies of franchising. For example, while total number of franchised and company-owned outlets was provided, numbers of co-branded outlets, outlets operating on different programs or business types, or number of area development and/or master franchises were not revealed. Although part of the same system, these franchises differ in fees, terms, and other provisions from those of franchise outlets.

8.5.3 Unit of Analysis

Unit of analysis distinctions have been problematic in studies of franchising. Franchisees, often used as a unit of analysis in studies of franchising, represent a diverse group; from individual owner-managers of a single outlet, to multi-outlet owners, to multinational corporations with hundreds of franchised outlets. Larger franchisees are likely to have operations that more closely resemble a franchisor than owner-managers of single franchised outlets. Franchisees within the same franchise system may include those that own one or more franchised outlets, area developers, sub-franchisees, master franchisees, or be passive owners of one or more outlets. Franchisees within the same system may be operating under different programs or business types, such as kiosks or *express* locations, with different financial and management obligations and requirements. Franchisees within the same system may also operate co-branded outlets, with two or more concepts offered at a single outlet. Because franchisors periodically modify their agreements, franchisees in the same system may be operating under different franchise agreements than other franchisees.

Further, a distinction between *franchisees* and *franchised outlets* was not always evident in previous studies of franchising.

Franchisors often serve as a unit of analysis, routinely found in studies of success or failure (e.g., (Bates 1996);(Shane 1997)). Studies of franchisors do not always consider that some franchisors offer franchises in several different concepts. Examples are Tricon Global Restaurants that offers Taco Bell, Pizza Hut, and KFC franchises, and Brinker International with eight different franchise concepts.[142] In addition, franchisors of one or more concepts may also be franchisees of one or more other concepts, as described earlier in this study. Success or failure of any one concept does not necessarily equate to failure of a franchisor, and distinctions between franchise *concept* and *franchisor* are essential. These distinctions have not always been made clear in previous studies of franchising. An example is evident in Shane's study that used exit from *Entrepreneur* Magazine's listing as an indicator of franchisor failure (Shane 1995). This magazine's listing is comprised of franchise concepts, separately listing and differentiating between Tricon's Taco Bell, Pizza Hut, and KFC concepts.

8.6 IMPLICATIONS

8.6.1 Implications for Theory

This study found support for Stanworth's observation that a study of franchising based exclusively on its formal context presents only a partial view of the phenomenon (Stanworth 1995). Stanworth's study revealed that despite contractual provisions that "appeared to closely circumscribe the franchisee's freedom of action as a businessman,"

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[142] Brinker International is the parent company of Chili's Grill and Bar, Romano's Macaroni Grill, On the Border Mexican Café, Maggiano's Little Italy, Coymel's Coastal Mexican Grill and Corner Bakery, and three smaller concepts, eatZi's Market and Bakery, Big Bowl, and Wildfire. Obtained 11/25/01from: http://www.reportgallery.com/work/Brinker2000/Brinker2000ar25.html.

(p. 163) franchisees reported relatively high levels of independence. He concluded that franchising's formal contract "was often a poor guide to the world of operational reality," (p. 161) suggesting that an operational realm of franchisor-franchisee relations is "not necessarily revealed by an analysis of contractual relations" (p. 165). Stanworth posited that both a formal context and operational realm must be considered in studies of franchising.

Consistent with Stanworth's earlier work, several differences between franchising's formal context and its operational realm were revealed in this study. One explanation for disparity between formal and operational contexts may be found in the selective enforcement of contract terms by franchisors revealed in interviews with franchise owners. Selective enforcement by franchisors suggests that substantive differences may exist between contractual stipulations found in franchise agreements and UFOCs, and what actually occurs in the day-to-day operations of franchised outlets. Additionally, data derived from franchising's formal context, such as firm characteristics and contractual provisions, had limited power in explaining firm growth as revealed in this study's regression analysis. This finding also supports Stanworth's view that suggests analysis of franchising's formal context presents only a partial view of the phenomenon.

This study's findings also offer evidence contradictory to some previous studies of franchising. Citing Horne (1995), Price opined that most franchisors are ruthless with franchisees that attempt to bend the rules (Horne, 1995 in (Price 1997, p. 45). Although the sample size was small and not intended to represent the population, franchisees in this study offered no examples of ruthless franchisor behaviour, but cited several instances where franchisors relaxed, ignored, or did not enforce contractual requirements. In the case of one former franchisee, his franchisor agreed to reimburse him for his initial investment when a new franchisee purchases his former territory, contrary to provisions in the franchise agreement. In another case, a contractual obligation to purchase a van was not enforced in order to give a new franchisee an opportunity to grow her business without incurring more debt. Enforcement of contractual provisions was not absolute, but rather remained at the discretion of franchisors.

Stereotypical images of franchisees as owner-managers of single franchised outlets were not supported in this study. Secondary data revealed that franchisee-owned chains, some exceeding 700 outlets, were prevalent in the restaurant industry (FFCA 2000). The population of franchisees was found to also include area developers, master franchisees, and those who purchased outlet(s) from another franchisee under a sub-franchise agreement. Despite their common categorization as *franchisees*, area developers, master franchisees, multi-unit franchise owners, and single-unit owner-managers are likely to have diverse responsibilities and duties. Interviews with franchisees revealed that franchise marketing and quality control duties, widely assumed to be duties of franchisors, were actually performed by area development or master franchisees. Diversity in roles and responsibilities among a collective group of franchisees would appear to conflict with development of a franchisee as a separate 'type' of entrepreneur, as advocated by Ucbasaran et al. (Ucbasaran, Westhead et al. 2000). Area developers and master franchisees introduce variables not always considered in previous studies of franchisor-franchisee relations. In other words, an owner-manager's opinion of relations with their franchisor is likely to be influenced by an absence or presence of area developers and master franchisees in their system.

This study also found differences among widely used sources of secondary data, presented in Section 6.3.4, contrary to a previous study by Mehta et al. (Mehta, Luza et al. 1999). In the absence of a single, official source of data on franchising, these secondary sources of data are important to practitioners, are often used in franchise marketing literature, and are frequently cited in the popular press. In addition, secondary data from these sources have been previously used for theoretical development, hypothesis testing, and sample validation in academic studies. This suggests limits on generalizability of this and other studies of franchising that employ secondary sources of franchising data.

8.6.2 Implications for Practice

There were a number of findings revealed in this study with implications for those involved in a franchise purchase. First, this study offered support for a view that most prospective franchisees do not read a UFOC before making their franchise purchase. Although these documents were shown to have consistent frameworks, and are widely believed to be non-negotiable, this study found that franchises differed significantly in contractual provisions and in the organizational complexity in their systems. Multi-unit ownership, area development agreements, sub-franchising and master franchising create hierarchies within some franchise systems. Owners of single outlets may have clear paths for increased responsibilities and wealth creation within these organizations, creating entrepreneurial networks (Shane and Hoy 1996).

Franchisors who provide financing may lower capital constraints faced by prospective franchisees, enabling their systems to grow more rapidly. Although growth is not a predictor of success, it does provide franchisors with economies of scale in purchasing materials and marketing, widely considered to represent competitive advantages in franchising. Voluntary earnings claim disclosures, made by 26 percent of franchises in this sample, may be made only by more successful franchisors, those with "good news" to report. Franchisors who disclose average outlet sales or earnings are likely to recover their increased investment risk through higher fees, increased average start-up costs, and longer contract terms.

Disclosure and contractual documents, those that define the formal context of franchising, were found to have little effect on daily operations of a franchised business. The documents do, however, become important should a franchisor-franchisee dispute arise, and at time of renewal. Some franchisors selectively enforced contractual provisions, creating disparities between what is contractually specified in an agreement and what actually occurs in the operational realm. Despite an average term of ten years, franchise contractual provisions evolve over time. Franchisors may retain a right to increase fees or require upgrades to equipment or facilities during an agreement's term. Franchisees operating within the same franchise organization may be doing so under different contractual agreements, depending on the agreement in effect at the time of purchase. Differences between existing and current agreements become most evident at time of contract renewal.

Another finding with implications for prospective franchisees is that substantial differences were found among franchising firms in terms of their historical growth, projected growth, and in their growth strategies. The inclusion or exclusion of a few, large franchise firms, such as McDonald's or KFC, may influence aggregate measures of franchise growth in secondary data sources. Differences between three widely used sources of secondary information revealed in this study suggest that studies performed using one dataset may or may not be applicable to those firm in the other datasets. Factor analysis and multiple regression revealed that measures typically found in these sources of information provide only a partial explanation of previous franchise system growth, and are less effective tools for predicting future growth of a franchise.

Measures of historic growth, such as CAGR, have limitations when used with firms in existence for less than five years, which excludes some of the fastest growing firms. Projected growth expressed as the number of outlets or as a ratio of projected outlets to current size, only presents a partial picture of the dynamics of growth within franchising, since it ignores outlet closures and transfers. Franchise firms in Source Book's sample were also found to differ in their growth strategies, some preferring regional or targeted growth in selected markets, while others pursued more aggressive expansion in all designated markets.

8.6.3 Implications for Policy

Findings of this study also have implications for policy makers. Designed in similar fashion to securities offering documents, UFOCs were perceived by franchisees as lengthy, legal documents. Arguably, the selection process of a franchise purchase has few similarities to a selection process of a unit trust or mutual fund, especially when individual commitments to management are considered. Contractual provisions and language in these documents often contrasts with discussions between prospective franchisees and franchisor representatives. Given the language, complexity, and non-negotiable nature of franchise agreements, these documents were viewed by some as a formality, the "fine print" of this complex business transaction. Despite a requirement to be written in *plain English,* UFOCs are read by few prospective franchisees, making it an ineffective communication and disclosure vehicle.

Nearly 40 percent of North American franchisors surveyed by Source Book Publications intend to expand into overseas markets. Emerging economies, such as Poland, represent potentially attractive markets for franchisors (Service 1998). Emerging and developed countries and provinces have considered adoption of the U.S. system of franchise legislation. The Canadian Province of Alberta, for example, first adopted a system of franchise registration in 1971, and has recently enacted more stringent disclosure regulations, in similar fashion to a UFOC (Coleman 1998). Ontario and the remainder of Canadian provinces have also debated statutory obligations of franchise disclosure (Cohen 1998). This study revealed that the U.S. system of disclosure, as characterized by a UFOC and franchise agreement, has limitations as an efficient communication vehicle between franchisors and prospective franchisees, and may provide a less than effective prototype for jurisdictions considering franchise-specific legislation.

Absence of official information on franchising has hampered research in franchising. This study found that although reliable sources of secondary franchise data are available, significant differences existed among firms in each sample. Although meaningful analysis of firms within a sample is possible, content validity and generalizability of findings is limited. Without an official source of information, prospective franchisees may be influenced by data and rankings presented in popular publications such as *Entrepreneur* Magazine, as the GNC franchise owner in this study revealed. Until a recent study by Clarkin et al., this widely recognized franchise comparison system had not been scrutinized by systematic research (Clarkin, Hasbrouck et al. 2002). The adequacy of these secondary data sources as a reliable source of comparative information on franchises is questionable, requiring further study.

Given an official source of reliable information on firms engaged in franchising, rigorous academic research would be facilitated, establishing meaningful constructs for comparing success and performance among firms. When franchising's socio-economic impact in North America is considered, and the costs of dispute and litigation between franchisors and franchisees is weighed, an official source of franchise data appears justified.

Although technical and lifestyle aspects are also considered, an ability of a franchised business to produce profits is an important part of many franchise selection processes. Despite its importance to prospective franchisees, disclosure of average outlet sales, costs, or earnings is voluntary under present U.S. Federal Trade Commission regulations.[143] Earnings disclosure has been a topic of debate for many years (Wieczorek 1999), and is often a subject of franchisor-franchisee disputes, litigation, and federal investigations. Employing a larger sample, this study found that 26 percent of franchises disclosed earnings information in their UFOC, consistent with Price's earlier study (Price 2000). Representing 800 franchisors and 28,000 franchisees, the International Franchise Association (IFA) strongly opposed mandatory earnings disclosure (DeBolt and Shay 1999). The authors noted that the membership viewed a

[143] The only lawful mechanism for franchisors or their representatives to disclose outlet sales, costs, or profits is through Item 19 of a UFOC.

mandatory one-size-fits-all approach to financial performance as impractical, and fails to consider the many variations that exist among the dozens of industries and thousands of companies in franchising. They argue that information is available through direct communication with existing franchisees. This study revealed through interviews with existing and former franchise owners the importance of due diligence through UFOC examination and direct communication with existing and former franchisees before franchise purchase. This study also revealed that franchisors that disclose earnings seek to recover their increased investment risk through higher fees and longer contract terms.

8.7 Suggestions for further research

Lewis observed that contracts are mutual business plans, and while they fortify promises, they restrict flexibility (Lewis 1990). He argued that too much planning implies a lack of trust.[144] Trust becomes both possible and important in contexts where both parties have something at risk (Wicks, Berman et al. 1999). In his review of the literature, Ring concluded that trust played two important roles in facilitating economic exchange: (1) trust served as a substitute for more formal control systems, such s contracts; and (2) trust served as an enabling condition facilitating ongoing cooperative relationships (Ring 1996). Empirical studies have found that trustworthiness among parties to a contract were positively associated with resource exchange and combination, creating value for a firm, and increasing innovation (Tsai and Ghoshal 1998). Falbe and Dandridge found the most troubling results revealed in their study was a lack of trust in the franchisor by franchisees (Falbe and Dandridge 1992). Greater trust facilitated "open" agreements, ones focused on desired outcomes rather than interim structures and plans (Hart, Stevenson et al. 1995). The context of

[144] Trust refers to the belief that contracting partners will honor the contractual terms and will not take advantage even when the opportunity is available, and is key to contracting longevity and success (Hudson and McArthur 1994).

franchising appears to represent fertile ground for studies that examine trust among contracting parties.

This study employed several measures of growth, each derived from changes in the number of outlets. Within organizations, growth through additional outlets is consistent with venturing, one of the widely accepted indicators of corporate entrepreneurship (Guth and Ginsberg 1990). Although preliminary in nature, the explanatory power of the regression analysis in this study suggests that a typology of firms within franchising is possible, consistent with the entrepreneurial orientation approach used by Covin and Slevin (Covin and Slevin 1991). Further research could develop a typology of franchising firms, based on their entrepreneurial orientation using franchisee networks as a basis for comparison.

This study represented one of the first explorations of franchise networks, examining the relationship between area development agreements, master franchising, and passive ownership with various forms of firm growth. In Kaufmann and Kim's survey of 169 franchisors, the authors found that master franchisors grew faster than those that did not engage in that practice (Kaufmann and Kim 1995). The authors did not rule out that these systems grew because of their ability to attract individuals interested in area development and sub-franchising, while slower growing systems may be less likely to offer the same opportunities. Causality was not examined in either Kaufmann and Kim's or in this study, and further examination is needed to determine whether presence of franchise networks is an enabling attribute or a result of franchise system growth.

This study examined the potential for entrepreneurial opportunities within franchising's context, building on a framework of context and opportunity recognition. While this study focused on associations among variables, future work in this area may employ longitudinal studies of franchising firms. One example would be an examination of changes in firm performance realized by a franchise before and after providing financial assistance or earnings claim disclosure. Following the theme established in entrepreneurship research, future studies could build on this examination of context and presence of opportunities toward exploitation of identified opportunities. Development of franchise networks provides a basis for continued exploration in this area.

Relationships among individuals in franchising and between franchising's formal and operational contexts may be better performed using a case study methodology, considering variations among franchise documents and organizational complexity found within franchise organizations. De Rose observed that strategic alliances and various forms of partnerships are analogous to marriages (DeRose 1994). In similar fashion, relationships between franchisors and franchisees have also been compared to marriages (Mendelsohn 1992); (Morrison 1997). As in relationships between partners in a marriage, personalities and other human behaviours become key determinants of performance, success, and/or failure. If franchising is analogous to marriage, franchise agreements and disclosure documents may serve a function analogous to pre-nuptial agreements between marital partners. In both instances, these documents have little to do with the daily conduct of the parties, but usually play an important part in determining each party's legal rights in the event of separation or dissolution.

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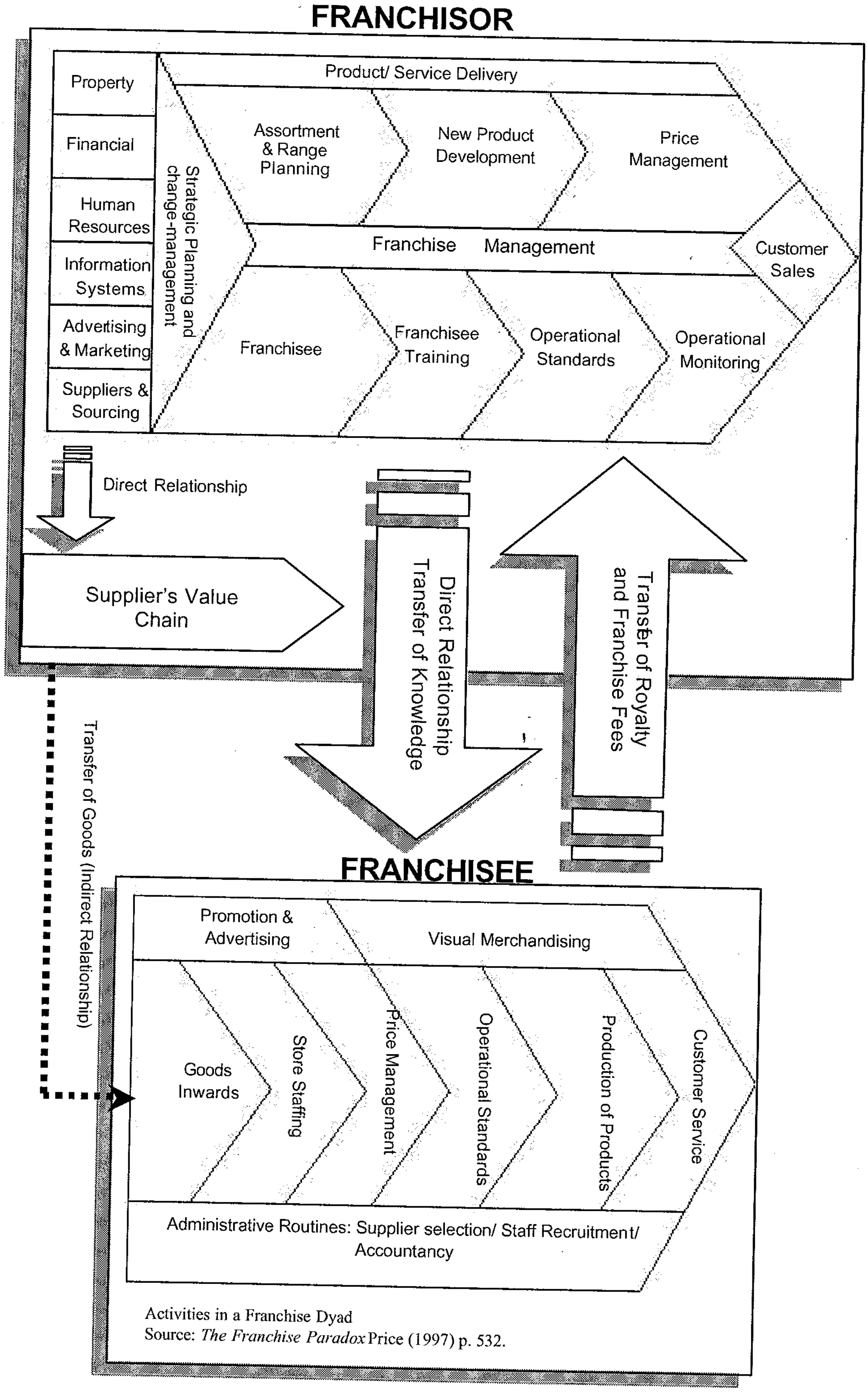
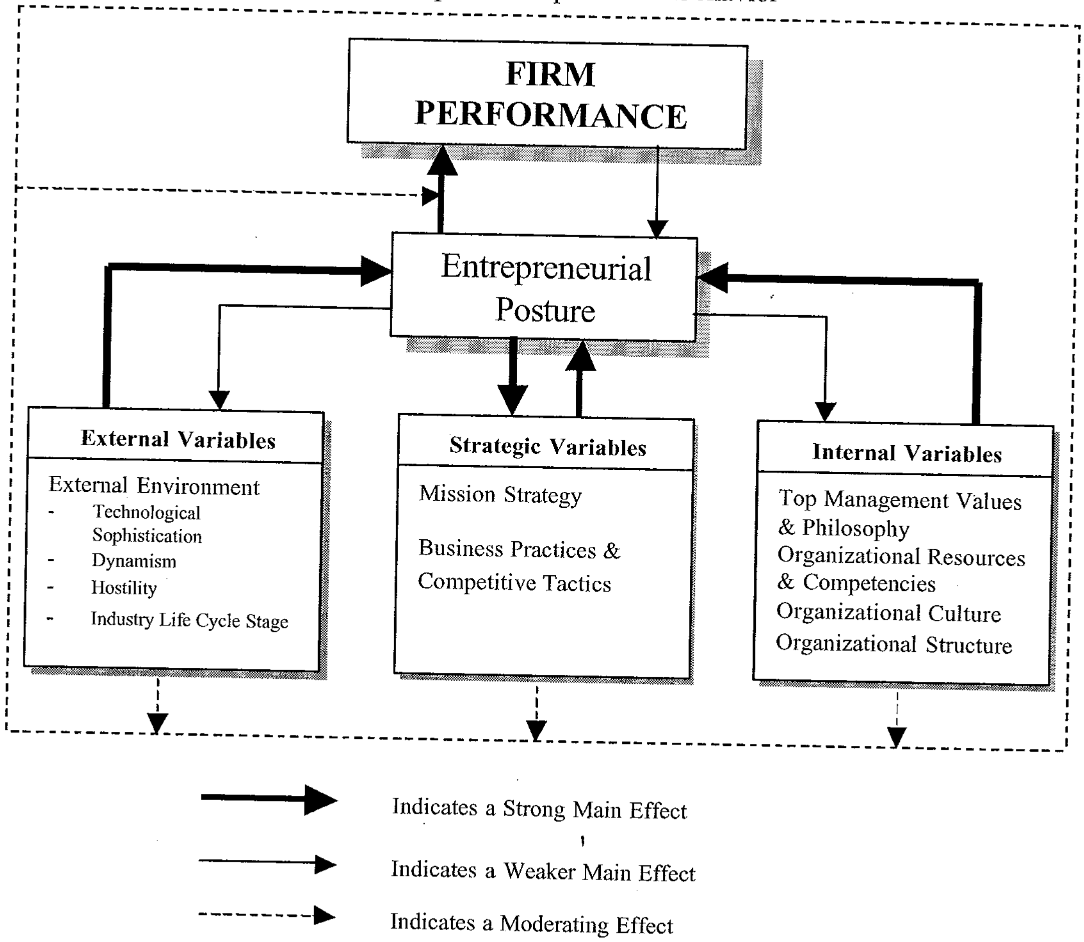
APPENDICES

Figure A1: Franchise Value Chain



Activities in a Franchise Dyad
Source: *The Franchise Paradox* Price (1997) p. 532.

Figure A2: Entrepreneurship as Firm Behavior



A Conceptual Model of Entrepreneurship as Firm Behavior, Covin & Slevin (1991) p. 10

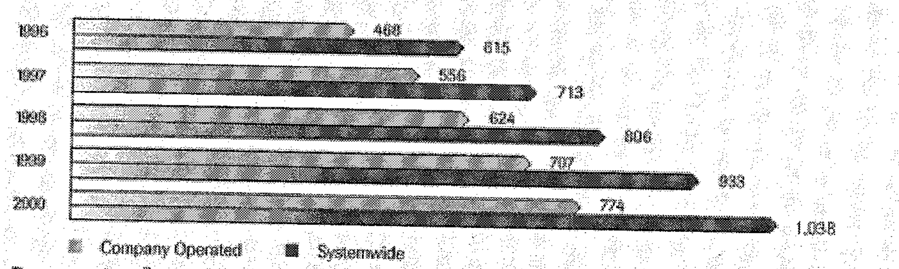
Figure A3

BRINKER INTERNATIONAL, INC.
SELECTED FINANCIAL HIGHLIGHTS

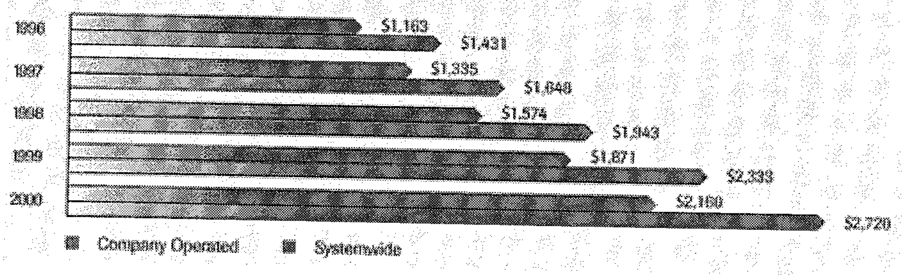
(Amounts in thousands, except per share amounts)

	Fiscal Years 2000	1999	1998
Revenues	$ 2,159,837	$ 1,870,554	$ 1,574,414
Operating Income	195,669	154,182	117,930
Income Before Provision for Income Taxes and Cumulative Effect of Accounting Change	181,542	130,539	105,458
Income Before Cumulative Effect of Accounting Change	117,840	85,242	69,075
Cumulative Effect of Accounting Change	–	6,407	–
Net Income	$ 117,840	$ 78,835	$ 69,075
Basic Earnings Per Share:			
Income Before Cumulative Effect of Accounting Change	$ 1.80	$ 1.30	$ 1.05
Cumulative Effect of Accounting Change	–	0.10	–
Basic Net Income Per Share	$ 1.80	$ 1.20	$ 1.05
Diluted Earnings Per Share:			
Income Before Cumulative Effect of Accounting Change	$ 1.75	$ 1.25	$ 1.02
Cumulative Effect of Accounting Change	–	0.09	–
Diluted Net Income Per Share	$ 1.75	$ 1.16	$ 1.02
Basic Weighted Average Shares Outstanding	65,631	65,926	65,766
Diluted Weighted Average Shares Outstanding	67,410	68,123	67,450

Number Of Restaurants



Revenues *(in millions)*



Appendix B

Table B1: Alberta Franchise Statutes and Disclosure Requirements

1.	Franchisor Information	a. Name and address of franchisor b. Name under which franchisor does business c. Principal business address, and address of franchisor's attorney d. Business form of franchisor e. Length of time franchisor has conducted business f. Length of time franchisor has offered franchises of same type g. Whether franchisor has offered franchises of different types, including descriptions of other lines, number sold in previous five years, length of time other franchises offered h. Names of directors, partners, officers of franchisor
2.	Previous Convictions and Pending Charges	a. For commission of indictable offenses involving franchise or other business b. For commission of offenses involving fraud, embezzlement, unfair or deceptive acts
3.	Civil Litigation and Liabilities	Details from franchisor, directors, general partners, and managers of any civil actions involving franchises or other businesses, involving misrepresentation, unfair or deceptive acts
4.	Administrative Proceedings	Details from franchisor, directors, general partners, and managers of any currently effective injunctive or restrictive orders or pending administrative actions before any public agency
5.	Bankruptcy	Details of any bankruptcy or insolvency proceedings in previous 6 years against franchisor or associates, against a corporation whose directors have management responsibilities for the franchise
6.	Nature of the Business	Franchisor's business and franchises to be offered
7.	Initial Franchise Fee and Other Fees	Include conditions under which fees are refundable, other recurring or isolated fees or payments franchisees must make to franchisor
8.	Initial Investment Required	Details of amounts required to start business operations
9.	Financing	Disclose terms and conditions of each financing arrangement offered directly or indirectly by franchisor
10.	Working Capital	If estimate provided, must have reasonable basis and include material assumptions underlying presentation. If estimate not provided, disclosure must include statement of additional funds required to finance operations until positive cash flow is produced.
11.	Restrictions on Sources of Products and Services and on What Franchisees May Sell	Franchisee's obligations to purchase or lease from franchisor or from approved suppliers. Include restrictions on goods that franchisee may sell, or that limit the customers to whom the franchisee may sell
12.	Rebates or Other Benefits to the Franchisor	Rebates or other benefits received by franchisor as result of purchase of goods by franchisees, indicating whether benefits are shared directly or indirectly with franchisees.
13.	Obligations to Participate in Actual Operations	Whether or not franchisor requires franchisee to personally participate in direct operation of business.
14.	Existing Outlets	Names, addresses, and phone numbers of all existing franchisees in Alberta under same trade name, and addresses and phone numbers of outlets
15.	Franchise Closures	Information about closures of outlets operated under same trade name within past three fiscal years, including total

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		number that have been terminated or cancelled by franchisor, not renewed by franchisor, reacquired by franchisor, otherwise left system.
16.	Earnings Claims	If information is given on specific level or range of actual or potential sales, costs, income, or profit, it must have reasonable basis and include material assumptions underlying its presentation.
17.	Termination, Renewal, and Transfer	Disclose whether or not provisions in agreement address renewal, termination, and transfer, and if so, where they can be found.
18.	Territory	Describe any exclusive territory granted, include policy on how franchisor may establish another franchise, a franchised outlet may be established, the franchisor may establish other methods of distribution, franchisor may establish other franchises to distribute similar products under different mark. Describe policy, if any, whether continuation of territory depends on achievement of sales volume, market penetration, or other contingency.
19.	Notice of Rescission and Effect of Cancellation	Quote sections 13 and 14 of the Act
20.	Right of Action for Damages	Quote section 9 of the Act
21.	Financial Statements	Financial statements must be included, and must comply with sections 2 and 3 of the Regulation
Source: Alberta Statutes and Regulations		

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Table B2: Summary of European Union and U.S. Competitive Practices Law	
SIMILARITIES	1. Elements of Article 85 violations are similar to Sherman Act violations: a. Two or more participants. b. Conduct must restrict competition. c. Prosecutors often look for conspiracy. 2. Both EU and US enforcement agencies highly suspicious of agreements: a. Between competitors. b. Which involve prices. c. Involving companies with high market power. 3. Similar analysis of abuse in market power. 4. Increasing similarity in enforcement power and size of penalties. 5. Both have vehicles for defensive use of antitrust law (counterclaims in US, and "null and void" contracts in EU. 6. Both feature: a. Merger control systems. b. Favorable view of intellectual property licensing, alliances, joint ventures, etc.
DIFFERENCES	1. Significantly different procedures followed in restraint of trade area. a. EU uses block exemption or individual exemption threshold. b. US uses rule of reason. 2. US antitrust connected to economic philosophy favoring competition, EU Treaty focused on preventing market segmentation. 3. US antitrust analysis of vertical restraints consider level of interbrand competition more important than level of intrabrand competition; EU considers both levels relevant. 4. Substantially different legal environment for private enforcement of antitrust. US system provides greater 'access to courthouse'. 5. Treatment of mergers and acquisitions: a. EU merger that does not require notification will not be challenged. b. US government may challenge any merger. 6. Analysis of joint ventures and strategic alliances: a. EU views venture as either consolidation (analyzed under Merger Control Rules) or collaboration (analyzed under Article 85). b. US views these ventures as somewhere between consolidation and agreement between separate entities. 7. Restrictions in intellectual property licensing or association restrictions may require exemption from Article 85. Some EU member states may have price discrimination statutes in national legislation.
Source: Steven P. Reynolds (1996), *International Antitrust Compliance for a Company with Multinational Operations*, International Quarterly, Vol. 76.	

Appendix B

Table B3: Empirical Studies in Entrepreneurship: Definitions and Characteristics

Author	Definition	Sample	Characteristics
Brockhaus (1980)	…major owner and manager of a business venture not employed elsewhere	31 owner-managers who ceased working for their employers	Risk taking propensity
Collins and Moore (1970)	"everyone is an entrepreneur only when he actually carries out new combinations, and loses that character as soon as he has built up the business."	Owners of 110 manufacturing firms in Michigan	Parent's occupation, education, previous job satisfaction, social attitudes
Cooper and Dunkelberg (1981)	Owner-managers	1,805 members of National Federation of Independent Businesses.	Parents, immigrants, education, number of previous jobs, age.
Davids (1963)	Founders of new businesses	521 owners of firms in Georgia and Texas	Education, number of children, religious, sports and club affiliations
DeCarlo & Lyons (1979)	None given	Random selection of 122 individuals drawn from business directories	Age, marriage rate, education, previous entrepreneurial effort, regimentation, independence, etc.
Draheim (1972)	Act of founding a new company where none existed before	Survey of studies on technical companies	Credibility, fear of losing job, prior work experience, "track record.""
Durand (1975)	None given	27 male and 8 females from black community in metropolitan Midwest area	Achievement motivation, locus of control, training
Gomolka (1977)	None given	220 respondents to national mail survey	Sex, age, ethnicity, education, parents' work and social background
Gould (1969)	None given	119 High School boys	Delinquent associations, perception of opportunity, social class, achievement motivation
Hisrich & O'Brien (1981)	None given	21 female entrepreneurs in Boston	Self-discipline and perseverance, desire to succeed, action orientation, goal orientation, energy level
Hornaday & Aboud (1971)	"successful" entrepreneur was an individual who had started a business, building it where no previous business had been functioning, and continuing operations for five or more years with 15 or more employees."	20 individuals from Boston area	Need for achievement, intelligence, creativity, energy level, taking initiative, self-reliance, leadership, desire or money, recognition desire, accomplishment drive, power, affiliations, tolerance of uncertainty.
Howell (1972)	Aact of founding a new company where none had existed before.	12 founders of semiconductor companies in Palo Alto area	Age, marital status, outside activities, educational level, number of previous jobs, influences.

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Hull, Bosley, and Udell (1980)	Person who organizes and manages a business undertaking assuming risk for the sake of profit. Excludes individuals who purchase or inherit an existing business.	57 owners or partial owners of businesses.	Interests in money or fame, social desirability, task preferences, locus of control, risk propensity, creativity, achievement.
Lachman (1980)	Person who uses a new combination of production factors to produce the first brand in an industry.	29 males who started at least one new enterprise in Israel which was the first in the industry.	Age, years in Israel, education, father's occupation, achievement motivation, achievement orientation.
Litzinger (1965)	Entrepreneurs are goal and action oriented, as contrasted with managers who carry out policies and procedures	15 "mom and pop" owners of motels in Northern Arizona	Risk preference, independence, leadership, recognition, support, conformity, benevolence, structure, consideration.
McClelland (1961)	Someone who exercises control over the means of production, and produces more than he can consume in order to sell it for income.	Middle-level managers from Harvard and MIT Executive programs	Achievement, optimism, affiliation, power, conscientiousness, optimism, asceticism, belief in achieved status, market morality
Meson & Montanari (1981)	By definition, founders of new businesses	31 real estate brokers who owned and operated their own firms in north central U.S.	Achievement, autonomy, dominance, endurance, order, locus of control
Schrage (1965)	None given	22 R&D companies, less than 10 years old, in service, consulting, and manufacturing	Veridical perception, achievement motivation, awareness of impaired performance under tension.
Thorne & Ball (1981)	None given	51 founders of smaller manufacturing firms, with average age of 11 years	Age, number of previous ventures, education, family background.
Wainer & Rubin (1969)	Man who organizes the firm and/or increases its productive capacity.	51 technically-based service and manufacturing companies that were spin-offs from MIT	Achievement, power, affiliation
Welsch & Young (1982)	None given	53 owners of small businesses	Locus of control, Machiavellianism, self-esteem, risk-taking, openness to innovation, rigidity, government regulation, economic optimism
Source: Gartner, W. B. (1988). ""Who is an Entrepreneur?" Is the Wrong Question." Entrepreneurship Theory & Practice(Summer): 47-68.			

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Table B4: Summary of Theoretical and Empirical Studies of Franchising

Author	Type	Focus	Sample	Dependent Variable	Conclusions
Adams, Jones, & Hickey (1997)	Legal Text	Legal definitions and case law from the UK and US			American courts have not stepped beyond principal and agent categories. In UK, relationship is that of master and servant.
Barrow (1989)	Literature Review	US and UK franchising data			The idea that franchisees are independent business people is somewhat of a myth.
Bates (1995)	Empirical	Investigate business survival rates of young firms	19,278 US independent businesses and 1,276 franchises		Young franchisees report 5 times annual sales of independents, capitalization of 3 times, yet are dramatically less profitable. Franchisees are much more likely to go out of business than cohort independent firms.
Bates (1997)	Empirical	Survival rates among newcomers to franchising	52,088		New and small franchisees are more likely to cease operations than independent start-ups.
Baucus, Baucus, & Human (1993)	Empirical	Whether franchisees receive good value for their fees	1,050 U.S. franchisors		In general, franchisees get value comparable to fees and royalties paid. Franchisees can ensure they get what they pay for by comparing franchise against industry averages.
Birley, Leleaux & Spinelli (1997)	Empirical	Compare financial performance of franchisors	83 US franchisors		Returns posted from by franchisors from 1987 to 1994 are close to that of overall market, with similar risk. High fees and royalties negatively affect growth rates.
Brickley & Dark (1987)	Theoretical/ Empirical	Choice of organizational form	36 U.S. franchisors with 10,524 units		Factors favoring franchising include high monitoring costs, low investment costs per unit, and higher frequency of repeat customers

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Brown (1998)	Theoretical	Transaction Costs and management incentives			Nature of production in some industries promotes 'dual labor' system: some franchisees and some promotion-based employment.
Burke (1996)	Empirical	Inducement problems in buying a franchise	1 case study		Franchisee should be: (1) familiar with type of business; (2) familiar with area; and (3) skeptical and cautious of franchisors.
Bygrave & Spinelli (1992)	Empirical	Structural flaws in franchising forecast conflict	Random sample of 75 U.S. franchisors		91% of franchisors were involved in litigation with their franchisees
Castrogiovanni, Bennet, and Combs (1995)	Empirical	Franchisor type distinctions	717 franchisors using secondary data		Franchisors are very similar. Franchisors are concerned with both resource scarcity and administrative efficiency.
Castrogiovanni, Justis, & Julian (1993)	Empirical	Franchise failure rates	103 UFOCs		Department of Commerce 1988 estimates of less than 4% franchise failures is corroborated.
Castrogiovanni & Justis (1998)	Theoretical	Place the franchise organization within Mintzberg's framework			Extends Mintzberg's five organizations: (1) entrepreneurial; (2) machine; (3) professional; (4) adhocracy; and (5) diversified. Few, if any, franchises can be described as perfect 'turn-key' operations that will essentially run themselves.
Chan & Justis (1992)	Theory	US and EC franchising			The EC would have to produce an additional 1,300 franchisors and 375,000 franchisees to attain the same market penetration as the U.S.
Cohen & Thompson (1971)	Theory	Conflict and resolution in franchise systems			Basic flaw in the structure of this form of marketing. Collision course inevitable because of opposing goals of participants.
Combs & Castrogiovanni (1994)	Theoretical/ Empirical	Franchise vs. Company Ownership decision	558 U.S. franchisors	Proportion of franchised units in system	Results do not support resource scarcity theory. Additional support for agency and risk-spreading theories of franchising.

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Curran & Stanworth (1983)	Literature Review/ Theoretical	Theoretical understanding of franchising		Misleading claims of returns and independence in popular media are exception, not rule.
Dant & Gundlach (1998)	Empirical	Autonomy and Dependence in Franchising	174 franchisees	Franchisors should expect franchisees to be a diverse group of individuals, that evolve in dependence and autonomy over time.
Dant & Nasr (1998)	Empirical	Control techniques and upward flow of information	20	Choosing a franchisee in a culturally or geographically distant location is high-risk and expensive.
Dant (1995)	Empirical	Motivation for franchising	Three studies: 37, 31, 16 US franchisees	78.4% of franchisees would choose it again. Growth, market access, and profits were top motivators for franchising.
Dant, Paswan & Stanworth (1996)	Literature Review of Empirical Studies	Ownership redirection trends		Franchising is temporary expansion method. Companies will return to traditional growth measures once local intelligence is acquired. Measures of ownership redirection may not be valid across industries.
Elango & Fried (1997)	Literature Review	Broad review of franchising research		Past research too closely tied to theories of agency and power. More fine-grained research methods needed.
Falbe & Dandridge (1992)	Theoretical	Cooperation and conflict in global market		Key success factors that rest on the inter-dependence of the franchisee and franchisor are the integrity of the business system and the capacity for innovation and renewal.
Falbe, Dandridge, Kumar (1999)	Empirical	Context of franchisor affects franchisee perceptions	50 interviews	Studies of entrepreneurship should consider franchisor and industry contexts. Entrepreneurial activities by franchisees implies partnership in adapting to environment.
Fenwick & Strombom (1998)	Empirical	Determinants of Franchisee Performance	36 New Zealand Franchisees	Managerial competence is not a significant predictor of performance. Location, growth in sales, and Return on assets only significant contributors to firm performance.

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Fulop & Forward (1997)	Literature Review	Analysis of major issues covered in research and debate.		Covers: (1) determinants of franchising; (2) reasons and factors associated with why franchisors have franchised and company-owned outlets; (3) franchisor/franchisee relationship.
Hoy (1994)	Literature Review	Examine the less savory aspects of franchisor-franchisee relationship		Violations of agreement are natural outgrowth of franchisor/ franchisee relationship. Task motivation, franchisee expertise, expectations of self-gain, and supportive environment issues are predictors of conflict.
Julian & Castrogiovanni (1995)	Empirical	Desired expansion of US franchisors	1,005 US franchisors	Expansion is attractive for its revenue streams, especially with mature franchisors.
Kalnins & Lafontaine (1996)	Empirical	Multi-Unit ownership in fast-food	3,400 restaurants in Texas	Single-unit owners make up less than 11% of total units. More than 30% are owned by franchisees with 5 or more units.
Kaufmann & Dant (1996)		Multi-Unit franchising	152 US franchisors	Prevalence of Multi-Unit franchises indicates that franchising image as mom and pop enterprises is not valid. Multi-unit franchising positively related to franchisor growth rates.
Kaufmann & Dant (1999)	Theoretical/ Literature Review	Franchising in domain of entrepreneurship research		Like entrepreneurship in general, franchising is a vital sector of the U.S. economy. Hence, revenues generated by overseas franchising royalties are a great source of foreign exchange earnings with no strings attached.

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Kaufmann & Eroglu (1998)	Theoretical	Standardization and Adaptation in Business Format Franchising		Despite direct interest in standardization, franchisees have incentives to cheat and free ride. Successful franchisors are first entrepreneurs and innovators. Striking balance between standardization and adaptation is one of the greatest challenges for franchisors.
Kaufmann & Stanworth (1995)	Empirical	Why individuals become franchisees instead of employees or independents	408 individuals	Advantages of franchising are different for those who have been self-employed and those that have not. Salaried employees likely to value relative freedom.
Koiranen, Hyrsky, Tuunanen (1997)	Empirical	Perceived advantages and disadvantages of franchising	686 Franchisees in Finland	Most relevant advantages: Known company name, Proven business concept, economies of scale, franchisor support, greater job satisfaction, opportunity for family business. Most relevant disadvantages: Fees, excessive working hours, contractual issues.
Krueger (1991)	Empirical	Estimate differences in wages paid by company vs. franchised restaurants	1,889 non- management, 198 hourly assistant mgrs. In 204 U.S. fast-food restaurants -	Employees in company-owned and franchised restaurants have similar characteristics. Wages are 9% higher for low-level managers and 1-2% higher for workers at company-owned restaurants compared to franchised. Tenure/Earnings slope is also steeper in former.
Lafontaine & Shaw (1997)	Empirical	Franchising growth, entry and exit in U.S.	Department of Commerce data	Franchising has grown since 1986, but at a rate comparable to the U.S. economy overall. Franchisees cannot rely on publicly available information on franchisors for investment decision.
Lafontaine & Slade (1997)	Theoretical	Contractual relationships between manufacturers and exclusive resellers		Some patterns are consistent with incentive-cum-insurance theory of organizations, while others are not. Evidence is consistent across industries and firms. Standard agency model is unsupported.

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Lafontaine & Slade (1998)	Theoretical	Incentive contracting and franchise decision		Higher monitoring costs lead to vertical integration. Higher substitutability, harder it is for agent to maintain sales levels.
Lafontaine (1995)	Empirical	Pricing decisions in franchised fast-food restaurants		Value of inputs sold by franchisors only account for 4.5% of franchisee sales. Franchisors might want to control prices downward.
Leblebici & Shalley (1996)	Theoretical/ Empirical	Contract, Rights	30 UFOCs	Of 75 franchisors contacted, 35 had gone out of business or were in bankruptcy
Mendelsohn & Bynoe (1995)	Legal	UK and EU laws applicable to franchising		There is no such thing in England or anywhere else as franchise law.
Michael (1993)	Literature Review	Analysis of property rights and organizational forms,		Efficient allocation of property rights, low levels of business risk and human capital are required for franchising success
Morrison (1995)	Empirical	Franchise system characteristics and proportion of franchisee-owned outlets	743	Higher monitoring cost leads to attractiveness of franchisee-owned outlets. Higher investment costs and royalties are inversely related to franchisee-owned units based on efficient risk-bearing considerations.
Morrison (1997)	Empirical	Franchisee job satisfaction and performance	307 US franchisees	Positive influence of job satisfaction on performance. Congenial franchisor relations had negative effect.
Peterson & Dant (1990)	Empirical	Franchisee reasons for choosing franchise	74	Training provisions, greater independence, and established name were most positively perceived advantages of franchising. Findings did not relate to studies by Stanworth, Knight, or Hough.
Phan, Butler & Lee (1996)	Empirical	Understand informal interaction dynamics	160 truck manufacturers in the US.	Franchisees exercising strategic discretion and expecting entrepreneurial returns to risk are really entrepreneurs. In declining industries goals are likely to conflict.

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Pilling (1991)	Empirical	Competitive advantages offered by franchised business	209 Independent Truck-Stop Operators in U.S.	Initial franchisor support enhances chances of success. Current financial success has inverse effect on independent's attitude toward franchising. Franchising is not a panacea for marginal business.
Preble & Hoffman (1995)	Empirical	Status of franchising around the world	13 national franchise associations	24 nations have formed franchise associations. Franchising can help build economic base in developing countries.
Price (1997)	Theoretical/ Empirical/ Literature Review	Comprehensive review of theoretical and empirical research on franchising	Multiple studies	Extensive monograph on relevant theories, empirical studies and literature on franchising.
Shane (1996)	Empirical	Why franchise companies expand overseas	815 largest US franchisors	Key capability that predicts intent is superior capability to reduce franchisee opportunism Foreign entrepreneurs can identify American franchisors most likely to expand overseas by looking at their pricing structure and monitoring capabilities.
Shane (1998)	Empirical	Franchise survival	157	72% of new franchise systems in sample ceased to franchise. Systems that economize on agency costs are more likely to survive than those who do not.
Spinelli & Birley (1996)	Theoretical	Conflict in Franchise System		Measure 'tolerance zone' in franchisor/franchisee relationship
Stanworth & Dandridge (1993)	Literature Review	Issues in franchise research		Problems in empirical work on failure rates is hampered by lack of consensus on definition of 'failure'.
Stanworth & Kaufmann (1996)	Empirical	Compare US and UK data on franchisee motivations		Results from US and UK data are very similar. Experience of self-employment was key variable in attending a franchise exhibition. Franchisors prefer no self-employment experience
Stanworth, Purdy & Price (1997)	Empirical	Franchise growth and survival	74	Since 1990, UK franchise industry has realized negative real growth

Stanworth, Purdy, Price & Zafiris (1998)	Literature Review	UK and US comparison of franchise survival rates		Royalty regime imparts heavy burden on franchisees especially in times of market saturation or economic recession.
Stern & Stanworth (1993)	Empirical	Role of banks in franchising in Europe	10 franchise associations	UK and Dutch banks most knowledgeable. Denmark, Finland, Greece, Italy, and Sweden were found to have banks with poor knowledge.
Thompson (1971)	Theoretical	Contractual marketing systems		Franchising as distribution and marketing system is transitional rather than permanent.
Vaughn (1979)	Literature Review (monograph)	Franchising: Nature, scope and development		Franchising, albeit beset with many legal and public relations problems, is a dynamic marketing method.
Vincent (1998)	Literature Review	Legal restrictions on franchise expansion		Encroachment will become problem for expanding franchise organizations. Legal restrictions unlikely due to uniqueness of each franchise system
Williams (1999)	Empirical	Entrepreneur's decision to become franchisee	14,550 firms with 951 franchisees	Decision to become franchisee is consistent with wealth maximization. Franchisees generate below average profits.
Withane (1991)		Study Canadian franchisees		78% found proven business format to be influential in decision to buy a franchise.
Wu (1998)	Empirical	Compare brand name pricing	155 motels, 90 franchised	On average, franchised rooms were priced 21% higher than comparable independent.

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Table B5: Tau_b Correlation Coefficients of UFOC and Franchise Agreement Provisions

		OAP	RMP	APL	LAL	ASO	SHO	ET	MA	OAP	AA	OOS	OFT	OPT	DM	MAR	IC	IB	QA
OAP	Coef.	1.000																	
RMP	Coef.	0.202	1.000																
APL	Coef.	0.566	0.111	1.000										Significant >= .001					
LAL	Coef.	0.664	0.039	0.664	1.000									Significant >= .05					
ASO	Coef.	0.243	0.124	0.417	0.425	1.000													
SHO	Coef.	0.135	0.244	-0.029	0.100	-0.009	1.000												
ET	Coef.	0.288	0.034	0.356	0.374	0.236	-0.073	1.000											
MA	Coef.	0.298	-0.027	0.298	0.266	0.085	0.167	-0.052	1.000										
OAP	Coef.	-0.121	-0.084	-0.140	-0.071	-0.021	0.182	-0.159	0.129	1.000									
AA	Coef.	0.033	-0.062	-0.046	0.062	0.235	0.134	-0.037	0.355	0.380	1.000								
OOS	Coef.	0.150	0.175	0.216	0.134	0.098	-0.036	0.117	0.252	-0.024	-0.057	1.000							
OFT	Coef.	0.167	0.171	0.275	0.180	0.229	0.103	0.065	0.240	0.053	0.014	0.742	1.000						
OPT	Coef.	0.437	0.245	0.417	0.425	0.471	0.094	0.150	0.361	0.074	0.151	0.514	0.549	1.000					
DM	Coef.	0.449	0.163	0.414	0.649	0.292	0.243	0.227	0.278	0.044	0.231	0.087	0.102	0.377	1.000				
MAR	Coef.	0.467	0.200	0.333	0.577	0.212	0.289	0.301	0.290	0.105	0.309	0.000	-0.015	0.376	0.890	1.000			
IC	Coef.	0.202	0.182	-0.011	0.039	0.124	-0.039	-0.082	-0.027	0.044	0.165	0.062	0.062	0.124	0.048	0.089	1.000		
IB	Coef.	0.467	0.070	0.368	0.550	0.243	0.021	0.288	0.197	0.087	0.125	0.241	0.343	0.534	0.542	0.467	0.202	1.000	
QA	Coef.	0.313	0.019	0.297	0.399	0.351	0.009	0.204	0.151	0.187	0.260	0.067	0.342	0.351	0.424	0.337	0.255	0.790	1.000

OAP	Sell only approved products
RMP	Required minimum purchase
APL	Approved product line
LAL	Limited to approved product line
ASO	Accepted suppliers only
SHO	Set hours of operation
ET	Exclusive territory
MA	Mandatory advertising contribution
OAP	Opening advertising program
AA	Advertising approval required
OOS	Owner required to be on-site
OFT	Owner must devote full-time to business
OPT	Owner may be part-time
DM	Owner may designate manager
MAR	Manager must be approved by franchisor
IC	Franchisor may interview customers
IB	Franchisor reserves right to inspect business
QA	Franchisor reserves right to quality audit inspections

Appendix B

Table B6: Descriptive Statistics FRANDATA Dataset Variables

		Min.	Max.	Mean	Std. Dev.	Freq.	Percent.
YBF[a]		0	118	5.92	11.91		
NUM[a]		1	17	3.23	2.13		
NFRA[a]		0	11541	266.08	886.55		
NCOM[a]		0	5014	48.60	278.02		
PERF[b]		0	100	81.78	28.84		
FEEL[a]		0	72500	21598.54	11139.51		
FEEH[a]		0	500000	27141.76	27290.50		
ATER[b]		0	40	10.80	5.20		
RTER[c]		0	40	10.8025	5.2046		
RFEE[d]		1	25000	3440.09	3531.89		
TFEE[e]		0	25000	4599.38	3381.95		
AGE[a]		2	123	21.36	15.8		
EXP[a]		2	75	15.44	12.06		
MUA[a]	No					416	70.3%
	Yes					176	29.7%
DEV[a]	No					417	70.4%
	Yes					175	29.6%
EXC[a]	No					127	21.5%
	Yes					465	78.5%
FIN[a]	No					312	52.7%
	Yes					280	47.3%
OTHR[a]	No					502	84.8%
	1					65	11.0%
	2					15	2.5%
	3					4	0.7%
	4					2	0.3%
	7					4	0.7%
TYPE[a]	No					487	82.3%
	1					90	15.2%
	2					13	2.2%
	3					2	0.3%

[a] N= 592; [b] N= 569; [c] N= 567; [d] N= 142; [e] N= 324

YBF= Number of years in business before franchising
NUM= Number of legal agreements required to sign
NFRA= number of franchised outlets
NCOM= number of company-owned outlets
PERF= Percent of units franchised
FEEL= Franchise fee low
FEEH= Franchise fee high
ATER= Agreement term in years
RTER= Renewal term in years
RFEE= Renewal fee (in U.S. dollars)
TFEE= Transfer fee (in U.S. dollars)
AGE= Number of years since franchisor incorporated
EXP= Number of years experience in franchising
MUA= Multi-unit agreements offered
DEV= Area development agreements offered
EXC= Exclusive territory
FIN= Financial assistance provided
OTHR= Other programs offered to become franchisee
TYPE= Number of other types of businesses offered

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Table B7: Descriptive Statistics Source Book Publications Dataset Variables

	Min.	Max.	Mean	Std. Dev.	Freq.	Percent.
NUMUS[a]	0	12627	212.14	749.19		
NUMCA[b]	0	3555	27.04	139.19		
NUMIN[a]	0	12836	57.44	567.48		
SIZE[b]	1	26588	303.95	1265.53		
NFRA[a]	0	20531	260.85	1068.51		
NCOM[a]	0	6057	43.10	300.77		
PERF[a]	0	100	81.54	26.32		
FFEE[c]	0	82.00	21.91	11.94		
STARTLO[d]	0	22000	242.21	1079.19		
STARTHI[e]	0	44000	500.13	2326.73		
ATER[f]	0	40.00	10.64	5.09		
AGE[b]	1	136	23.14	16.2		
EXP[a]	1	76	15.37	10.88		
PNU[m]	0	1782	33.2	96.88		
ROY[n]	0	40.0	5.38	2.96		
HQ[a]	Canada				175	14.6%
	U.S.				1026	85.4%
EC[g]	No				873	72.6%
	Yes				312	26.3%
PO[h]	No				302	25.1%
	Discouraged				626	52.1%
	Permitted				248	21.1%
AD[i]	No				545	45.3%
	Yes				623	51.8%
SF[j]	No				916	76.2%
	Yes				266	22.1%
ET[k]	No				166	13.8%
	Yes				999	83.1%
FIN[l]	No				363	30.2%
	Indirect				554	46.1%
	Direct				176	14.6%
	Both				20	1.7%

[a] N= 1201; [b] N= 1202; [c] N= 1175; [d] N= 1171; [e] N= 1162; [f] 1156; [g] 1185; [h] 1176; [i] 1168; [j] N=1182; [k] N=1165; [l] N= 1113; [m] N= 1126; [n] N= 1100

NUMUS= Number of U.S. outlets	ATER= Agreement term in years
NUMCA= Number of Canadian outlets	AGE= Number of years since franchisor incorporated
NUMIN= Number of international outlets	EXP= Number of years experience in franchising
SIZE= Total number of outlets	PNU= Projected new unit openings
NFRA= Number of franchised outlets	ROY= Royalties in percent
NCOM= Number of company-owned outlets	HQ= Location of headquarters
PERF= Percentage of units franchised	EC= Earnings claim provided
FFEE= Franchise fee in $1,000s	PO= Passive ownership
STARTLO= Average start-up fees low in $1,000	AD= Area directorships offered
STARTHI= Average start-up fees high in $1,000	SF= Sub-franchising permitted
	ET= Expansion within territory allowed
	FIN= Financial assistance provided

Appendix B

Table B8: Crosstabs Analysis of Relationships Between Contractual Provisions and Franchise Characteristics- FRANDATA

		Contractual Provisions															
		DEV		MULTI		EXCL		NUM		TERM		FIN		BIZTYPE		OTHER	
		tau-b	sig.	tau-b	sig.	tau-b	sig.	tau-b	sig.	tau-b	sig.	tau-b	sig.	tau-b	sig.	tau-b	sig.
Franchise Characteristics	**YBF**	.046	.224	.044	.224	.014	.697	.085	.017	.031	.393	-.015	.694	.021	.590	.072	.064
	NFRA	.022	.556	.123	.001	-.154	.000	.207	.000	.181	.000	.202	.000	.111	.003	.243	.000
	NCOM	.206	.000	.072	.059	-.071	.070	.203	.000	.109	.004	.060	.111	.023	.557	.004	.922
	FEEL	.169	.000	.085	.018	-.013	.725	.102	.003	.110	.003	-.003	.926	.067	.081	.067	.081
	FEEH	.092	.010	.009	.807	.001	.974	.108	.002	.110	.003	-.003	.926	.048	.187	.079	.032
	AGE	-.021	.583	.094	.010	-.058	.127	.160	.000	.196	.000	.163	.000	.142	.000	.189	.000
	EXP	-.025	.498	.079	.029	-.087	.014	.112	.001	.179	.000	.144	.000	.122	.001	.153	.000
	SIZE	.042	.265	.107	.004	-.140	.000	.225	.000	-.092	.012	.220	.000	.133	.000	.242	.000
	PERFRAN	-.183	.000	.004	.918	-.036	.301	-.097	.004	-.038	.301	.035	.339	.028	.430	.068	.055
	CAGR	.021	.579	.024	.528	-.041	.293	-.028	.423	-.092	.012	-.007	.849	-.040	.281	.000	1.00

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Table B9: Crosstabs Analysis of Relationships Between Contractual Provisions and Franchise Characteristics- Source Book

		Contractual Provisions															
		DEV		SUB		PASS		EXT		FIN		EC		TERM		HQ	
		tau-b	sig.	tau-b	sig.	tau-b	sig.	tau-b	sig.	tau-b	sig.	tau-b	sig.	tau-b	sig.	tau-b	sig.
Franchise Characteristics	YBF	.052	.054	-.071	.006	-.009	.724	.017	.518	-.029	.291	.040	.141	-.015	.556	.037	.158
	NFRA	-.017	.527	.024	.364	.010	.704	-.002	.954	.100	.000	.046	.079	.096	.000	.015	.526
	NCOM	.129	.000	-.049	.058	-.001	.996	.031	.253	-.074	.007	.094	.000	.145	.000	.046	.076
	FFEE	.085	.002	-.080	.002	-.024	.366	-.041	.136	-.036	.202	.084	.002	.180	.000	-.095	.000
	AGE	.029	.283	.002	.945	-.046	.070	.008	.765	-.026	.352	.059	.024	.158	.000	-.017	.495
	ILOW	.209	.000	-.063	.015	-.012	.663	.001	.983	-.093	.001	.099	.000	.303	.000	-.090	.000
	IHIGH	.220	.000	-.032	.215	.015	.574	.002	.933	-.082	.004	.092	.001	.322	.000	-.034	.186
	EXP	.001	.973	.063	.017	-.054	.027	.020	.460	-.021	.458	.025	.353	.173	.000	-.091	.000
	SIZE	.001	.977	.002	.952	.011	.684	-.001	.971	.073	.008	.057	.032	.113	.000	.025	.296
	PERFRAN	-.111	.000	.084	.001	.000	.998	-.013	.629	.121	.000	-.057	.029	-.073	.004	-.059	.019
	GROWTH	.059	.031	.040	.135	.070	.006	.013	.642	.025	.373	-.030	.268	-.137	.000	.096	.000
	CAGR	.008	.766	.025	.336	.039	.130	.006	.822	.085	.002	.014	.596	-.067	.007	.034	.195
	PNU	.082	.003	.037	.177	.063	.017	.037	.186	.148	.000	.034	.213	.029	.281	.123	.000
	EXPUS	-.022	.451	-.014	.642	**.128**	.000	.061	.047	**.146**	.000	-.022	.453	-.010	.731	**.282**	.000
	EXPCAN	.025	.378	.097	.000	.035	.199	.001	.960	.083	.005	.037	.191	-.070	.010	**-.251**	.000
	EXPINT	.002	.000	**.155**	.000	.075	.005	.067	.013	.086	.002	-.038	.177	.028	.306	.024	.386

Table B10: Independent Sample T-Test for Provision to Provide Financing

	FIN	N	Mean	Std. Dev.	Equal Variance	F	Sig.	t	df	Sig. (2-tailed)	M. Diff.
NUS	0	363	204.10	843.49	A	0.10	0.7471	-0.56	1111	0.5770	-27.65
	1	750	231.75	739.98	NA			-0.53	639	0.5941	-27.65
NINT	0	363	61.61	699.67	A	0.02	0.8947	0.04	1111	0.9717	1.34
	1	750	60.28	526.20	NA			0.03	567	0.9743	1.34
AGE	0	363	23.37	15.38	A	0.10	0.7550	0.40	1111	0.6868	0.41
	1	750	22.95	16.40	NA			0.41	759	0.6801	0.41
EXP	0	362	15.88	10.99	A	0.48	0.4885	0.60	1110	0.5509	0.42
	1	750	15.46	10.90	NA			0.59	708	0.5521	0.42
SIZE	0	363	304.42	1594.58	A	0.00	0.9513	-0.18	1111	0.8543	-15.38
	1	750	319.80	1146.41	NA			-0.16	549	0.8695	-15.38
NFRA	0	363	241.89	1265.85	A	0.22	0.6410	-0.58	1111	0.5621	-40.91
	1	750	282.80	1015.64	NA			-0.54	595	0.5910	-40.91
NCOM	0	363	62.53	374.63	A	4.29	0.0386	1.28	1111	0.2009	25.53
	1	750	36.99	276.79	NA			1.15	560	0.2486	25.53
PNU	0	341	23.68	52.08	A	7.18	0.0075	-2.27	1075	0.0234	-14.64
	1	736	38.32	113.64	NA			-2.90	1075	0.0038	-14.64
GROW	0	340	60.79	142.32	A	16.83	0.0000	2.05	1069	0.0402	13.78
	1	731	47.01	76.74	NA			1.68	433	0.0946	13.78
PERF	0	363	76.21	29.31	A	53.69	0.0000	-5.75	1111	0.0000	-9.22
	1	750	85.43	22.75	NA			-5.27	580	0.0000	-9.22
AILO	0	352	326.53	1416.68	A	16.85	0.0000	2.83	1083	0.0048	160.60
	1	733	165.93	413.93	NA			2.08	380	0.0378	160.60
AILHI	0	349	598.41	2526.44	A	10.22	0.0014	2.22	1074	0.0270	257.68
	1	727	340.73	1288.86	NA			1.80	437	0.0731	257.68
FFEE	0	352	22.89	13.05	A	4.98	0.0259	2.01	1089	0.0450	1.55
	1	739	21.34	11.32	NA			1.91	611	0.0567	1.55
TERM	0	346	10.84	5.29	A	7.22	0.0073	0.58	1071	0.5633	0.19
	1	727	10.65	5.00	NA			0.57	645	0.5712	0.19
EXUS	0	354	1.47	0.66	A	39.64	0.0000	-4.97	1081	0.0000	-0.19
	1	729	1.66	0.56	NA			-4.70	609	0.0000	-0.19
EXIN	0	360	0.56	0.80	A	17.56	0.0000	-3.08	1101	0.0021	-0.17
	1	743	0.73	0.87	NA			-3.18	767	0.0015	-0.17
YBF	0	362	7.52	12.07	A	0.37	0.5420	0.04	1110	0.9669	0.03
	1	750	7.49	13.23	NA			0.04	776	0.9658	0.03
CAGR	0	363	0.26	0.28	A	2.78	0.0958	-1.88	1111	0.0607	-0.08
	1	750	0.34	0.75	NA			-2.46	1056	0.0139	-0.08

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Table B11: Independent Sample T-Test for Area Development

	AD	N	Mean	Std. Dev.	Equal Variance	F	Sig.	t	df	Sig. (2-tailed)	M. Diff.
NUS	0	545	233.19	841.02	A	1.99	0.1582	0.80	1166	0.4261	35.37
	1	623	197.82	676.07	NA			0.78	1042	0.4327	35.37
NINT	0	545	82.60	784.84	A	6.91	0.0087	1.34	1166	0.1790	45.34
	1	623	37.26	284.40	NA			1.28	668	0.2019	45.34
AGE	0	545	23.08	16.69	A	1.46	0.2279	-0.18	1166	0.8559	-0.17
	1	623	23.25	15.86	NA			-0.18	1127	0.8564	-0.17
EXP	0	545	15.51	11.07	A	4.84	0.0280	0.56	1165	0.5737	0.35
	1	622	15.16	10.42	NA			0.56	1123	0.5752	0.35
SIZE	0	545	358.80	1606.41	A	5.00	0.0256	1.28	1166	0.2004	96.24
	1	623	262.56	904.71	NA			1.24	832	0.2163	96.24
NFRA	0	545	316.17	1313.58	A	6.37	0.0118	1.55	1166	0.1202	98.49
	1	623	217.69	822.73	NA			1.51	890	0.1313	98.49
NCOM	0	545	42.63	379.17	A	0.02	0.8793	-0.13	1166	0.9002	-2.24
	1	623	44.87	220.40	NA			-0.12	848	0.9034	-2.24
PNU	0	514	29.13	59.18	A	2.27	0.1320	-1.32	1098	0.1861	-7.81
	1	586	36.94	121.81	NA			-1.38	870	0.1686	-7.81
GROW	0	511	53.37	115.22	A	2.45	0.1177	0.38	1091	0.7061	2.37
	1	582	51.00	92.50	NA			0.37	976	0.7100	2.37
PERF	0	545	83.15	26.63	A	0.11	0.7444	1.76	1166	0.0795	2.69
	1	623	80.46	25.68	NA			1.75	1133	0.0802	2.69
AILO	0	526	250.03	1289.28	A	1.91	0.1672	0.13	1139	0.8971	8.40
	1	615	241.63	892.46	NA			0.13	912	0.8999	8.40
AILHI	0	522	562.18	2870.18	A	5.54	0.0187	0.72	1130	0.4726	100.97
	1	610	461.21	1806.05	NA			0.69	850	0.4875	100.97
FFEE	0	530	21.14	13.42	A	21.25	0.0000	-2.06	1142	0.0399	-1.46
	1	614	22.60	10.62	NA			-2.02	1003	0.0433	-1.46
TERM	0	518	9.81	5.20	A	4.47	0.0347	-5.24	1127	0.0000	-1.58
	1	611	11.39	4.93	NA			-5.22	1075	0.0000	-1.58
EXUS	0	529	1.59	0.63	A	1.49	0.2224	0.14	1137	0.8890	0.01
	1	610	1.59	0.59	NA			0.14	1085	0.8896	0.01
EXIN	0	521	0.55	0.81	A	14.56	0.0001	-3.86	1121	0.0001	-0.19
	1	602	0.75	0.87	NA			-3.88	1115	0.0001	-0.19
YBF	0	545	7.57	13.05	A	0.06	0.8062	-0.71	1165	0.4797	-0.55
	1	622	8.12	13.38	NA			-0.71	1152	0.4790	-0.55
CAGR	0	545	0.34	0.87	A	6.14	0.0133	1.53	1166	0.1272	0.06
	1	623	0.29	0.29	NA			1.45	653	0.1483	0.06

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Table B12: Independent Sample T-Test for Passive Ownership

	PO	N	Mean	Std. Dev.	Equal Variance	F	Sig.	t	df	Sig. (2-tailed)	M. Diff.
NUS	0	302	245.21	1103.95	A	5.76	0.0166	1.31	926	0.1908	69.72
	1	626	175.48	518.91	NA			1.04	367	0.2975	69.72
NINT	0	302	112.25	1035.07	A	13.20	0.0003	1.87	926	0.0614	80.21
	1	626	32.05	194.20	NA			1.34	311	0.1828	80.21
AGE	0	302	23.05	15.13	A	1.94	0.1639	-0.47	926	0.6379	-0.53
	1	626	23.58	16.72	NA			-0.49	651	0.6261	-0.53
EXP	0	301	15.51	10.19	A	1.46	0.2265	-0.14	925	0.8890	-0.11
	1	626	15.62	11.23	NA			-0.14	647	0.8852	-0.11
SIZE	0	302	413.66	2124.93	A	12.06	0.0005	2.00	926	0.0455	186.31
	1	626	227.35	662.40	NA			1.49	330	0.1374	186.31
NFRA	0	302	347.30	1755.55	A	12.03	0.0005	1.98	926	0.0481	152.82
	1	626	194.48	561.33	NA			1.48	331	0.1407	152.82
NCOM	0	302	66.36	447.62	A	7.00	0.0083	1.49	926	0.1368	33.49
	1	626	32.86	237.13	NA			1.22	385	0.2231	33.49
PNU	0	282	29.82	76.82	A	1.92	0.1660	0.67	873	0.5012	3.26
	1	593	26.56	61.74	NA			0.62	460	0.5335	3.26
GROW	0	281	46.90	104.63	A	0.13	0.7180	-0.49	867	0.6275	-3.45
	1	588	50.36	94.83	NA			-0.47	506	0.6393	-3.45
PERF	0	302	78.68	29.20	A	16.72	0.0000	-2.46	926	0.0142	-4.52
	1	626	83.20	24.72	NA			-2.32	515	0.0208	-4.52
AILO	0	292	179.98	245.09	A	2.12	0.1458	1.35	904	0.1771	29.89
	1	614	150.09	338.19	NA			1.51	761	0.1315	29.89
AILHI	0	292	291.73	403.96	A	0.10	0.7543	0.43	900	0.6707	14.11
	1	610	277.63	493.10	NA			0.46	687	0.6486	14.11
FFEE	0	292	22.30	11.59	A	0.01	0.9357	0.53	908	0.5950	0.45
	1	618	21.85	12.13	NA			0.54	595	0.5890	0.45
TERM	0	290	10.83	5.07	A	0.70	0.4044	1.15	896	0.2486	0.41
	1	608	10.42	4.94	NA			1.14	556	0.2531	0.41
EXUS	0	285	1.50	0.65	A	2.98	0.0846	-1.40	899	0.1630	-0.06
	1	616	1.56	0.62	NA			-1.37	529	0.1711	-0.06
EXIN	0	291	0.53	0.80	A	13.84	0.0002	-3.00	892	0.0027	-0.18
	1	603	0.71	0.86	NA			-3.09	616	0.0021	-0.18
YBF	0	301	7.58	12.38	A	0.73	0.3927	-0.41	925	0.6802	-0.38
	1	626	7.97	13.73	NA			-0.43	650	0.6691	-0.38
CAGR	0	302	0.26	0.22	A	2.75	0.0977	-1.18	926	0.2366	-0.06
	1	626	0.32	0.80	NA			-1.61	796	0.1069	-0.06

Table B13: Independent Sample T-Test for Earnings Claims

	EC	N	Mean	Std. Dev.	Equal Variance	F	Sig.	t	df	Sig. (2-tailed)	M. Diff.
NUS	0	873	221.15	826.25	A	2.45	0.1175	0.65	1183	0.5142	32.41
	1	312	188.73	493.62	NA			0.82	918	0.4125	32.41
NINT	0	873	70.41	656.20	A	5.58	0.0183	1.26	1183	0.2084	47.42
	1	312	22.99	182.19	NA			1.94	1140	0.0531	47.42
AGE	0	873	22.92	16.74	A	1.32	0.2511	-0.83	1183	0.4063	-0.89
	1	312	23.81	14.92	NA			-0.88	609	0.3809	-0.89
EXP	0	872	15.26	11.24	A	0.74	0.3891	-0.54	1182	0.5881	-0.39
	1	312	15.65	9.95	NA			-0.57	614	0.5662	-0.39
SIZE	0	873	326.89	1424.68	A	4.05	0.0443	0.98	1183	0.3283	82.16
	1	312	244.73	692.52	NA			1.32	1081	0.1864	82.16
NFRA	0	873	285.19	1201.78	A	5.40	0.0203	1.19	1183	0.2357	84.15
	1	312	201.04	590.12	NA			1.60	1074	0.1102	84.15
NCOM	0	873	41.70	323.74	A	0.02	0.8974	-0.10	1183	0.9205	-1.98
	1	312	43.68	225.52	NA			-0.12	786	0.9062	-1.98
PNU	0	822	34.57	98.92	A	2.04	0.1530	0.66	1114	0.5088	4.37
	1	294	30.20	92.63	NA			0.68	548	0.4957	4.37
GROW	0	815	57.11	115.58	A	19.96	0.0000	2.78	1107	0.0055	19.41
	1	294	37.69	50.86	NA			3.87	1068	0.0001	19.41
PERF	0	873	82.01	26.42	A	0.22	0.6382	0.89	1183	0.3750	1.54
	1	312	80.47	26.07	NA			0.89	554	0.3723	1.54
AILO	0	850	210.82	955.05	A	5.62	0.0179	-1.73	1153	0.0834	-125.54
	1	305	336.36	1386.27	NA			-1.46	412	0.1445	-125.54
AILHI	0	844	438.61	2100.16	A	5.38	0.0206	-1.59	1144	0.1119	-249.76
	1	302	688.37	2911.20	NA			-1.37	418	0.1718	-249.76
FFEE	0	850	21.44	11.75	A	0.51	0.4734	-2.49	1156	0.0131	-1.98
	1	308	23.42	12.52	NA			-2.41	515	0.0162	-1.98
TERM	0	836	10.45	5.03	A	7.72	0.0056	-2.51	1139	0.0121	-0.85
	1	305	11.30	5.23	NA			-2.47	522	0.0140	-0.85
EXUS	0	851	1.61	0.60	A	3.75	0.0531	0.99	1151	0.3235	0.04
	1	302	1.57	0.64	NA			0.96	499	0.3394	0.04
EXIN	0	841	0.68	0.86	A	5.10	0.0241	1.42	1139	0.1555	0.08
	1	300	0.60	0.82	NA			1.45	550	0.1464	0.08
YBF	0	872	7.67	13.40	A	0.00	0.9596	-0.56	1182	0.5740	-0.49
	1	312	8.16	12.34	NA			-0.58	591	0.5591	-0.49
CAGR	0	873	0.33	0.72	A	3.56	0.0593	1.11	1183	0.2680	0.05
	1	312	0.28	0.28	NA			1.59	1172	0.1127	0.05

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Table B14: Independent Sample T-Test for Permission to Sub-Franchise

	SF	N	Mean	Std. Dev.	Equal Variance	F	Sig.	t	df	Sig. (2-tailed)	M. Diff.
NUS	0	916	218.29	786.61	A	0.16	0.6932	0.33	1180	0.7440	17.18
	1	266	201.11	634.56	NA			0.37	524	0.7137	17.18
NINT	0	916	66.37	644.50	A	3.25	0.0718	0.91	1180	0.3640	36.18
	1	266	30.19	150.96	NA			1.56	1151	0.1194	36.18
AGE	0	916	23.41	16.65	A	8.07	0.0046	0.95	1180	0.3418	1.08
	1	266	22.33	14.89	NA			1.01	474	0.3125	1.08
EXP	0	915	15.09	10.81	A	0.07	0.7909	-1.63	1179	0.1033	-1.23
	1	266	16.32	11.04	NA			-1.61	424	0.1077	-1.23
SIZE	0	916	314.89	1374.40	A	0.52	0.4721	0.37	1180	0.7112	32.92
	1	266	281.97	854.80	NA			0.47	698	0.6352	32.92
NFRA	0	916	262.55	1136.44	A	0.01	0.9122	-0.07	1180	0.9431	-5.35
	1	266	267.91	841.07	NA			-0.08	574	0.9331	-5.35
NCOM	0	916	52.34	341.69	A	9.96	0.0016	1.81	1180	0.0699	38.27
	1	266	14.07	72.47	NA			3.15	1127	0.0017	38.27
PNU	0	864	29.56	64.83	A	14.83	0.0001	-2.42	1111	0.0156	-16.93
	1	249	46.49	166.44	NA			-1.57	270	0.1173	-16.93
GROW	0	859	51.60	103.50	A	0.53	0.4687	0.07	1104	0.9462	0.49
	1	247	51.11	92.75	NA			0.07	438	0.9428	0.49
PERF	0	916	79.72	27.61	A	48.09	0.0000	-4.35	1180	0.0000	-7.90
	1	266	87.62	19.81	NA			-5.20	594	0.0000	-7.90
AILO	0	896	282.99	1229.10	A	11.69	0.0007	2.28	1151	0.0227	175.20
	1	257	107.79	119.82	NA			4.20	952	0.0000	175.20
AILHI	0	889	589.58	2650.47	A	14.43	0.0002	2.34	1142	0.0193	389.41
	1	255	200.17	213.02	NA			4.33	927	0.0000	389.41
FFEE	0	900	22.48	12.35	A	11.00	0.0009	2.85	1154	0.0044	2.41
	1	256	20.07	10.43	NA			3.13	477	0.0019	2.41
TERM	0	879	10.62	5.11	A	0.42	0.5181	-0.20	1138	0.8446	-0.07
	1	261	10.69	5.04	NA			-0.20	431	0.8434	-0.07
EXUS	0	891	1.60	0.59	A	6.79	0.0093	0.98	1151	0.3268	0.04
	1	262	1.56	0.66	NA			0.92	392	0.3559	0.04
EXIN	0	882	0.58	0.83	A	2.39	0.1223	-5.25	1134	0.0000	-0.31
	1	254	0.90	0.87	NA			-5.10	393	0.0000	-0.31
YBF	0	915	8.33	13.51	A	10.07	0.0015	2.55	1179	0.0110	2.33
	1	266	6.00	11.66	NA			2.76	490	0.0060	2.33
CAGR	0	916	0.32	0.70	A	1.08	0.3000	0.51	1180	0.6135	0.02
	1	266	0.30	0.31	NA			0.74	985	0.4589	0.02

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Table B15: Tamhane Pairwise Comparisons of Expansion Strategy in U.S. Market							
	EXPUS		Mean Dif.	Std. Error	Sig.	95% Confidence Interval	
	(I)	(J)	I minus J			Lower	Upper
Number of US outlets	0	1	-143.7222	96.9888	0.0003	-230.99	-56.45
		2	-227.0577	91.5620	0.0000	-304.90	-149.22
	1	0	143.7222	96.9888	0.0003	56.45	230.99
		2	-83.3354	50.1317	0.1946	-193.07	26.40
	2	0	227.0577	91.5620	0.0000	149.22	304.90
		1	83.3354	50.1317	0.1946	-26.40	193.07
Number of international outlets	0	1	-50.8298	73.6215	0.4774	-144.67	43.01
		2	-57.6515	69.5022	0.0124	-105.65	-9.66
	1	0	50.8298	73.6215	0.4774	-43.01	144.67
		2	-6.8218	38.0536	0.9981	-111.07	97.43
	2	0	57.6515	69.5022	0.0124	9.66	105.65
		1	6.8218	38.0536	0.9981	-97.43	111.07
Age of Business	0	1	1.7944	2.0850	0.8191	-3.76	7.35
		2	4.8670	1.9683	0.0866	-0.50	10.23
	1	0	-1.7944	2.0850	0.8191	-7.35	3.76
		2	3.0726	1.0777	0.0097	0.58	5.56
	2	0	-4.8670	1.9683	0.0866	-10.23	0.50
		1	-3.0726	1.0777	0.0097	-5.56	-0.58
Experience	0	1	2.3404	1.3972	0.1886	-0.73	5.41
		2	3.6025	1.3191	0.0091	0.72	6.48
	1	0	-2.3404	1.3972	0.1886	-5.41	0.73
		2	1.2622	0.7222	0.2243	-0.47	2.99
	2	0	-3.6025	1.3191	0.0091	-6.48	-0.72
		1	-1.2622	0.7222	0.2243	-2.99	0.47
Total outlets	0	1	-128.4770	164.3081	0.1743	-293.00	36.05
		2	-238.3685	155.1148	0.0000	-363.27	-113.47
	1	0	128.4770	164.3081	0.1743	-36.05	293.00
		2	-109.8914	84.9279	0.4605	-308.55	88.77
	2	0	238.3685	155.1148	0.0000	113.47	363.27
		1	109.8914	84.9279	0.4605	-88.77	308.55
Number of franchised outlets	0	1	-82.5333	138.5845	0.3652	-216.58	51.51
		2	-209.4896	130.8304	0.0000	-317.40	-101.58
	1	0	82.5333	138.5845	0.3652	-51.51	216.58
		2	-126.9562	71.6318	0.1794	-290.63	36.71
	2	0	209.4896	130.8304	0.0000	101.58	317.40
		1	126.9562	71.6318	0.1794	-36.71	290.63
Number of company outlets	0	1	-45.9437	39.0781	0.0649	-93.90	2.01
		2	-28.8789	36.8916	0.0292	-55.58	-2.18
	1	0	45.9437	39.0781	0.0649	-2.01	93.90
		2	17.0648	20.1987	0.8312	-36.69	70.82
	2	0	28.8789	36.8916	0.0292	2.18	55.58
		1	-17.0648	20.1987	0.8312	-70.82	36.69
Projected new openings	0	1	-9.2000	12.7621	0.0026	-15.77	-2.63
		2	-30.4788	12.0240	0.0000	-41.67	-19.29
	1	0	9.2000	12.7621	0.0026	2.63	15.77
		2	-21.2788	6.6645	0.0000	-32.88	-9.68
	2	0	30.4788	12.0240	0.0000	19.29	41.67
		1	21.2788	6.6645	0.0000	9.68	32.88
Growth Percentage	0	1	-18.4600	17.5365	0.6663	-62.07	25.15
		2	-32.9073	16.5223	0.1707	-75.03	9.22
	1	0	18.4600	17.5365	0.6663	-25.15	62.07
		2	-14.4472	9.1578	0.2632	-35.25	6.35
	2	0	32.9073	16.5223	0.1707	-9.22	75.03

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		1	14.4472	9.1578	0.2632	-6.35	35.25
Percent of units franchised	0	1	11.1747	3.3304	0.0004	4.28	18.07
		2	3.4031	3.1441	0.4640	-2.83	9.63
	1	0	-11.1747	3.3304	0.0004	-18.07	-4.28
		2	-7.7715	1.7214	0.0001	-12.10	-3.45
	2	0	-3.4031	3.1441	0.4640	-9.63	2.83
		1	7.7715	1.7214	0.0001	3.45	12.10
Average Investment Low	0	1	46.4018	141.2373	0.6394	-59.25	152.06
		2	-37.3897	133.2581	0.9132	-190.09	115.31
	1	0	-46.4018	141.2373	0.6394	-152.06	59.25
		2	-83.7916	73.3467	0.2683	-205.14	37.55
	2	0	37.3897	133.2581	0.9132	-115.31	190.09
		1	83.7916	73.3467	0.2683	-37.55	205.14
Average investment high	0	1	580.6104	305.9241	0.5569	-611.14	1772.36
		2	425.4135	288.9744	0.7770	-784.71	1635.54
	1	0	-580.6104	305.9241	0.5569	-1772.36	611.14
		2	-155.1969	158.2491	0.3123	-392.05	81.65
	2	0	-425.4135	288.9744	0.7770	-1635.54	784.71
		1	155.1969	158.2491	0.3123	-81.65	392.05
Franchise Fee	0	1	5.3984	1.5487	0.0193	0.69	10.11
		2	5.4078	1.4643	0.0157	0.81	10.00
	1	0	-5.3984	1.5487	0.0193	-10.11	-0.69
		2	0.0094	0.7966	1.0000	-1.80	1.82
	2	0	-5.4078	1.4643	0.0157	-10.00	-0.81
		1	-0.0094	0.7966	1.0000	-1.82	1.80
ROYALTY	0	1	0.1617	0.4037	0.9448	-0.62	0.95
		2	0.0872	0.3826	0.9875	-0.63	0.80
	1	0	-0.1617	0.4037	0.9448	-0.95	0.62
		2	-0.0745	0.2053	0.9791	-0.58	0.43
	2	0	-0.0872	0.3826	0.9875	-0.80	0.63
		1	0.0745	0.2053	0.9791	-0.43	0.58
Agreement term	0	1	-2.5820	0.6627	0.0002	-4.07	-1.09
		2	-1.8047	0.6271	0.0074	-3.22	-0.39
	1	0	2.5820	0.6627	0.0002	1.09	4.07
		2	0.7773	0.3403	0.0629	-0.03	1.58
	2	0	1.8047	0.6271	0.0074	0.39	3.22
		1	-0.7773	0.3403	0.0629	-1.58	0.03
Years before franchising	0	1	-0.5459	1.6865	0.9897	-5.33	4.23
		2	1.2645	1.5921	0.8787	-3.34	5.87
	1	0	0.5459	1.6865	0.9897	-4.23	5.33
		2	1.8104	0.8717	0.1039	-0.25	3.87
	2	0	-1.2645	1.5921	0.8787	-5.87	3.34
		1	-1.8104	0.8717	0.1039	-3.87	0.25
CAGR	0	1	0.0013	0.0812	0.9999	-0.05	0.05
		2	-0.1423	0.0766	0.0001	-0.22	-0.06
	1	0	-0.0013	0.0812	0.9999	-0.05	0.05
		2	-0.1436	0.0419	0.0000	-0.22	-0.07
	2	0	0.1423	0.0766	0.0001	0.06	0.22
		1	0.1436	0.0419	0.0000	0.07	0.22

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Table B16: Tamhane Pairwise Comparisons of Expansion Strategy in Overseas Market

	EXPUS		Mean Dif.	Std. Error	Sig.	95% Confidence Interval	
	(I)	(J)	(I) minus (J)			Lower	Upper
Number of US outlets	0	1	-158.92	62.36	.007	-282.48	-35.36
		2	-290.01	52.98	.000	-471.50	-108.51
	1	0	158.92	62.36	.007	35.36	282.48
		2	-131.09	70.98	.362	-343.15	80.98
	2	0	290.01	52.98	.000	108.51	471.50
		1	131.09	70.98	.362	-80.98	343.15
Number of international outlets	0	1	-28.97	47.61	.613	-91.98	34.03
		2	-133.74	40.45	.044	-264.72	-2.75
	1	0	28.97	47.61	.613	-34.03	91.98
		2	-104.76	54.13	.164	-236.80	27.28
	2	0	133.74	40.45	.044	2.75	264.72
		1	104.76	54.13	.164	-27.28	236.80
Age of Business	0	1	-1.94	1.35	.404	-5.24	1.36
		2	-1.35	1.15	.626	-4.33	1.64
	1	0	1.94	1.35	.404	-1.36	5.24
		2	.59	1.53	.979	-3.40	4.58
	2	0	1.35	1.15	.626	-1.64	4.33
		1	-.59	1.53	.979	-4.58	3.40
Experience	0	1	-2.50	.90	.030	-4.83	-.18
		2	-1.71	.76	.103	-3.66	.24
	1	0	2.50	.90	.030	.18	4.83
		2	.79	1.02	.868	-1.96	3.54
	2	0	1.71	.76	.103	-.24	3.66
		1	-.79	1.02	.868	-3.54	1.96
Total outlets	0	1	-206.41	105.41	.010	-373.08	-39.74
		2	-472.80	89.56	.001	-783.31	-162.28
	1	0	206.41	105.41	.010	39.74	373.08
		2	-266.38	119.83	.165	-602.91	70.14
	2	0	472.80	89.56	.001	162.28	783.31
		1	266.38	119.83	.165	-70.14	602.91
Number of franchised outlets	0	1	-177.43	88.69	.006	-314.36	-40.51
		2	-438.56	75.36	.000	-702.28	-174.84
	1	0	177.43	88.69	.006	40.51	314.36
		2	-261.12	100.83	.083	-545.68	23.43
	2	0	438.56	75.36	.000	174.84	702.28
		1	261.12	100.83	.083	-23.43	545.68
Number of company outlets	0	1	-28.98	25.37	.523	-85.43	27.48
		2	-34.24	21.55	.514	-100.22	31.75
	1	0	28.98	25.37	.523	-27.48	85.43
		2	-5.26	28.84	.998	-86.63	76.11
	2	0	34.24	21.55	.514	-31.75	100.22
		1	5.26	28.84	.998	-76.11	86.63
Projected new openings	0	1	-9.46	8.07	.050	-18.92	2.06E-03
		2	-42.08	6.86	.000	-67.20	-16.97
	1	0	9.46	8.07	.050	-2.06E-03	18.92
		2	-32.62	9.19	.008	-58.52	-6.72
	2	0	42.08	6.86	.000	16.97	67.20
		1	32.62	9.19	.008	6.72	58.52
Growth Percentage	0	1	12.7965	11.2216	.515	-11.8878	37.4809
		2	9.6308	9.5458	.646	-12.2573	31.5188
	1	0	-12.7965	11.2216	.515	-37.4809	11.8878
		2	-3.1658	12.7770	.989	-30.3097	23.9781
	2	0	-9.6308	9.5458	.646	-31.5188	12.2573
		1	3.1658	12.7770	.989	-23.9781	30.3097
Percent of units franchised	0	1	-6.7422	2.1380	.002	-11.5259	-1.9585
		2	-10.2371	1.8166	.000	-14.1356	-6.3386
	1	0	6.7422	2.1380	.002	1.9585	11.5259

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		2	-3.4949	2.4305	.247	-8.4331	1.4432
	2	0	10.2371	1.8166	.000	6.3386	14.1356
		1	3.4949	2.4305	.247	-1.4432	8.4331
Average Investment Low	0	1	-112.2758	74.1322	.554	-339.6368	115.0852
		2	-22.8995	62.7704	.958	-144.3636	98.5646
	1	0	112.2758	74.1322	.554	-115.0852	339.6368
		2	89.3763	84.1178	.728	-140.9107	319.6633
	2	0	22.8995	62.7704	.958	-98.5646	144.3636
		1	-89.3763	84.1178	.728	-319.6633	140.9107
Average investment high	0	1	-284.1361	158.8215	.269	-696.6529	128.3806
		2	-113.3904	134.8935	.802	-448.1714	221.3905
	1	0	284.1361	158.8215	.269	-128.3806	696.6529
		2	170.7457	180.5113	.775	-306.6114	648.1028
	2	0	113.3904	134.8935	.802	-221.3905	448.1714
		1	-170.7457	180.5113	.775	-648.1028	306.6114
Franchise Fee	0	1	-2.4939	1.0064	.036	-4.8638	-.1241
		2	-1.3954	.8492	.316	-3.5367	.7459
	1	0	2.4939	1.0064	.036	.1241	4.8638
		2	1.0985	1.1426	.724	-1.7103	3.9073
	2	0	1.3954	.8492	.316	-.7459	3.5367
		1	-1.0985	1.1426	.724	-3.9073	1.7103
ROYALTY	0	1	-5.5885E-02	.2555	.996	-.7339	.6221
		2	7.649E-02	.2197	.977	-.4232	.5762
	1	0	5.589E-02	.2555	.996	-.6221	.7339
		2	.1324	.2917	.964	-.6087	.8734
	2	0	-7.6490E-02	.2197	.977	-.5762	.4332
		1	-.1324	.2917	.964	-.8734	.6087
Agreement term	0	1	-.5985	.4280	.456	-1.6770	.4799
		2	-.4360	.3661	.559	-1.3212	.4493
	1	0	.5985	.4280	.456	-.4799	1.6770
		2	.1625	.4872	.985	-1.3928	1.0677
	2	0	.4360	.3661	.559	-.4493	1.3212
		1	-.1625	.4872	.985	-1.3928	1.0677
Years before franchising	0	1	.5828	1.0922	.935	-2.0679	3.2335
		2	.3836	.9280	.973	-2.0055	2.7728
	1	0	-.5828	1.0922	.935	-3.2335	2.0679
		2	-.1991	1.2414	.998	-3.3858	2.9875
	2	0	-3836	.9280	.973	-2.7728	2.0055
		1	.1991	1.2414	.998	-2.9875	3.3858
CAGR	0	1	-5.7535E-02	5.233E-02	.086	-.1208	5.681E-02
		2	-.2002	4.446E-02	.014	-.3683	-3.2131E-02
	1	0	5.7535E-02	5.233E-02	.086	-5.6808E-02	.1208
		2	-.1427	5.949E-02	.151	-.3191	3.374E-02
	2	0	.2002	4.446E-02	.014	3.213E-02	.3683
		1	.1427	5.949E-02	.151	-3.3742E-02	.3191

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Table B17: Existing Definitions in Corporate Entrepreneurship

CORPORATE ENTREPRENEURSHIP

Author	Definition
Burgelman (1983)	Process whereby firms engage in diversification through internal development. Diversification requires new resource combinations to extend firm's activities in areas unrelated to existing domain of competence and opportunity set.
Chung & Gibbons (1997)	Organizational process for transforming individual ideas into collective actions through management of uncertainties.
Covin & Slevin (1991)	Extending the firm's domain of competence and corresponding opportunity set through internally generated new resource combinations.
Guth & Ginsberg (1990)	Encompasses two types of phenomena and processes: (1) the birth of new businesses within existing organizations (venturing); (2) transformation of organizations through renewal of key ideas on which they are built (strategic renewal)
Jennings & Lumpkin (1989)	Extent to which new products and/or new markets are developed. Organization is entrepreneurial if it develops a higher than average number of new products and/or new markets.
Schendel (1990)	Involves the notion of birth of new businesses within on-going business, and …transformation of stagnant, on-going business in need of revival or transformation
Spann, Adams, & Wortman (1988)	Establishment of separate corporate organization (profit center, division, strategic business unit, or subsidiary) to introduce a new product, serve or create a new market, or utilize new technology.
Vesper (1984)	Involves employee initiative from below in the organization to undertake something new. An innovation which is created by subordinates without being asked, expected, or perhaps even given permission by higher management to do so.
Zahra (1993)	Process of organizational renewal that has two distinct but related dimensions: innovation and venturing, and strategic renewal.
Zahra (1995, 1996)	The sum of a company's innovation, renewal, and venturing efforts.

CORPORATE VENTURING

Author	Definition
Biggadike (1979)	A business marketing a product or service that the parent company has not previously marketed and that requires the parent company to obtain new equipment or new people or new knowledge.
Block & MacMillan (1993)	A project is a corporate venture when it (a) involves an activity new to the organization, (b) is initiated or conducted internally, (c) involves significantly higher risk of failure or large losses than the organization's base business, (d) is characterized by greater uncertainty than the base business, (e) will be managed separately at some time during its life, (f) is undertaken for the purpose of increasing sales, profit, productivity, or quality.
Ellis & Taylor (1987)	Postulated to pursue a strategy of unrelatedness to present activities, to adopt the structure of an independent unit and to involve a process of assembling and configuring novel resources.
Von Hippel (1977)	Activity which seeks to generate new businesses for the corporation in which it resides through establishment of external or internal corporate ventures.

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VENTURE, INTERNAL VENTURES, INTERNAL CORPORATE VENTURING, BUSINESS VENTURING	
Author	**Definition**
Hornsby, Naffziger, Kuratko, Montagno (1993)	Venture may be applied to the development of new business endeavors within the corporate framework.
Roberts & Berry (1985)	Internal ventures are a firm's attempts to enter different markets or develop substantially different products from those of its existing base business by setting up a separate entity within the existing corporate body.
Stopford & Baden-Fuller (1994)	New business venturing occurs when individuals and small teams form entrepreneurial groups inside an organization capable of persuading others to alter their behavior, thus influencing the creation of new corporate resources.
Zahra (1996)	Venturing means that the firm will enter new businesses by expanding operations in existing or new markets.
Zajac, Golden, Shortell (1991)	Internal corporate venturing involves the creation of an internally-staffed venture unit that is semi-autonomous, with the sponsoring organization maintaining ultimate authority.

INTRAPRENEURSHIP	
Author	**Definition**
Nielson, Peters, & Hisrich (1985)	Development within a large organization of internal markets and relatively small and independent units designed to create, internally test-market, and expand improved and/or innovative staff services, technologies or methods within the organization. This is different from the large organization entrepreneurship/ venture units whose purpose is to develop profitable positions in external markets.
Pinchot III (1985)	Intrapreneurs are any of the "dreamers who do." Those who take hands-on responsibility for creating innovation of any kind within an organization. They are the creators or inventors but are always the dreamers who figure out how to turn an idea into a profitable reality.

Appendix B

TABLE B18

Entrepreneur Magazine Descriptive Statistics and Correlations

	Variables	Mean	s.d.	Freq	%	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1	AGE	23.42	16.29																		
2	EXP	16.10	10.94			.754															
3	OPB4F	7.32	12.60			.470	-.071														
4	F97	418.69	1481.83			.450	.615	-.109													
5	F98	445.3	1538.91			.409	.559	-.118	.985												
6	F99	483.76	1747.14			.384	.518	-.116	.964	.990											
7	C97	75.13	457.16			.240	.108	.205	.150	.147	.147										
8	C98	76.30	452.72			.231	.101	.207	.158	.156	.157	.926									
9	C99	77.90	457.84			.235	.110	.179	.159	.162	.164	.874	.925								
10	PERF97	87.47	20.31			-.064	.143	-.252	.227	.224	.214	-.871	-.801	-.755							
11	PERF98	88.31	19.26			-.092	.108	-.268	.193	.200	.194	-.829	-.886	-.819	.923						
12	PERF99	88.88	18.28			-.106	.084	-.245	.171	.177	.177	-.798	-.833	-.894	.875	.932					
13	FEEL	20.55†	11.48†			.081	.060	.025	-.054	-.058	-.053	.095	.087	.113	-.113	-.127	-.142				
14	FEEH	26.07†	17.08†			.123	.119	.015	.064	.056	.063	.121	.118	.120	-.094	-.115	-.114	.713			
15	STARTLO	258.92†	1556.44†			.227	.179	.089	-.002	-.008	-.007	.312	.310	.308	-.276	-.308	-.311	.617	.399		
16	STARTHI	532.21†	2692.92†			.284	.215	.114	.079	.073	.077	.356	.364	.346	-.284	-.321	-.312	.447	.409	.851	
17	FIN		No	193	32.3	.065	.074	-.024	.159	.157	.146	-.008	-.029	-.046	.084	.089	.095	-.003	.071	-.038	-.029
			Yes	404	67.6																

AGE	Number of years since incorporation	PERF97	Percent of total outlets franchised in 1997
EXP	Number of years experience franchising	PERF98	Percent of total outlets franchised in 1998
OPB4F	Number of years of operation before franchising	PERF99	Percent of total outlets franchised in 1999
F97	Number of franchises in 1997	FEEL	Franchise fee (low average)
F98	Number of franchises in 1998	FEEH	Franchise fee (high average)
F99	Number of franchises in 1999	STARTLO	Average start-up expenses (low average)
C97	Number of company-owned outlets in 1997	STARTHI	Average start-up expenses (high average)
C98	Number of company-owned outlets in 1998	FIN	Franchisee financing available
C99	Number of company-owned outlets in 1999		

† In Thousands U.S. $

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TABLE B19
Source Book Publications Descriptive Statistics and Correlations

	Variables	Mean	s.d.	Freq	%	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1	AGE	23.14	16.20																		
2	EXP	15.37	10.88			.720															
3	NFRA	260.85	1068.51			.378	.539														
4	NCOM	43.10	300.77			.205	.060	.071													
5	PERF	81.54	26.32			.025	.253	.433	-.791												
6	PNU	33.2	96.88			.001	.033	.638	.049	.251											
7	TERM	10.64	5.09			.178	.191	.115	.191	-.081	.027										
8	FEE	21.91	11.94			.092	.059	.069	.166	-.103	.021	.238									
9	STARTLO	242.21	1079.19			.215	.172	.071	.338	-.218	-.017	.376	.580								
10	STARTHI	500.13	2326.73			.248	.207	.140	.356	-.200	.025	.406	.503	.885							
11	ROYAL	5.38	2.96			-.065	-.017	.014	-.093	.080	-.039	-.089	-.007	-.248	-.270						
12	EC		No	873	72.6	.063	.037	.053	.110	-.058	.030	.079	.077	.123	.103	-.045					
			Yes	312	26.3																
13	PO		No	302	25.1	-.042	-.051	.018	-.004	.001	.095	-.014	-.029	-.021	.019	-.095	.035				
			Disc.	626	52.1																
			Allowed	248	21.1																
14	AD		No	545	45.3	.028	-.002	-.012	.153	-.112	.098	.189	.094	.236	.241	-.063	.065	.070			
			Yes	623	51.8																
15	SF		No	916	76.2	.006	.066	.037	-.054	.090	.046	.001	-.084	-.079	-.046	.049	.005	.027	.266		
			Yes	266	22.1																
16	FIN		No	363	30.2	-.033	-.005	.136	-.122	.166	.157	-.049	-.097	-.224	-.236	.209	.069	.031	-.055	.057	
			Indirect	554	46.1																
			Direct	176	14.6																
			Both	20	1.7																
17	ET		No	166	13.8	.012	.025	.013	.027	-.011	.049	-.019	-.044	-.003	.011	.012	-.067	.079	.062	.072	.005
			Yes	999	83.1																

AGE	Number of years since incorporation	TERM	Agreement term in years	PO	Passive ownership
EXP	Number of years experience franchising	FEE	Average franchise fee	AD	Area directorships offered
NFRA	Number of franchised outlets	STARTLO	Average start-up costs (low)	SF	Sub-franchising permitted
NCOM	Number of company-owned outlets	STARTHI	Average start-up costs (high)	FIN	Financing offered
PERF	Percent of total outlets franchised	ROYAL	Royalty payments in percent of sales	ET	Expansion in territory permitted
PNU	Projected number of new outlets	EC	Earnings claim		

Appendix B

Table B20: Entrepreneurial Orientation Definitions

Attribute	Definition	Other Work
Autonomy	Independent action of individual or team in bringing forth idea or vision and carrying it through to completion. Ability and will to be self-directed in pursuit of opportunities (p. 140).	Mintzberg (1973) Mintzberg & Waters (1985) Hart (1992) Miller (1983) (p. 141)
Innovativeness	A firm's tendency to engage in and support new ideas, novelty, experimentation and creative processes that may result in new products, services, or technological processes (p. 142).	Kimberly (1981) Downs & Mohr (1976) Miller & Friesen (1978) Miller (1978, 1988) Covin & Slevin (1989) (p. 142,3)
Risk Taking	Risk taking at the firm level is the proclivity to engage in risky projects and manager's preferences for bold versus cautious acts to achieve firm objectives (p. 146)	Cantillon (1734) Baird & Thomas (1985) Miller & Friesen (1978) Brockhaus (1980) Miller (1983) Venkatraman (1989) (p. 145,6)
Proactiveness	Processes aimed at anticipating and acting on future needs by seeking new opportunities which may or may not be related to the present line of operations (p. 146)	Venkatraman (1989) Covin & Slevin (1989) Chen & Hambrick (1995) Morris & Paul (1987) Miles & Snow (1978) (p. 147,8)
Competitive Aggressiveness	A firm's propensity to directly and intensely challenge its competitors to achieve entry or improve position; to outperform industry rivals in the marketplace (p. 148,50)	Cooper et al. (1986) MacMillan & Jones (1984) Porter (11985) MacMillan & Day (1987) Covin & Covin (1990) (p. 148,9)

Clarifying the Entrepreneurial Orientation Construct and Linking it to Performance, Lumpkin, G. T. and G. G. Dess (1996). "Clarifying the Entrepreneurial Orientation Construct and Linking it to Performance." Academy of Management Review **21**(1): 135-172.

Appendix B

Table B21: Item 9 Franchisee's Obligations		
OBLIGATION	SECTION IN AGREEMENT	ITEM IN OFFERING CIRCULAR
a. Site selection and acquisition/lease	n/a	7,8,11
b. Pre-opening purchases/leases	7.5.1	5,8
c. Site development and other pre-opening requirements	n/a	5,7,12
d. Initial and ongoing training	5.1, 6.4	11
e. Opening	7.3.1	11
f. Fees	6.1- 6.8	5,6
g. Compliance with standards and policies/ Operating Manual	3.10, 3.13, 7.3	11
h. Trademarks and proprietary information	3.11, 3.13, 3.16, 5.3, 7.1, 8.1, 8.4, Attachment 3	13,14
i. Restrictions on products/services offered	7.3.3.	16
j. Warranty and customer service requirements	7.3.4	
k. Territorial development and sales quota	3.16, 4.2, 6.3	12
l. Ongoing product/ service purchases	5.5, 6.2, 7.3.3, Attachment 2	8,10
m. Maintenance, appearance, and remodeling requirements	n/a	8,17
n. Insurance	7.7	6,8
o. Advertising	7.5	6,8,11
p. Indemnification	8.5	6
q. Owner's participation/ management/ staffing	7.4	15
r. Records/ reports	7.6	6
s. Inspections/ Audits	7.3.5	6
t. Transfer	3.17	17
u. Renewal	4.3.2	17
v. Post-termination obligations	10.4	17
w. Non-Competition covenants	8.6, Attachment 3	17
x. Dispute Resolution	11.1, 11.6- 11.10	17
Source: The Pet Pantry International, Inc. UFOC- December 31, 1998 p. 8.		

Appendix B

Table B22: IFA Code of Ethics

Code of Ethics
International Franchise Association

Each member company pledges:
1. In the advertisement and grant of franchises for dealerships, a member shall comply with all applicable laws and regulations and the member's offering circular shall be complete, accurate, and not misleading with respect to the franchisee's or dealer's investment, the obligations of a member, and the franchise or dealer under the franchise or dealership and all material facts relating to the franchise for dealership.
2. All matters material to the member's franchise or dealership's shall be contained in one more written agreements, which shall clearly set forth the terms of the relationship and the respective rights and obligations of the parties.
3. A member shall select and accept only those franchisee's or dealers who, upon reasonable investigation, appear to possess the basic skills, education, experience, personal characteristics and financial resources requisite to conduct the franchised business or dealership and meet the obligations of the franchise or dealer under the franchise and other agreements. There shall be no discrimination in the granting of franchisees based solely on race, color, religion, national origin or sex. However, this in no way prohibits the franchisor from granting franchises to prospective franchisees as part of a program to make franchises available to persons lacking the capital, training, business experience, or other qualifications ordinarily required a franchisee's or any other affirmative action program adopted by the franchisor.
4. A member shall provide reasonable guidance to its franchisees or dealers in a manner consistent with its franchise agreement.
5. Fairness shall characterize all dealings between a member and its franchisees or dealers. A member shall make every good faith effort to resolve complaints by and disputes with its franchisees or dealers through direct communication and negotiation. To the extent reasonably appropriate in the circumstances, a member shall give its franchisee or dealer notice of, and a reasonable opportunity to cure, a breach of their contractual relationship.
6. No member shall engage in the pyramid system of distribution. A pyramid is a system wherein a buyer's feature compensation is expected to be based primarily upon recruitment of new participants, rather than upon the sale of products or services.

Source: U.S. Department of Commerce, International Trade Administration and Minority Business Development Agency, Franchise Opportunities Handbook, January 1988, U.S. Government Printing Office, Washington, D.C., p. xxxiii.

Appendix C

*** THE FEDERAL REGISTER ***
TITLE 16 -- COMMERCIAL PRACTICES
CHAPTER I -- FEDERAL TRADE COMMISSION
SUBCHAPTER C -- REGULATIONS UNDER SPECIFIC ACTS OF CONGRESS
PART 436 -- DISCLOSURE REQUIREMENTS AND PROHIBITIONS CONCERNING FRANCHISING AND BUSINESS OPPORTUNITY VENTURES
16 CFR 436.1 § 436.1

The Rule.

In connection with the advertising, offering, licensing, contracting, sale, or other promotion in or affecting commerce, as "commerce" is defined in the Federal Trade Commission Act, of any franchise, or any relationship which is represented either orally or in writing to be a franchise, it is an unfair or deceptive act or practice within the meaning of section 5 of that Act for any franchisor or franchise broker:

(a) To fail to furnish any prospective franchisee with the following information accurately, clearly, and concisely stated, in a legible, written document at the earlier of the "time for making of disclosures" or the first "personal meeting":

(1)(i) The official name and address and principal place of business of the franchisor, and of the parent firm or holding company of the franchisor, if any;

(ii) The name under which the franchisor is doing or intends to do business; and

(iii) The trademarks, trade names, service marks, advertising or other commercial symbols (hereinafter collectively referred to as "marks") which identify the goods, commodities, or services to be offered, sold, or distributed by the prospective franchisee, or under which the prospective franchisee will be operating.

(2) The business experience during the past 5 years, stated individually, of each of the franchisor's current directors and executive officers (including, and hereinafter to include, the chief executive and chief operating officer, financial, franchise marketing, training and service officers). With regard to each person listed, those persons' principal occupations and employers must be included.

(3) The business experience of the franchisor and the franchisor's parent firm (if any), including the length of time each: (i) Has conducted a business of the type to be operated by the franchisee; (ii) has offered or sold a franchise for such business; (iii) has conducted a business or offered or sold a franchise for a business (A) operating under a name using any mark set forth under paragraph (a)(1)(iii) of this section, or (B) involving the sale, offering, or distribution of goods, commodities, or services which are identified by any mark set forth under paragraph (a)(1)(iii) of this section; and (iv) has offered for sale or sold franchises in other lines of business, together with a description of such other lines of business.

(4) A statement disclosing who, if any, of the persons listed in paragraphs (a) (2) and (3) of this section:

(i) Has, at any time during the previous seven fiscal years, been convicted of a felony or pleaded nolo contendere to a felony charge if the felony involved fraud (including violation of any franchise law, or unfair or deceptive practices law), embezzlement, fraudulent conversion, misappropriation of property, or restraint of trade;

(ii) Has, at any time during the previous seven fiscal years, been held liable in a civil action resulting in a final judgment or has settled out of court any civil action or is a party to any civil action (A) involving allegations of fraud (including violation of any franchise law, or unfair or deceptive practices law), embezzlement, fraudulent conversion, misappropriation of property, or restraint of trade, or (B) which was brought by a present or former franchisee or franchisees and which involves or involved the franchise relationship; Provided, however, That only material individual civil actions need be so listed pursuant to paragraph (4)(ii) of this section, including any group of civil actions which, irrespective of the materiality of any single such action, in the aggregate is material;

(iii) Is subject to any currently effective State or Federal agency or court injunctive or restrictive order, or is a party to a proceeding currently pending in which such order is sought, relating to or affecting franchise activities or the franchisor-franchisee relationship, or involving fraud (including violation of any franchise law, or unfair or deceptive practices law), embezzlement, fraudulent conversion, misappropriation of property, or restraint of trade.

Such statement shall set forth the identity and location of the court or agency; the date of conviction, judgment, or decision; the penalty imposed; the damages assessed; the terms of settlement or the terms of the order; and the date, nature, and issuer of each such order or ruling. A franchisor may include a summary opinion of counsel as to any pending litigation, but only if counsel's consent to the use of such opinion is included in the disclosure statement.

(5) A statement disclosing who, if any, of the persons listed in paragraphs (a) (2) and (3) of this section at any time during the previous 7 fiscal years has:

(i) Filed in bankruptcy;

(ii) Been adjudged bankrupt;

(iii) Been reorganized due to insolvency; or

(iv) Been a principal, director, executive officer, or partner of any other person that has so filed or was so adjudged or reorganized, during or within 1 year after the period that such person held such position in such other person. If so, the name and location of the person having so filed, or having been so adjudged or reorganized, the date thereof, and any other material facts relating thereto, shall be set forth.

(6) A factual description of the franchise offered to be sold by the franchisor.

(7) A statement of the total funds which must be paid by the franchisee to the franchisor or to a person affiliated with the franchisor, or which the franchisor or such affiliated person imposes or collects in whole or in part on behalf of a third party, in order to obtain or commence the franchise operation, such as initial franchise fees, deposits, downpayments, prepaid rent, and equipment and inventory purchases. If all or part of these fees or deposits are returnable under certain conditions, these conditions shall be set forth; and if not returnable, such fact shall be disclosed.

(8) A statement describing any recurring funds required to be paid, in connection with carrying on the franchise business, by the franchisee to the franchisor or to a person affiliated with the franchisor, or which the franchisor or such affiliated person imposes or collects in whole or in part on behalf of a third party, including, but not limited to, royalty, lease, advertising, training, and sign rental fees, and equipment or inventory purchases.

(9) A statement setting forth the name of each person (including the franchisor) the franchisee is directly or indirectly required or advised to do business with by the franchisor, where such persons are affiliated with the franchisor.

(10) A statement describing any real estate, services, supplies, products, inventories, signs, fixtures, or equipment relating to the establishment or the operation of the franchise business which the franchisee is directly or indirectly required by the franchisor to purchase, lease or rent; and if such purchases, leases or rentals must be made from specific persons (including the franchisor), a list of the names and addresses of each such person. Such list may be made in a separate document delivered to the prospective

franchisee with the prospectus if the existence of such separate document is disclosed in the prospectus.

(11) A description of the basis for calculating, and, if such information is readily available, the actual amount of, any revenue or other consideration to be received by the franchisor or persons affiliated with the franchisor from suppliers to the prospective franchisee in consideration for goods or services which the franchisor requires or advises the franchisee to obtain from such suppliers.

(12)(i) A statement of all the material terms and conditions of any financing arrangement offered directly or indirectly by the franchisor, or any person affiliated with the franchisor, to the prospective franchisee; and

(ii) A description of the terms by which any payment is to be received by the franchisor from (A) any person offering financing to a prospective franchisee; and (B) any person arranging for financing for a prospective franchisee.

(13) A statement describing the material facts of whether, by the terms of the franchise agreement or other device or practice, the franchisee is:

(i) Limited in the goods or services he or she may offer for sale;

(ii) Limited in the customers to whom he or she may sell such goods or services;

(iii) Limited in the geographic area in which he or she may offer for sale or sell goods or services; or

(iv) Granted territorial protection by the franchisor, by which, with respect to a territory or area, (A) the franchisor will not establish another, or more than any fixed number of, franchises or company-owned outlets, either operating under, or selling, offering, or distributing goods, commodities or services, identified by any mark set forth under paragraph (a)(1)(iii) of this section; or (B) the franchisor or its parent will not establish other franchises or company-owned outlets selling or leasing the same or similar products or services under a different trade name, trademark, service mark, advertising or other commercial symbol.

(14) A statement of the extent to which the franchisor requires the franchisee (or, if the franchisee is a corporation, any person affiliated with the franchisee) to participate personally in the direct operation of the franchis e.

(15) A statement disclosing, with respect to the franchise agreement and any related agreements:

(i) The term (i.e., duration of arrangement), if any, of such agreement, and whether such term is or may be affected by any agreement (including leases or subleases) other than the one from which such term arises;

(ii) The conditions under which the franchisee may renew or extend;

(iii) The conditions under which the franchisor may refuse to renew or extend;

(iv) The conditions under which the franchisee may terminate;

(v) The conditions under which the franchisor may terminate;

(vi) The obligations (including lease or sublease obligations) of the franchisee after termination of the franchise by the franchisor, and the obligations of the franchisee (including lease or sublease obligations) after termination of the franchise by the franchisee and after the expiration of the franchise;

(vii) The franchisee's interest upon termination of the franchise, or upon refusal to renew or extend the franchise, whether by the franchisor or by the franchisee;

(viii) The conditions under which the franchisor may repurchase, whether by right of first refusal or at the option of the franchisor (and if the franchisor has the option to repurchase the franchise, whether there will be an independent appraisal of the franchise, whether the repurchase price will be determined by a predetermined formula and whether there will be a recognition of goodwill or other intangibles associated therewith in the repurchase price to be given the franchisee);

(ix) The conditions under which the franchisee may sell or assign all or any interest in the ownership of the franchise, or of the assets of the franchise business;

(x) The conditions under which the franchisor may sell or assign, in whole or in part, its interest under such agreements;

(xi) The conditions under which the franchisee may modify;

(xii) The conditions under which the franchisor may modify;

(xiii) The rights of the franchisee's heirs or personal representative upon the death or incapacity of the franchisee; and

(xiv) The provisions of any covenant not to compete.

(16) A statement disclosing, with respect to the franchisor and as to the particular named business being offered:

(i) The total number of franchises operating at the end of the preceding fiscal year;

(ii) The total number of company-owned outlets operating at the end of the preceding fiscal year;

(iii) The names, addresses, and telephone numbers of (A) The 10 franchised outlets of the named franchise business nearest the prospective franchisee's intended location; or (B) all franchisees of the franchisor, or (C) all franchisees of the franchisor in the State in which the prospective franchisee lives or where the proposed franchise is to be located, Provided, however, That there are more than 10 such franchisees. If the number of franchisees to be disclosed pursuant to paragraph (a)(16)(iii)(B) or (C) of this section exceeds 50, such listing may be made in a separate document delivered to the prospective franchisee with the prospectus if the existence of such separate document is disclosed in the prospectus;

(iv) The number of franchises voluntarily terminated or not renewed by franchisees within, or at the conclusion of, the term of the franchise agreement, during the preceding fiscal year;

(v) The number of franchises reacquired by purchase by the franchisor during the term of the franchise agreement, and upon the conclusion of the term of the franchise agreement, during the preceding fiscal year;

(vi) The number of franchises otherwise reacquired by the franchisor during the term of the franchise agreement, and upon the conclusion of the term of the franchise agreement, during the preceding fiscal year;

(vii) The number of franchises for which the franchisor refused renewal of the franchise agreement or other agreements relating to the franchise during the preceding fiscal year; and

(viii) The number of franchises that were canceled or terminated by the franchisor during the term of the franchise agreement, and upon conclusion of the term of the franchise agreement, during the preceding fiscal year.

With respect to the disclosures required by paragraphs (a)(16) (v), (vi), (vii), and (viii) of this section, the disclosure statement shall also include a general categorization of the reasons for such reacquisitions, refusals to renew or terminations, and the number falling within each such category, including but not limited to the following: failure to comply with quality control standards, failure to make sufficient sales, and other breaches of contract.

(17) (i) If site selection or approval thereof by the franchisor is involved in the franchise relationship, a statement disclosing the range of time that has elapsed between signing of franchise agreements or other agreements relating to the franchise and site selection, for agreements entered into during the preceding fiscal year; and

(ii) If operating franchise outlets are to be provided by the franchisor, a statement disclosing the range of time that has elapsed between the signing of franchise agreements or other agreements relating to the franchise and the commencement of the franchisee's business, for agreements entered into during the preceding fiscal year.

With respect to the disclosures required by paragraphs (a)(17) (i) and (ii) of this section, a franchisor may at its option also provide a distribution chart using meaningful classifications with respect to such ranges of time.

(18) If the franchisor offers an initial training program or informs the prospective franchisee that it intends to provide such person with initial training, a statement disclosing:

(i) The type and nature of such training;

(ii) The minimum amount, if any, of training that will be provided toa franchisee; and

(iii) The cost, if any, to be borne by the franchisee for the training to be provided, or for obtaining such training.

(19) If the name of a public figure is used in connection with a recommendation to purchase a franchise, or as a part of the name of the franchise operation, or if the public figure is stated to be involved with the management of the franchisor, a statement disclosing:

(i) The nature and extent of the public figure's involvement and obligations to the franchisor, including but not limited to the promotional assistance the public figure will provide to the franchisor and to the franchisee;

(ii) The total investment of the public figure in the franchise operation; and

(iii) The amount of any fee or fees the franchisee will be obligated to pay for such involvement or assistance provided by the public figure.

(20) (i) A balance sheet (statement of financial position) for the franchisor for the most recent fiscal year, and an income statement (statement of results of operations) and statement of changes in financial position for the franchisor for the most recent 3 fiscal years. Such statements are required to have been examined in accordance with generally accepted auditing standards by an independent certified or licensed public accountant.

Provided, however, That where a franchisor is a subsidiary of another corporation which is permitted under generally accepted accounting principles to prepare financial statements on a consolidated or combined statement basis, the above information may be submitted for the parent if (A) the corresponding unaudited financial statements of the franchisor are also provided, and (B) the parent absolutely and irrevocably has agreed to guarantee all obligations of the subsidiary;

(ii) Unaudited statements shall be used only to the extent that audited statements have not been made, and provided that such statements are accompanied by a clear and conspicuous disclosure that they are unaudited. Statements shall be prepared on an audited basis as soon as practicable, but, at a minimum, financial statements for the first full fiscal year following the date on which the franchisor must first comply with this part shall contain a balance sheet opinion prepared by an independent certified or licensed public accountant, and financial statements for the following fiscal year shall be fully audited.

(21) All of the foregoing information in paragraphs (a) (1) through (20) of this section shall be contained in a single disclosure statement or prospectus, which shall not contain any materials or information other than that required by this part or by State law not preempted by this part. This does not preclude franchisors or franchise brokers from giving other nondeceptive information orally, visually, or in separate literature so long as such information is not contradictory to the information in the disclosure statement required by paragraph (a) of this section. This disclosure statement shall carry a cover sheet distinctively and conspicuously showing the name of the franchisor, the date of issuance of the disclosure statement, and the following notice imprinted thereon in upper and lower case bold-face type of not less than 12 point size:

Information for Prospective Franchises Required by Federal Trade Commission

* * * * *

To protect you, we've required your franchisor to give you this information. We haven't checked it, and don't know if it's correct. It should help you make up your mind. Study it carefully. While it includes some information about your contract, don't rely on it alone to understand your contract. Read all of your contract carefully. Buying a franchise is a complicated investment. Take your time to decide. If possible, show your contract and this information to an advisor, like a lawyer or an accountant. If you find anything you think may be wrong or anything important that's been left out, you should let us know about it. It may be against the law.

There may also be laws on franchising in your state. Ask your state agencies about them.

Federal Trade Commission,

Washington, D.C.

Provided, That the obligation to furnish such disclosure statement shall be deemed to have been met for both the franchisor and the franchise broker if either such party furnishes the prospective franchisee with such disclosure statement.

(22) All information contained in the disclosure statement shall be current as of the close of the franchisor's most recent fiscal year. After the close of each fiscal year, the franchisor shall be given a period not exceeding 90 days to prepare a revised disclosure statement and, following such 90 days, may distribute only the revised prospectus and no other. The franchisor shall, within a reasonable time after the close of each quarter of the fiscal year, prepare revisions to be attached to the disclosure statement to reflect any material change in the franchisor or relating to the franchise business of the franchisor, about which the franchisor or franchise broker, or any agent, representative, or employee thereof, knows or should know. Each prospective franchisee shall have in his or her possession, at the "time for making of disclosures," the disclosure statement and quarterly revision for the period most recent to the "time for making of disclosures" and available at that time. Information which is required to be audited pursuant to paragraph (a)(20) of this section is not required to be audited for quarterly revisions, Provided, however, That the unaudited information be accompanied by a statement in immediate conjunction therewith that clearly and conspicuously discloses that such information has not been audited.

(23) A table of contents shall be included within the disclosure statement.

(24) The disclosure statement shall include a comment which either positively or negatively responds to each disclosure item required to be in the disclosure statement, by use of a statement which fully incorporates the information required by the item. Each disclosure item therein must be preceded

by the appropriate heading, as set forth in Note 3 of this part.

(b) To make any oral, written, or visual representation to a prospective franchisee which states a specific level of potential sales, income, gross or net profit for that prospective franchisee, or which states other facts which suggest such a specific level, unless:

(1) At the time such representation is made, such representation is relevant to the geographic market in which the franchise is to be located;

(2) At the time such representation is made, a reasonable basis exists for such representation and the franchisor has in its possession material which constitutes a reasonable basis for such representation, and such material is made available to any prospective franchisee and to the Commission or its staff upon reasonable demand.

Provided, further, That in immediate conjunction with such representation, the franchisor shall disclose in a clear and conspicuous manner that such material is available to the prospective franchisee; and Provided, however, That no provision within paragraph (b) of this section shall be construed as requiring the disclosure to any prospective franchisee of the identity of any specific franchisee or of information reasonably likely to lead to the disclosure of such person's identity; and Provided, further, That no additional representation as to a prospective franchisee's potential sales, income, or profits may be made later than the "time for making of disclosures";

(3) Such representation is set forth in detail along with the material bases and assumptions therefor in a single legible written document whose text accurately, clearly and concisely discloses such information, and none other than that provided for by this part or by State law not preempted by this part. Each prospective franchisee to whom the representation is made shall be furnished with such document no later than the "time for making of disclosures"; Provided, however, That if the representation is made at or prior to a "personal meeting" and such meeting occurs before the "time for making of disclosures", the document shall be furnished to the prospective franchisee to whom the representation is made at that "personal meeting";

(4) The following statement is clearly and conspicuously disclosed in the document described by paragraph (b)(3) of this section in immediate conjunction with such representation and in not less than twelve point upper and lower-case boldface type:

CAUTION

These figures are only estimates of what we think you may earn. There is no assurance you'll do as well. If you rely upon our figures, you must accept the risk of not doing as well.

(5) The following information is clearly and conspicuously disclosed in the document described by paragraph (b)(3) of this section in immediate conjunction with such representation:

(i) The number and percentage of outlets of the named franchise business which are located in the geographic markets that form the basis for any such representation and which are known to the franchisor or franchise broker to have earned or made at least the same sales, income, or profits during a period of corresponding length in the immediate past as those potential sales, income, or profits represented; and

(ii) The beginning and ending dates for the corresponding time period referred to by paragraph (b)(5)(i) of this section, Provided, however, That any franchisor without prior franchising experience as to the named franchise business so indicate such lack of experience in the document described in paragraph (b)(3) of this section.

Except, That representations of the sales, income or profits of existing franchise outlets need not comply with paragraph (b) of this section.

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(c) To make any oral, written or visual representation to a prospective franchisee which states a specific level of sales, income, gross or net profits of existing outlets (whether franchised or company-owned) of the named franchise business, or which states other facts which suggest such a specific level, unless:

(1) At the time such representation is made, such representation is relevant to the geographic market in which the franchise is to be located;

(2) At the time such representation is made, a reasonable basis exists for such representation and the franchisor has in its possession material which constitutes a reasonable basis for such representation, and such material is made available to any prospective franchisee and to the Commission or its staff upon reasonable demand,

Provided, however, That in immediate conjunction with such representation, the franchisor discloses in a clear and conspicuous manner that such material is available to the prospective franchisee; and Provided, further, That no provision within paragraph (c) of this section shall be construed as requiring the disclosure to any prospective franchisee of the identity of any specific franchisee or of information reasonably likely to lead to the disclosure of such person's identity; and Provided, further, That no additional representation as to the sales, income, or gross or net profits of existing outlets (whether franchised or company-owned) of the named franchise business may be made later than the "time for making of disclosures";

(3) Such representation is set forth in detail along with the material bases and assumptions therefor in a single legible written document which accurately, clearly and concisely discloses such information, and none other than that provided for by this part or by State law not preempted by this part. Each prospective franchisee to whom the representation is made shall be furnished with such document no later than the "time for making of disclosures",

Provided, however, That if the representation is made at or prior to a "personal meeting" and such meeting occurs before the "time for making of disclosures," the document shall be furnished to the prospective franchisee to whom the representation is made at that "personal meeting";

(4) The underlying data on which the representation is based have been prepared in accordance with generally accepted accounting principles;

(5) The following statement is clearly and conspicuously disclosed in the document described by paragraph (c)(3) of this section in immediate conjunction with such representation, and in not less than twelve point upper and lower case boldface type:

CAUTION

Some outlets have [sold] [earned] this amount. There is no assurance you'll do as well. If you rely upon our figures, you must accept the risk of not doing as well.

(6) The following information is clearly and conspicuously disclosed in the document described by paragraph (c)(3) of this section in immediate conjunction with such representation:

(i) The number and percentage of outlets of the named franchise business which are located in the geographic markets that form the basis for any such representation and which are known to the franchisor or franchise broker to have earned or made at least the same sales, income, or profits during a period of corresponding length in the immediate past as those sales, income, or profits represented; and

(ii) The beginning and ending dates for the corresponding time period referred to by paragraph (c)(6)(i) of this section,

Provided, however, That any franchisor without prior franchising experience as to the named franchise business so indicate such lack of experience in the document described in paragraph (c)(3) of this section.

(d) To fail to provide the following information within the document(s) required by paragraphs (b)(3) and (c)(3) of this section whenever any representation is made to a prospective franchisee regarding its potential sales, income, or profits, or the sales, income, gross or net profits of existing outlets (whether franchised or company-owned) of the named franchise business:

(1) A cover sheet distinctively and conspicuously showing the name of the franchisor, the date of issuance of the document and the following notice imprinted thereon in upper and lower case boldface type of not less than twelve point size:

INFORMATION FOR PROSPECTIVE FRANCHISES ABOUT FRANCHISES (SALES) [INCOME] [PROFIT] REQUIRED BY THE FEDERAL TRADE COMMISSION.

To protect you, we've required the franchisor to give you this information. We haven't checked it and don't know if it's correct. Study these facts and figures carefully. If possible, show them to someone who can advise you, like a lawyer or an accountant. Then take your time and think it over.

If you find anything you think may be wrong or anything important that's been left out, let us know about it. It may be against the law.

There may also be laws on franchising in your State. Ask your State agencies about them.

Federal Trade Commission,

Washington, D.C.

(2) A table of contents.

Provided, however, That each prospective franchisee to whom the representation is made shall be notified at the "time for making of disclosures" of any material change (about which the franchisor, franchise broker, or any of the agents, representatives, or employees thereof, knows or should know) in the information contained in the document(s) described by paragraphs (b)(3) and (c)(3) of this section.

(e) To make any oral, written, or visual representation for general dissemination (not otherwise covered by paragraph (b) or (c) of this section) which states a specific level of sales, income, gross or net profits, either actual or potential, of existing or prospective outlets (whether franchised or company-owned) of the named franchise business or which states other facts which suggest such a specific level, unless:

(1) At the time such representation is made, a reasonable basis exists for such representation and the franchisor has in its possession material which constitutes a reasonable basis for such representation and which is made available to the Commission or its staff upon reasonable demand;

(2) The underlying data on which each representation of sales, income or profit for existing outlets is based have been prepared in accordance with generally accepted accounting principles;

(3) In immediate conjunction with such repres entation, there shall be clearly and conspicuously disclosed the number and percentage of outlets of the named franchise business which the franchisor or the franchise broker knows to have earned or made at least the same sales, income, or profits during aperiod of corresponding length in the immediate past as those sales, income, or profits represented, and the beginning and ending dates for said time period;

(4) In immediate conjuction with each such representation of potential sales, income or profits, the following statement shall be clearly and conspicuously disclosed:

CAUTION

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These figures are only estimates; there is no assurance you'll do as well. If you rely upon our figures, you must accept the risk of not doing as well.

Provided, however, That if such representation is not based on actual experience of existing outlets of the named franchise business, that fact also should be disclosed;

(5) No later than the earlier of the first "personal meeting" or the "time for making of disclosures," each prospective franchisee shall be given a single, legible written document which accurately, clearly and concisely sets forth the following information and materials (and none other than that provided for by this part or by State law not preempted by t his part):

(i) The representation, set forth in detail along with the material bases and assumptions therefor;

(ii) The number and percentage of outlets of the named franchise business which the franchisor or the franchise broker knows to have earned or made at least the same sales, income or profits during a period of corresponding length in the immediate past as those sales, income, or profits represented, and the beginning and ending dates for said time period;

(iii) With respect to each such representation of sales, income, or profits of existing outlets, the following statement shall be clearly and conspicuously disclosed in immediate conjunction therewith, printed in not less than 12 point upper and lower case boldface type:

CAUTION

Some outlets have [sold] [earned] this amount. There is no assurance you'll do as well. If you rely upon our figures, you must accept the risk of not doing as well.

(iv) With respect to each such representation of potential sales, income, or profits, the following statement shall be clearly and conspicuously disclosed in immediate conjunction therewith, printed in not less than 12 point upper and lower case boldface type:

CAUTION

These figures are only estimates. There is no assurance that you'll do as well. If you rely upon our figures, you must accept the risk of not doing as well.

(v) If applicable, a statement clearly and conspicuously disclosing that the franchisor lacks prior franchising experience as to the named franchise business;

(vi) If applicable, a statement clearly and conspicuously disclosing that the franchisor has not been in business long enough to have actual business data;

(vii) A cover sheet, distinctively and conspicuously showing the name of the franchisor, the date of issuance of the document, and the following notice printed thereon in not less than 12 point upper and lower case boldface type:

INFORMATION FOR PROSPECTIVE FRANCHISES ABOUT FRANCHISE (SALES) [INCOME] [PROFIT] REQUIRED BY THE FEDERAL TRADE COMMISSION.

To protect you, we've required the franchisor to give you this information. We haven't checked it and don't know if it's correct. Study these facts and figures carefully. If possible, show them to someone who can advise you, like a lawyer or an accountant. If you find anything you think may be wrong or anything important that's been left out, let us know about it. It may be against the law. There may also be laws about franchising in your State. Ask your State agencies about them.

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Federal Trade Commisssion,

Washington, D.C.

(viii) A table of contents;

(6) Each prospective franchisee shall be notified at the "time for making of disclosures" of any material changes that have occurred in the information contained in this document.

(f) To make any claim or representation which is contradictory to the information required to be disclosed by this part.

(g) To fail to furnish the prospective franchisee with a copy of the franchisor's franchise agreement and related agreements with the document, and a copy of the completed franchise and related agreements intended to be executed by the parties at least 5 business days prior to the date the agreements are to be executed.

Provided, however, That the obligations defined in paragraphs (b) through (g) of this section shall be deemed to have been met for both the franchisor and the franchise broker if either such person furnishes the prospective franchisee with the written disclosures required thereby.

(h) To fail to return any funds or deposits in accordance with any conditions disclosed pursuant to paragraph (a)(7) of this section.

HISTORY:
43 FR 59614, Dec. 21, 1978.

AUTHORITY:
38 Stat. 717, as amended, 15 U.S.C. 41-58.

NOTES:
NOTES APPLICABLE TO ENTIRE PART:
[PUBLISHER'S NOTE: For Federal Register citations concerning Part 436 Authorizations, see: 58 FR 69224, Dec. 30, 1993; 60 FR 51895, Oct. 4, 1995.]
[PUBLISHER'S NOTE: For Federal Register citations concerning Part 436 Grants of Petition for Exemption, see: 63 FR 64616, Nov. 23, 1998.]

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Appendix D

Table D1: Exploratory Study of UFOC and Franchise Agreements, Part 1

Description	UFOC 1	Quizno's Corporation
	UFOC 2	Case Handyman Services
	UFOC 3	The Pet Pantry
	UFOC 4	Piggly Wiggly*
	UFOC 5	The Entrepreneur's Source-Consultant
	UFOC 6	The Entrepreneur's Source- Regional
	UFOC 7	Tilden Associates
	UFOC 8	Décor and You Designer Franchise
	UFOC 9	Golf Augusta Pro Shops
	UFOC 10	World Inspection Network
	UFOC 11	Great Clips
	UFOC 12	Little Scientists
	UFOC 13	Party Land

*Franchisee under a Franchisee with a master agreement (second generation).

ITEM 1. The Franchisor, its Predecessors and Affiliates:
Included in this section are brief historical data; founders; industry specific information on competitors, etc.; franchises previously and presently offered.

Corporation Founded	UFOC 1	1991
	UFOC 2	1967
	UFOC 3	1995
	UFOC 4	1916
	UFOC 5	1997
	UFOC 6	1997
	UFOC 7	1923
	UFOC 8	1998
	UFOC 9	1994
	UFOC 10	1993
	UFOC 11	1982
	UFOC 12	1995
	UFOC 13	1985

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Began Franchising	UFOC 1	1981
	UFOC 2	1997
	UFOC 3	1995
	UFOC 4	1919
	UFOC 5	1997
	UFOC 6	1997
	UFOC 7	1976
	UFOC 8	1998
	UFOC 9	1997
	UFOC 10	1994
	UFOC 11	1983
	UFOC 12	1996
	UFOC 13	1988

ITEM 2: Business Experience- This section describes the names, titles, and responsibilities of the officers and directors with relevant experience over the past five years

ITEM 3: Litigation- This section provides information on pending litigation involving the franchisor, including amounts.

ITEM 4: Bankruptcy- This section discloses previous bankruptcy proceedings involving the company, affiliates, or members identified in item 2.

ITEM 5: Initial Franchise Fee- This section describes the initial franchise fee with payment and cancellation terms.

Franchise Fee	UFOC 1	$20,000
	UFOC 2	$35,000 for territory of 4,500-5,500 'qualified' homes
	UFOC 3	$20,000
	UFOC 4	None*
	UFOC 5	$19,500
	UFOC 6	$50,000 to $100,000 depending on territory
	UFOC 7	$25,000
	UFOC 8	$12,000
	UFOC 9	$40,000
	UFOC 10	$19,900

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	UFOC 11	$17,500
	UFOC 12	$20,000
	UFOC 13	$35,000

*Although no initial fee is required for this 2nd generation franchisee, there is a substantial cancellation fee listed in another section.

ITEM 6: Other Fees- This section describes the fees imposed by and paid to franchisor.

Royalty	UFOC 1	6% of total gross sales; paid weekly through electronic transfer
	UFOC 2	Greater of 6% of monthly gross sales or $1,000; payable monthly via check
	UFOC 3	Quarterly minimum $500, required to buy minimum 450 fifty-pound bags of proprietary product each quarter
	UFOC 4	2 ¾% on first $5,000 per week; 2 ½% on all gross sales over $5,000 per week
	UFOC 5	0
	UFOC 6	0
	UFOC 7	6% of weekly gross revenues; minimum of $350 per week.
	UFOC 8	10% of gross weekly sales ($25 min.) paid weekly, pre-authorized draft
	UFOC 9	5% of gross revenues paid monthly
	UFOC 10	7% of gross revenues monthly, min $300
	UFOC 11	6% of gross sales Biweekly
	UFOC 12	6% of gross sales; $250 minimum
	UFOC 13	5% of gross sales

Renewal Fees	UFOC 1	$1,000
	UFOC 2	10% of then current franchise fee or $15,000 whichever is less
	UFOC 3	Lesser of 25% initial fee or $3,000
	UFOC 4	None
	UFOC 5	10% of current IFF
	UFOC 6	10% of current IFF
	UFOC 7	None
	UFOC 8	10% of current IFF
	UFOC 9	None
	UFOC 10	5% of applicable IFF
	UFOC 11	$1,000
	UFOC 12	$1,000

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	UFOC 13	Greater of costs incurred or $1,000

Transfer Fees	UFOC 1	25% of current initial franchise fee
	UFOC 2	30% of current initial fee or $15,000, whichever is less
	UFOC 3	$3,000
	UFOC 4	none
	UFOC 5	$5,000 for training of transferee and 10% of IFF
	UFOC 6	$5,000 for training of transferee and 10% of IFF
	UFOC 7	Greater of $5,000 or 5% of sale
	UFOC 8	$5,000 plus $5,000 transferee training fee
	UFOC 9	Actual costs, not to exceed 25% of IFF
	UFOC 10	$2,500
	UFOC 11	None
	UFOC 12	$4,000
	UFOC 13	Greater of costs incurred or $1,000

Marketing Fees	UFOC 1	1% of monthly gross, plus 3% quarterly gross for local advertising
	UFOC 2	1% of monthly gross; plus 2% of quarterly gross for local advertising
	UFOC 3	None; but must spend $7,000 on initial advertising, the 2% of gross
	UFOC 4	None; but initial opening advertising requirement varies at discretion of franchisor
	UFOC 5	$350 per month; plus $400 per month
	UFOC 6	$350 per month; plus $400 per month
	UFOC 7	3% of weekly gross revenues; minimum of $175.00 per week.
	UFOC 8	3% weekly to national fund, plus $250 per month mandatory local advertising
	UFOC 9	1% of gross revenues, paid monthly
	UFOC 10	2% of monthly gross revenues, $75 minimum
	UFOC 11	5% of gross sales
	UFOC 12	$1% of gross sales
	UFOC 13	$2,000 to $3,000 per month depending on store size

Other mandatory fees	UFOC 1	Min $5,000 grand opening fee;
	UFOC 2	Special field services fee of $800 per day plus expenses.
	UFOC 3	Required opening order of $13,000 of inventory
	UFOC 4	None

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	UFOC 5	None
	UFOC 6	None
	UFOC 7	None
	UFOC 8	Additional on-site assistance $250 per day; additional training $1,000 per day.
	UFOC 9	Expense reimbursement for training on-site; $20,000 grand opening
	UFOC 10	None
	UFOC 11	Mandatory advertising; $55 software fee; $5,000 market development fund; lease review $2,500; $10,000 grand opening
	UFOC 12	1% local advertising;
	UFOC 13	None

ITEM 7- Initial Investment- This section itemizes the initial investment, and may provide a range of costs anticipated, the method of payment and to whom the payment is to be made.

Initial investment- Low	UFOC 1	$44,000.00 *
	UFOC 2	$74,925.00
	UFOC 3	$47,024.55
	UFOC 4	$15,500.00 *
	UFOC 5	$25,450
	UFOC 6	$66,650
	UFOC 7	$131,533**
	UFOC 8	$27,700
	UFOC 9	$319,200
	UFOC 10	$24,950
	UFOC 11	$87,200**
	UFOC 12	$21,500*
	UFOC 13	$189,000*

Initial investment- high	UFOC 1	$194,500.00 *
	UFOC 2	$100,900.00
	UFOC 3	$69,479.55
	UFOC 4	$158,000.00 *
	UFOC 5	$35,500
	UFOC 6	$130,300

	UFOC 7	$171,233**
	UFOC 8	$43,300
	UFOC 9	$723,600
	UFOC 10	$36,365
	UFOC 11	$161,500**
	UFOC 12	$34,500*
	UFOC 13	$299,000*

Note: * Excludes the cost of real estate
** Includes expected rent expenses and leasehold improvements, but not cost of real estate if purchased.

ITEM 8: Restrictions on Sources of Products or Services- This section provides information on the sources available for the franchisee to purchase products, the ability to offer other products or services, and the amount of revenue or profit derived by the franchisor from sales of these products to franchisees.

Product Specs.	UFOC 1	Required to buy only approved products
	UFOC 2	Solely through approved suppliers
	UFOC 3	Must buy product from franchisor or designee
	UFOC 4	No restrictions
	UFOC 5	No products other than marketing materials
	UFOC 6	No products other than marketing materials
	UFOC 7	All fixtures, furnishings, software, equipment, and materials specified. No requirements to purchase operating materials
	UFOC 8	Specified suppliers, any others must be approved
	UFOC 9	Must purchase any logo-bearing equipment from franchisor
	UFOC 10	Must comply with specifications;
	UFOC 11	Must purchase only designated supplies, equipment, fixtures
	UFOC 12	Must purchase copyrighted materials from franchisor; other supplies from approved list of vendors
	UFOC 13	Not currently required to purchase any goods, services, supplies or fixtures

Other Restrictions	UFOC 1	Zor sets hours of operation;
	UFOC 2	Must employ at least 2 full-time handymen; business (not craft) training; must own/ lease 3 trucks; pay cost to enforce
	UFOC 3	Must buy minimum quantity of proprietary products (min $4,500 per quarter)
	UFOC 4	None
	UFOC 5	Although may be operated as home business, must have outside office for consultations
	UFOC 6	Outside office approved by franchisor required

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	UFOC 7	Must be open 6 days per week; minimum hours of 8:00 a.m. to 5:30 p.m.
	UFOC 8	Site approval
	UFOC 9	Must hire Specified design firm, must use designated ad agency; must purchase equipment from selected suppliers
	UFOC 10	
	UFOC 11	
	UFOC 12	
	UFOC 13	

ITEM 9: Franchisee's obligations- this section lists the principal obligations of the franchisee including site selection, pre-opening purchases, training, advertising, inspections, etc. with references to sections of the agreements and offering circulars that pertain to the obligation.

a. Site selection and acquisition/lease

Site Selection	UFOC 1	Zor provides specifications, advice, consultation, approval required
	UFOC 2	Zor provides guidelines, reviews, provides assistance, approval required
	UFOC 3	No site required, may be home-based
	UFOC 4	Zor will assist, approval required
	UFOC 5	Zor approved
	UFOC 6	Zor approved
	UFOC 7	Zor will assist; approval required
	UFOC 8	No site selection provided if home based business
	UFOC 9	Zor approved, will assist but no liability
	UFOC 10	None, except any change must be approved
	UFOC 11	Zor will assist and approve; must use specified suppliers
	UFOC 12	Zor approved
	UFOC 13	Zor approved, must approve any relocation

b. Pre-opening purchases/leases

Pre-opening purchases	UFOC 1	PC that communicates with Point of sale terminal; approved equipment
Or leases	UFOC 2	Personal computer with software required; other equipment as specified in manual
	UFOC 3	Must spend at least $7,000 in initial advertising; computer; vehicle; signage
	UFOC 4	Pre-Opening advertising $4,000- $20,000; inventory $120,000- $810,000
	UFOC 5	Must have computer, fax, and copier
	UFOC 6	Must have computer, fax, and copier

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	UFOC 7	Must meet franchisor's specifications for signage, equipment, and inventory.
	UFOC 8	Must purchase required inventory, materials, supplies; computer, van, training
	UFOC 9	Specifications, inventory, décor, on-site assistance
	UFOC 10	Must have vehicle that complies with specs in operations manual
	UFOC 11	Must conduct grand opening
	UFOC 12	Must purchase materials and promotional items; must purchase office equipment as specified
	UFOC 13	All covenants performed, lease approved, facility conforms, insurance, training complete, fees paid, stocked, approval

c. Site development and other pre-opening requirements

Site/Pre-opening	UFOC 1	Must adhere to standards for design, construction, equipment
	UFOC 2	Required to qualify for authorization to sell based on expertise
	UFOC 3	None
	UFOC 4	Franchisee solely responsible; must purchase sign; Must have approval
	UFOC 5	None
	UFOC 6	None
	UFOC 7	Must complete training; must have 2 managers selected and approved.
	UFOC 8	None
	UFOC 9	Must hire selected firm for build-out; purchase lease all equipment as specified; written certification by zor;
	UFOC 10	
	UFOC 11	Site must meet company standards
	UFOC 12	Must have approved site, purchase materials, and complete training
	UFOC 13	30 day 'Opening Soon' sign; ad in Yellow Pages

d. Initial and ongoing training

Training	UFOC 1	22 days; ½ tasks, ½ management for 3 individuals; must pay expenses
	UFOC 2	60 hrs; Fee included, franchisee must pay expenses
	UFOC 3	40 hrs; fee included for 2 individuals; must pay expenses
	UFOC 4	11 day training; Cost $2,000 + expenses; educational seminars at no fee, just expenses
	UFOC 5	8 days included in fee; must pay expenses
	UFOC 6	8 days included in fee; must pay expenses
	UFOC 7	2 weeks included in fee; must pay expenses
	UFOC 8	10 day, 65 hour training; must pay expenses; continuing advisory services

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	UFOC 9	Initial training and 5 days on-site included in fee; must pay expenses
	UFOC 10	Initial training is 2 weeks; must pay expenses
	UFOC 11	Initial training provided; must pay expenses
	UFOC 12	Initial 5 day training provided, must pay expenses, additional training through purchase of materials
	UFOC 13	Completion of training program

e. Opening

Opening	UFOC 1	Complete training; paid all fees; furnish copies of insurance; built out according to specs.; purchase inventory
	UFOC 2	$5,000 to $7,500 grand opening promotion required;
	UFOC 3	Required opening order of $13,000 of inventory; certification
	UFOC 4	Must open within 12 months of signing agreement
	UFOC 5	Must be within 60 days of training completion
	UFOC 6	Must be within 60 days of training completion
	UFOC 7	None
	UFOC 8	Must open within 30 days of training completion
	UFOC 9	Must open within 60 after completion of training
	UFOC 10	Must open within 60 days after training completed
	UFOC 11	Must open within 60 days of training completion
	UFOC 12	Must begin within 90 days of signing agreement
	UFOC 13	Zor provides assistance 5 days preceding and 3 days following opening;

f. Fees

Other mandatory fees	UFOC 1	Min $5,000 grand opening advertising required;
	UFOC 2	Special field services fee of $800 per day plus expenses.
	UFOC 3	None
	UFOC 4	None
	UFOC 5	None
	UFOC 6	None
	UFOC 7	None
	UFOC 8	Min. grand opening $500-$1000; Minimum local advertising of $250 per month
	UFOC 9	None
	UFOC 10	

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	UFOC 11	Grand opening $10,000
	UFOC 12	
	UFOC 13	

g. Compliance with standards and policies/ Operating Manual

h. Trademarks and proprietary information

i. Restrictions on products/ services offered

Covered in UFOC Item 8.

Other Restrictions	UFOC 1	Franchisor sets hours of operation;
	UFOC 2	Must employ at least 2 full-time handymen; business (not craft) training; must own/ lease 3 trucks; pay cost to enforce
	UFOC 3	Must buy minimum quantity of proprietary products (min $4,500 per quarter)
	UFOC 4	None
	UFOC 5	None
	UFOC 6	None
	UFOC 7	Minimum hours of operation; uniforms
	UFOC 8	None
	UFOC 9	Must be open 6 days per week
	UFOC 10	
	UFOC 11	Franchisor sets hours of operations
	UFOC 12	Monthly sales quota
	UFOC 13	Minimum quantities of inventory by number; must approve any alternative source

j. Warranty and customer service requirements

Warranty & Customer	UFOC 1	None
	UFOC 2	Manual
	UFOC 3	Required to distribute response cards sent back to parent; must meet standards
	UFOC 4	None

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	UFOC 5	None
	UFOC 6	None
	UFOC 7	Accept all terms and payments for work connected with guarantee issued by franchisor
	UFOC 8	None
	UFOC 9	None
	UFOC 10	Franchisee must honor guarantees proposed by franchisor
	UFOC 11	Comply with all laws and operating procedures
	UFOC 12	None
	UFOC 13	Best efforts to promote sales; operate in compliance with manual

k. Territorial development and sales quotas

Covered in Item 12.

l. Ongoing product/ service purchases

Product Specs.	UFOC 1	Required to buy only approved products
	UFOC 2	Solely through approved suppliers
	UFOC 3	Must buy product from franchisor or designee
	UFOC 4	No restrictions
	UFOC 5	N/A
	UFOC 6	N/A
	UFOC 7	Required purchase of approved materials and equipment
	UFOC 8	Must purchase according to specifications, or have written permission
	UFOC 9	Must purchase according to specifications, or have written permission
	UFOC 10	
	UFOC 11	Only products and services as designated by franchisor
	UFOC 12	Must purchase copyrighted materials, approved suppliers for supplies and office equipment
	UFOC 13	Required inventory; approval for alternative suppliers

m. Maintenance, appearance and remodeling requirements

n. Insurance

Insurance required	UFOC 1	1% marketing fee; Minimum 3% of quarterly. Gross sales for local advertising
	UFOC 2	$1M general liability; replacement cost fire, vandalism; $100,000 fidelity bond; $1M vehicle; zor addl. insured

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	UFOC 3	Vehicle liability $1M; Casualty at replacement value; parent as additional insured
	UFOC 4	$3M liability; $3M auto liability
	UFOC 5	$1M liability; carrier must be rated A+; parent named as additional insured
	UFOC 6	$1M liability; carrier must be rated A+; parent named as additional insured
	UFOC 7	$1 M liability; workman's compensation; parent named as co-insured; umbrella policy required.
	UFOC 8	$2M aggregate liability and umbrella; $250,000 employer liability, $1M auto liability; company rated A or better
	UFOC 9	Insurance as required by franchisor
	UFOC10	Errors and omissions, liability, etc. as specified in operations manual
	UFOC 11	$1M liability
	UFOC 12	$1M in liability, with franchisor as additional insured
	UFOC 13	$1M in liability coverage, zor additional insured

o. Advertising

Covered in Item 3 of UFOC.

p. Indemnification

q. Owner's Participation/management/ staffing

Participation is covered in Item 15 of UFOC.

r. Record and Reports

Financial Reporting	UFOC 1	Weekly; must provide direct on-line access to zor; monthly income; annual income statement and balance sheet; audit
	UFOC 2	Zor may poll computer for sales, cost, and other financial or marketing data; monthly reports; audit
	UFOC 3	Monthly sales reports; audit
	UFOC 4	Weekly, may be audited without notice
	UFOC 5	Quarterly financial statements; audit
	UFOC 6	Quarterly financial statements; audit
	UFOC 7	Annual financial statements; weekly register reports
	UFOC 8	Submit all financials as specified;
	UFOC 9	Must submit gross revenues and sales tax reports monthly, must verify and sign each financial report
	UFOC 10	Access during normal working hours, furnish tax return, may require use of modem.
	UFOC 11	Weekly marketing report; bi-weekly financial report with payment of fees; tax returns as requested;
	UFOC 12	Weekly signed financial statements; must keep records for three years after agreement termination

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	UFOC 13	Signed weekly sales report; quarterly p&l; annual p&l and balance sheet; all daily records; tax returns

s. **Inspections and audits**

Monitoring/ Control	UFOC 1	Interview customers, inspect books, inventory, equipment, supplies, during business hours without notification
	UFOC 2	Right to use 'test customers' or communicate with franchisee's customers without prior notification
	UFOC 3	Periodic quality inspections
	UFOC 4	May be inspected any time during hours of operation
	UFOC 5	During working hours
	UFOC 6	During working hours
	UFOC 7	At any reasonable time
	UFOC 8	Right to enter business anytime during working hours; right to observe
	UFOC 9	Right to enter and inspect any time during business hours; observe operations
	UFOC 10	Right during normal working hours
	UFOC 11	Right to audit, franchisee pay expenses
	UFOC 12	Franchisor has free and full access; inspection during working hours
	UFOC 13	Full and free access with 48 hr. notice to all books and records.

t. **Transfer**

Transfer is covered in item 17 of UFOC.

u. **Renewal**

Renewal terms and fees are covered in Item 17 of the UFOC.

v. **Post-Termination obligations**

Non-competition both during the term of the agreement and after the terms of agreement ends is covered in Item 17 of the UFOC.

w. **Non-competition covenants**

Non-competition both during the term of the agreement and after the terms of agreement ends is covered in Item 17 of the UFOC.

x. **Dispute Resolution**

Dispute resolution is covered in Item 17 of UFOC.

y. **Other**

ITEM 10; Financing- This section details any available financing terms offered by the franchisor.

Financing Offered	UFOC 1	No

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	UFOC 2	No
	UFOC 3	No
	UFOC 4	No
	UFOC 5	No
	UFOC 6	No
	UFOC 7	No
	UFOC 8	No
	UFOC 9	No
	UFOC 10	Yes; 2 year financing of $11,450 @ 15% interest over 2 years
	UFOC 11	No; but has agreement with third party finance corporation for approved franchisees
	UFOC 12	No
	UFOC 13	No

ITEM 11: Franchisor's Obligations This section details the pre-opening support, training, advertising support and other franchisor obligations.

Site Selection	UFOC 1	Specifications, advice, consultation
	UFOC 2	Review, assistance, approval
	UFOC 3	None required
	UFOC 4	Assist, approve
	UFOC 5	Specifications, advice, lend copy of manual, training
	UFOC 6	Specifications, advice, lend copy of manual, training
	UFOC 7	Specifications, design, equipment, and inventory must be approved
	UFOC 8	Designate territory; Specifications, assistance, fixtures, inventory, training
	UFOC 9	Designate protected territory; specify site criteria; ongoing assistance; training
	UFOC 10	Designate boundaries, pre-training pack; vehicle selection
	UFOC 11	Help find suitable site, advise on shop layout, advise on marketing, lend manual, train, ongoing support
	UFOC 12	Designate territory, approve location, on-site assistance, start-up materials
	UFOC 13	Reasonably assist, approve location, designate territory, specifications, trraining

Advertising	UFOC 1	1% marketing fee; Minimum 3% of quarterly. Gross sales for local advertising
	UFOC 2	1% of monthly gross sales; 2% of quarterly gross sales for local advertising required; min $5,000 on grand opening
	UFOC 3	Must spend $7,000 in first 3 months; Annual requirement of 2% of annual gross sales
	UFOC 4	Included in fee
	UFOC 5	$350 per month to franchisor; must spend additional $400 per month using approved materials

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	UFOC 6	$350 per month to franchisor; must spend additional $400 per month using approved materials
	UFOC 7	Greater of 3% of weekly gross sales or $175.00 paid weekly
	UFOC 8	Fees specified
	UFOC 9	1% for ad fund; $30,000 min. required for local advertising;
	UFOC 11	Cooperate with advertising; must join co-op;
	UFOC 12	1% creative; 1% local
	UFOC 13	$2,000 per month if 3000 sq. ft. or less; $3,000 per month if >3000 sq. ft.

Training	UFOC 1	22 days; ½ tasks, ½ management for 3 individuals; must pay expenses
	UFOC 2	60 hrs; Fee included, franchisee must pay expenses
	UFOC 3	40 hrs.; fee included for 2 individuals; must pay expenses
	UFOC 4	11 day training; Cost $2,000 + expenses; educational seminars at no fee, just expenses
	UFOC 5	64 hrs. of instruction and self-study
	UFOC 6	64 hrs. of instruction and self-study
	UFOC 7	2 weeks
	UFOC 8	6 days
	UFOC 9	
	UFOC 10	Pre-training plus 2 weeks; franchisee pays expenses
	UFOC 11	104 hrs of classroom
	UFOC 12	5 days; must pay expenses
	UFOC 13	6 days; must pay expenses

Other	UFOC 1	PC that communicates with Point of sale terminal
	UFOC 2	Personal computer with software required.
	UFOC 3	None
	UFOC 4	None
	UFOC 5	On-going support available for fee
	UFOC 6	On-going support available for fee
	UFOC 7	Mandatory 2 hr. refresher courses.
	UFOC 8	Required inventory; specific cash register
	UFOC 9	Must purchase computer from selected vendor, initial license fee of $17,500 and $139 per month
	UFOC 10	
	UFOC 11	Must purchase software license $55 per month
	UFOC 12	Must purchase computer and software

	UFOC 13	Must be open minimum of 55 hrs. per week; only approved signs

ITEM 12: Territory- This section describes the territorial provisions included in the agreement (if any).

Territory Exclusivity	UFOC 1	No
	UFOC 2	Yes, although boundaries may change with demographics; allowed to sell outside if not designated territory of another
	UFOC 3	Yes, as approved, containing 50,000 households in contiguous zip codes
	UFOC 4	No
	UFOC 5	Yes, provided minimum performance targets are met
	UFOC 6	Yes, provided minimum performance targets are met; size determined by demographics
	UFOC 7	Yes, between 1 and 3 miles of outlet
	UFOC 8	Yes, in 40,000 household blocks by zip code
	UFOC 9	Yes, population density of 1,500 per square mile, avg. income of $50,000; may not solicit via internet.
	UFOC 10	Yes, contiguous zip code
	UFOC 11	Yes, protected area determined at time site is designated
	UFOC 12	Yes, by zip code; minimum sales of $5,000 per month
	UFOC 13	Limited exclusive territory of 3-5 miles depending on population density

ITEM 13: Trademarks and Patents- This section describes the right of the franchisor to license the use of trade and service marks to the franchisee under the agreement, and provisions for their use after termination, as well as infringement conditions.

ITEM 14: Patents, Copyrights, and Proprietary Information- his section describes the claims made by the franchisor to property rights associated with the manual and proprietary software, processes, advertising materials, and the confidentiality associated with their use, etc.

Intellectual Property	UFOC 1	None
	UFOC 2	Software license included in franchise fee.
	UFOC 3	None, although purchase of proprietary product is required
	UFOC 4	none
	UFOC 5	Operations manual
	UFOC 6	Operations manual
	UFOC 7	No patents, but Operations manual is copyrighted
	UFOC 8	No patents, but Operations manual protected by copyright, although not filed
	UFOC 9	No patents or registered copyrights, but copyright claim is made for manual, advertising, commercials, and other work
	UFOC 10	No patents, claim copyright on manuals, ad materials, forms and computer software

	UFOC 11	No patents, although it considers manuals and marketing material protected under copyright laws
	UFOC 12	No patents, considers marketing and operations materials to be copyright
	UFOC 13	No copyrights or patents, except operations manual

ITEM 15: Obligation to Participate in the Actual Operation of the Franchised Business- This section specifies the qualifications and involvement of the franchisee, and designated managers (if specified).

Participation	UFOC 1	Required to devote full time and best efforts to management and operation, unless corporation- then designated manager
	UFOC 2	Full-time, direct and on-site supervision, unless approved manager; corp. also limited to this franchised activity
	UFOC 3	80% commitment to this business required
	UFOC 4	Does not require personal participation
	UFOC 5	Not require full-time, but every energy and best efforts required
	UFOC 6	Full-time devotion to actual operation of the business
	UFOC 7	Full-time devotion to actual operation of business required
	UFOC 8	Full-time, every energy, best effort
	UFOC 9	Unit must be supervised by franchisee or designated manager approved by franchisor
	UFOC 10	None specifically required, although intentions is to select franchisees who participate in direct operations
	UFOC 11	Best efforts, but not required to personally manage shop
	UFOC 12	Must personally supervise day to day operations
	UFOC 13	Personally responsible for day to day operations, devote full attention

ITEM 16: Restrictions of What the Franchisee may Sell- This section specifies what is required to be offered, and what is allowed to be offered by the franchisee in the outlet.

Franchisor Products	UFOC 1	Sell only and all products approved by franchisor; must offer all menu items
	UFOC 2	Must offer and only offer authorized services as described in manual
	UFOC 3	Must be Offered
	UFOC 4	No restriction, but limited to operation of grocery store
	UFOC 5	Must offer all goods, and only approved goods
	UFOC 6	Must offer all goods, and only approved goods
	UFOC 7	May sell any goods related to automotive repair, with approval.
	UFOC 8	Only approved goods
	UFOC 9	Offer only authorized products or services
	UFOC 10	Offer and sell on approved goods and services

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	UFOC 11	Confined to retail and personal grooming business
	UFOC 12	Must offer items as prescribed in Operations manual
	UFOC 13	Only goods appearing in current listing of required inventory.

Other Products/Svcs	UFOC 1	Prohibited
	UFOC 2	Prohibited
	UFOC 3	Prohibited
	UFOC 4	Limited to items generally found in grocery store
	UFOC 5	Prohibited
	UFOC 6	Prohibited
	UFOC 7	No restrictions on offerings with approval
	UFOC 8	Only as approved
	UFOC 9	Prohibited
	UFOC 10	Prohibited
	UFOC 11	Prohibited
	UFOC 12	None
	UFOC 13	May promote services if (1) adhere to set standards, and (2) provide services to customers within territory

ITEM 17: Renewal, Termination, Transfer & Dispute Resolution- Stipulations and terms associated with each.

Contract Terms: Length	UFOC 1	15 Years
	UFOC 2	10 years, with exit option after 18 months- no reimbursement of fees
	UFOC 3	7 years
	UFOC 4	none
	UFOC 5	10 years
	UFOC 6	10 years
	UFOC 7	10 years
	UFOC 8	10 years
	UFOC 9	10 years
	UFOC 10	10 years
	UFOC 11	10 years
	UFOC 12	10 years
	UFOC 13	90 days, then enter into license agreement (10 years)

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Renewal Terms:	UFOC 1	30 day notice; sign current form; must be in compliance; sign release; pay fee; renovate if applicable
	UFOC 2	Give notice, pass inspection, sign new agreement, pay renewal fee, retrain
	UFOC 3	Good standing, give notice, sign new agreement, pay renewal fee
	UFOC 4	none
	UFOC 5	10 years; Previous compliance; pay 10% fee
	UFOC 6	10 years; Previous compliance; pay 10% fee
	UFOC 7	If franchisee is in good standing, franchisor obligated to renew for additional 5 years, no fee.
	UFOC 8	10 years, multiple consecutive
	UFOC 9	10 years if requirements met
	UFOC 10	Additional 10 years if in good standing
	UFOC 11	5 year renewal; $1,000 fee, sign then current agreement
	UFOC 12	10 year renewal option
	UFOC 13	None

Agreement Termination By Franchisee	UFOC 1	None
	UFOC 2	None
	UFOC 3	90 day notice; send customer report; zor has option to purchase inventory at cost and depreciated value of other assets
	UFOC 4	Termination fee if less than 5 years = 1 year service organization and license fee; if >5yrs = 2 times annual fee (2 ½% of gross sales plus ½ % of first $50,000 of gross sales each month
	UFOC 5	None
	UFOC 6	None
	UFOC 7	May terminate under any terms available by law
	UFOC 8	None
	UFOC 9	Only upon material breach by franchisor
	UFOC 10	None
	UFOC 11	Only with good cause
	UFOC 12	Terminate with 120 day notice
	UFOC 13	If company defaults after 60 day notice

Agreement Termination By Franchisor With Cause	UFOC 1	17 'cannot be cured' defaults; 4 'curable' defaults
	UFOC 2	6 'cannot be cured' defaults; applicable law, 30 day cure time
	UFOC 3	Only if default
	UFOC 4	5 'cannot be cured' defaults; 30 day cure time; may require payment of termination fee
	UFOC 5	5 'cannot be cured' defaults; 15 day cure time

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	UFOC 6	5 'cannot be cured' defaults; 15 day cure time
	UFOC 7	5 'cannot be cured' defaults; 10 day notice
	UFOC 8	10 'cannot be cured' defaults, 1 day notice; 4 can be cured, 10 day notice
	UFOC 9	6 'cannot be cured' and 4 curable with 30 days notice.
	UFOC 10	Only terminate if in default; 6 'cannot be cured', curable ones have between 7 and 30 days to cure.
	UFOC 11	Terminate if in breach, 24 hrs to 30 days to correct impairments
	UFOC 12	Terminate if in default
	UFOC 13	Only in case of default or failure to meet preconditions of renewal

Right of refusal	UFOC 1	1st right of refusal; right to match offer
	UFOC 2	1st right of refusal; right to match offer
	UFOC 3	1st right of refusal; right to match offer
	UFOC 4	1st right of refusal; right to match offer
	UFOC 5	1st right of refusal; right to match offer
	UFOC 6	1st right of refusal; right to match offer
	UFOC 7	1st right of refusal; right to match offer in 30 days
	UFOC 8	1st right of refusal; 30 days to match offer
	UFOC 9	1st right of refusal; 30 days to match bona fide offer.
	UFOC 10	1st right of refusal; right to match any legitimate offer.
	UFOC 11	1st right of refusal; right to match any legitimate offer
	UFOC 12	1st right of refusal; right to match any legitimate offer
	UFOC 13	1st right of refusal; right to match any legitimate offer

Buy Back Provision	UFOC 1	Right, but not obligation; 30% of gross sales for previous 12 months
	UFOC 2	Right, but not obligation; lesser of cost or fair market value
	UFOC 3	Right, but not obligation; lesser of cost or fair market value
	UFOC 4	Right, but not obligation; at fair market value
	UFOC 5	Right, but not obligation; at lesser of book value of assets, or FMV minus all indebtedness
	UFOC 6	Right, but not obligation; at lesser of book value of assets, or FMV minus all indebtedness
	UFOC 7	Right, but not obligation
	UFOC 8	No buy-back
	UFOC 9	Right but not obligation; assets at fair market value, free of liens
	UFOC 10	None
	UFOC 11	Right but not obligation to buy any or all equipment or furnishings at appraised price

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	UFOC 12	None
	UFOC 13	None

Transfer Fees	UFOC 1	25% of current initial franchise fee
	UFOC 2	30% of current initial fee or $15,000, whichever is less
	UFOC 3	$3,000
	UFOC 4	none
	UFOC 5	$5,000 training fee for transferee; 10% of then current IFF
	UFOC 6	$5,000 training fee for transferee; 10% of then current IFF
	UFOC 7	$5,000 transfer charge
	UFOC 8	10% of current IFF; if franchisor finds buyer, 10% commission is charged.
	UFOC 9	Actual expenses not to exceed 25% of IFF
	UFOC 10	Greater of 5% or $2,500
	UFOC 11	None
	UFOC 12	None
	UFOC 13	None

Non-Compete during Franchise Agreement	UFOC 1	No involvement in competing business anywhere; No branded business within ¼ mile radius without consent
	UFOC 2	No involvement in competing business anywhere
	UFOC 3	No competing business
	UFOC 4	No involvement in competing business anywhere
	UFOC 5	No competing business
	UFOC 6	No competing business
	UFOC 7	No competing business
	UFOC 8	No competing business
	UFOC 9	No competing business
	UFOC 10	No competing business
	UFOC 11	No competing business
	UFOC 12	No competing business
	UFOC 13	No involvement in competing business anywhere

Non-Compete after Termination of Agreement	UFOC 1	2 yrs. No competing business within 5 miles of any Quizno's
	UFOC 2	2 yrs. Within 30 miles of any Case business
	UFOC 3	2 yrs. Not own more than 10% of competing business within 75 miles of any Pet Pantry.

	UFOC 4	2 yrs. Cannot compete within 4 mile radius
	UFOC 5	2 years. Cannot compete anywhere within 50 miles of another outlet.
	UFOC 6	2 years. Cannot compete anywhere within 50 miles of another outlet.
	UFOC 7	3 years. Cannot compete within 50 miles of any operating franchise site.
	UFOC 8	2 years, any business located within 10 miles of any outlet
	UFOC 9	1 year; any competitive business within 5 miles of other outlet
	UFOC 10	1 year, within 25 miles.
	UFOC 11	1 year, within 5 miles
	UFOC 12	2 years in United States
	UFOC 13	18 months, within 25 miles of border of territory

Dispute Resolution	UFOC 1	No arbitration or mediation clause; all parties waive rights to jury trial; Denver venue; no class-action
	UFOC 2	All disputes subject to non-binding mediation; Maryland law
	UFOC 3	Arbitration in Nevada; waive jury trial rights; waive right to punitive damages
	UFOC 4	All disputes mediated in South Carolina
	UFOC 5	Must arbitrate; Connecticut law applies
	UFOC 6	Must arbitrate; Connecticut law applies
	UFOC 7	Disputes must be arbitrated; New York law applies
	UFOC 8	Attempt to mediate before any legal action
	UFOC 9	Arbitration (binding) in Atlanta
	UFOC 10	All disputes arbitrated
	UFOC 11	All disputes arbitrated in Minneapolis
	UFOC 12	Arbitration
	UFOC 13	Except for certain claims, must be submitted to arbitration

ITEM 18: Public Figures- This section describes the use of public figures to promote the franchised business.

ITEM 19: Earnings Claims- This section provides a place where any claims of earnings or sales by the franchisor may be disclosed.

Earnings or Sales Claim	UFOC 1	Yes, average gross sales of $300,580 in 89 outlets; 47% of which met or exceeded average
	UFOC 2	No
	UFOC 3	No
	UFOC 4	No

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	UFOC 5	No
	UFOC 6	No
	UFOC 7	No
	UFOC 8	No
	UFOC 9	Yes, provided data from one company store with disclaimers
	UFOC 10	No
	UFOC 11	Yes, provided sample of 400 units, with average costs as percentage of sales in range of sales and cash flows
	UFOC 12	No
	UFOC 13	None

ITEM 20: List of Outlets- This section details the franchised businesses, by state. It includes transfers, cancellations, those note renewed, reacquired by franchisor, and left the system –other. It also provides the number of franchises operating at the end of each of the previous three years. In addition, the number of company stores is also described, along with projected openings.

Total # of units	UFOC 1	156 (12/31/96)
	UFOC 2	13
	UFOC 3	26
	UFOC 4	723
	UFOC 5	0 (12/97)
	UFOC 6	0 (12/97)
	UFOC 7	10
	UFOC 8	6
	UFOC 9	12
	UFOC 10	45
	UFOC 11	1183
	UFOC 12	14
	UFOC 13	87

Number of Company-Owned Outlets	UFOC 1	9
	UFOC 2	0
	UFOC 3	0
	UFOC 4	0
	UFOC 5	8

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	UFOC 6	8	
	UFOC 7	0	
	UFOC 8	0	
	UFOC 9	1	
	UFOC 10	0	
	UFOC 11	13	
	UFOC 12	3	
	UFOC 13	9	

ITEM 21: Financial Statements of Franchisor
ITEM 22: Contracts
ITEM 23: Receipt

Appendix D

Table D2: Exploratory Study Part 2

a. Site selection and acquisition/lease

Site Selection	UFOC 1	Zor provides specifications, advice, consultation, approval required
	UFOC 2	Zor provides guidelines, reviews, provides assistance, approval required
	UFOC 3	No site required, may be home-based
	UFOC 4	Zor will assist, approval required
	UFOC 5	Zor approved
	UFOC 6	Zor approved
	UFOC 7	Zor will assist; approval required
	UFOC 8	No site selection provided if home based business
	UFOC 9	Zor approved, will assist but no liability
	UFOC 10	None, except any change must be approved
	UFOC 11	Zor will assist and approve; must use specified suppliers
	UFOC 12	Zor approved
	UFOC 13	Zor approved, must approve any relocation

b. Pre-opening purchases/leases

Pre-opening purchases	UFOC 1	PC that communicates with Point of sale terminal; approved equipment
Or leases	UFOC 2	Personal computer with software required; other equipment as specified in manual
	UFOC 3	Must spend at least $7,000 in initial advertising; computer; vehicle; signage
	UFOC 4	Pre-Opening advertising $4,000- $20,000; inventory $120,000- $810,000
	UFOC 5	Must have computer, fax, and copier
	UFOC 6	Must have computer, fax, and copier
	UFOC 7	Must meet franchisor's specifications for signage, equipment, and inventory.
	UFOC 8	Must purchase required inventory, materials, supplies; computer, van, training
	UFOC 9	Specifications, inventory, décor, on-site assistance
	UFOC 10	Must have vehicle that complies with specs in operations manual
	UFOC 11	Must conduct grand opening
	UFOC 12	Must purchase materials and promotional items; must purchase office equipment as specified
	UFOC 13	All covenants performed, lease approved, facility conforms, insurance, training complete, fees paid, stocked, approval

c. Site development and other pre-opening requirements

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Site/Pre-opening	UFOC 1	Must adhere to standards for design, construction, equipment
	UFOC 2	Required to qualify for authorization to sell based on expertise
	UFOC 3	None
	UFOC 4	Franchisee solely responsible; must purchase sign; Must have approval
	UFOC 5	None
	UFOC 6	None
	UFOC 7	Must complete training; must have 2 managers selected and approved.
	UFOC 8	None
	UFOC 9	Must hire selected firm for build-out; purchase lease all equipment as specified; written certification by zor;
	UFOC 10	
	UFOC 11	Site must meet company standards
	UFOC 12	Must have approved site, purchase materials, and complete training
	UFOC 13	30 day 'Opening Soon' sign; ad in Yellow Pages

d. Initial and ongoing training

Training	UFOC 1	22 days; ½ tasks, ½ management for 3 individuals; must pay expenses
	UFOC 2	60 hrs; Fee included, franchisee must pay expenses
	UFOC 3	40 hrs; fee included for 2 individuals; must pay expenses
	UFOC 4	11 day training; Cost $2,000 + expenses; educational seminars at no fee, just expenses
	UFOC 5	8 days included in fee; must pay expenses
	UFOC 6	8 days included in fee; must pay expenses
	UFOC 7	2 weeks included in fee; must pay expenses
	UFOC 8	10 day, 65 hour training; must pay expenses; continuing advisory services
	UFOC 9	Initial training and 5 days on-site included in fee; must pay expenses
	UFOC 10	Initial training is 2 weeks; must pay expenses
	UFOC 11	Initial training provided; must pay expenses
	UFOC 12	Initial 5 day training provided, must pay expenses, additional training through purchase of materials
	UFOC 13	Completion of training program

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e. Opening

Opening	UFOC 1	Complete training; paid all fees; furnish copies of insurance; built out according to specs.; purchase inventory
	UFOC 2	$5,000 to $7,500 grand opening promotion required;
	UFOC 3	Required opening order of $13,000 of inventory; certification
	UFOC 4	Must open within 12 months of signing agreement
	UFOC 5	Must be within 60 days of training completion
	UFOC 6	Must be within 60 days of training completion
	UFOC 7	None
	UFOC 8	Must open within 30 days of training completion
	UFOC 9	Must open within 60 after completion of training
	UFOC 10	Must open within 60 days after training completed
	UFOC 11	Must open within 60 days of training completion
	UFOC 12	Must begin within 90 days of signing agreement
	UFOC 13	Zor provides assistance 5 days preceding and 3 days following opening;

f. Fees

Other mandatory fees	UFOC 1	Min $5,000 grand opening advertising required;
	UFOC 2	Special field services fee of $800 per day plus expenses.
	UFOC 3	None
	UFOC 4	None
	UFOC 5	None
	UFOC 6	None
	UFOC 7	None
	UFOC 8	Min. grand opening $500-$1000; Minimum local advertising of $250 per month
	UFOC 9	None
	UFOC 10	
	UFOC 11	Grand opening $10,000
	UFOC 12	
	UFOC 13	

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g. Compliance with standards and policies/ Operating Manual

h. Trademarks and proprietary information

i. Restrictions on products/ services offered

Covered in UFOC Item 8.

Other Restrictions	UFOC 1	Zor sets hours of operation;
	UFOC 2	Must employ at least 2 full-time handymen; business (not craft) training; must own/ lease 3 trucks; pay cost to enforce
	UFOC 3	Must buy minimum quantity of proprietary products (min $4,500 per quarter)
	UFOC 4	None
	UFOC 5	None
	UFOC 6	None
	UFOC 7	Minimum hours of operation; uniforms
	UFOC 8	None
	UFOC 9	Must be open 6 days per week
	UFOC 10	
	UFOC 11	Franchisor sets hours of operations
	UFOC 12	Monthly sales quota
	UFOC 13	Minimum quantities of inventory by number ; must approve any alternative source

j. Warranty and customer service requirements

Warranty & Customer	UFOC 1	None
	UFOC 2	Manual
	UFOC 3	Required to distribute response cards sent back to parent; must meet standards
	UFOC 4	None
	UFOC 5	None
	UFOC 6	None
	UFOC 7	Accept all terms and payments for work connected with guarantee issued by franchisor
	UFOC 8	None
	UFOC 9	None

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	UFOC 10	Franchisee must honor guarantees proposed by franchisor
	UFOC 11	Comply with all laws and operating procedures
	UFOC 12	None
	UFOC 13	Best efforts to promote sales; operate in compliance with manual

k. Territorial development and sales quotas

Covered in Item 12.

l. Ongoing product/ service purchases

Product Specs.	UFOC 1	Required to buy only approved products
	UFOC 2	Solely through approved suppliers
	UFOC 3	Must buy product from franchisor or designee
	UFOC 4	No restrictions
	UFOC 5	N/A
	UFOC 6	N/A
	UFOC 7	Required purchase of approved materials and equipment
	UFOC 8	Must purchase according to specifications, or have written permission
	UFOC 9	Must purchase according to specifications, or have written permission
	UFOC 10	
	UFOC 11	Only products and services as designated by franchisor
	UFOC 12	Must purchase copyrighted materials, approved suppliers for supplies and office equipment
	UFOC 13	Required inventory; approval for alternative suppliers

m. Maintenance, appearance and remodeling requirements

n. Insurance

Insurance required	UFOC 1	1% marketing fee; Minimum 3% of quarterly. Gross sales for local advertising
	UFOC 2	$1M general liability; replacement cost fire, vandalism; $100,000 fidelity bond; $1M vehicle; zor addl. insured
	UFOC 3	Vehicle liability $1M; Casualty at replacement value; parent as additional insured
	UFOC 4	$3M liability; $3M auto liability
	UFOC 5	$1M liability; carrier must be rated A+; parent named as additional insured
	UFOC 6	$1M liability; carrier must be rated A+; parent named as additional insured
	UFOC 7	$1 M liability; workman's compensation; parent named as co-insured; umbrella policy required.

	UFOC 8	$2M aggregate liability and umbrella; $250,000 employer liability, $1M auto liability; company rated A or better
	UFOC 9	Insurance as required by franchisor
	UFOC10	Errors and omissions, liability, etc. as specified in operations manual
	UFOC 11	$1M liability
	UFOC 12	$1M in liability, with franchisor as additional insured
	UFOC 13	$1M in liability coverage, zor additional insured

o. Advertising

Covered in Item 3 of UFOC.

p. Indemnification

q. Owner's Participation/management/ staffing

Participation is covered in Item 15 of UFOC.

r. Record and Reports

Financial Reporting	UFOC 1	Weekly; must provide direct on-line access to zor; monthly income; annual income statement and balance sheet; audit
	UFOC 2	Zor may poll computer for sales, cost, and other financial or marketing data; monthly reports; audit
	UFOC 3	Monthly sales reports; audit
	UFOC 4	Weekly, may be audited without notice -
	UFOC 5	Quarterly financial statements; audit
	UFOC 6	Quarterly financial statements; audit
	UFOC 7	Annual financial statements; weekly register reports
	UFOC 8	Submit all financials as specified;
	UFOC 9	Must submit gross revenues and sales tax reports monthly, must verify and sign each financial report
	UFOC 10	Access during normal working hours, furnish tax return, may require use of modem.
	UFOC 11	Weekly marketing report; bi-weekly financial report with payment of fees; tax returns as requested;
	UFOC 12	Weekly signed financial statements; must keep records for three years after agreement termination
	UFOC 13	Signed weekly sales report; quarterly p&l; annual p&l and balance sheet; all daily records; tax returns

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s. Inspections and audits

Monitoring/ Control	UFOC 1	Interview customers, inspect books, inventory, equipment, supplies, during business hours without notification
	UFOC 2	Right to use 'test customers' or communicate with franchisee's customers without prior notification
	UFOC 3	Periodic quality inspections
	UFOC 4	May be inspected any time during hours of operation
	UFOC 5	During working hours
	UFOC 6	During working hours
	UFOC 7	At any reasonable time
	UFOC 8	Right to enter business anytime during working hours; right to observe
	UFOC 9	Right to enter and inspect any time during business hours; observe operations
	UFOC 10	Right during normal working hours
	UFOC 11	Right to audit, franchisee pay expenses
	UFOC 12	Franchisor has free and full access; inspection during working hours
	UFOC 13	Full and free access with 48 hr. notice to all books and records.

t. Transfer

Transfer is covered in item 17 of UFOC.

u. Renewal

Renewal terms and fees are covered in Item 17 of the UFOC.

v. Post-Termination obligations

Non-competition both during the term of the agreement and after the terms of agreement ends is covered in Item 17 of the UFOC.

w. Non-competition covenants

Non-competition both during the term of the agreement and after the terms of agreement ends is covered in Item 17 of the UFOC.

x. Dispute Resolution

Dispute resolution is covered in Item 17 of UFOC.

y. Other

Appendix E

Table E1

☐

☐FranchiseDocs

☐Franchise Select

☐Research FAQs

You have selected a snapshot for the following system:

Contact:	McDonald's Corporation dba McDonald's One McDonald's Plaza Oak Brook, IL 60521 630-623-3000
Description:	Franchise which operates a quick service restaurant offering a limited menu of value-priced foods using the McDonald's System.
Corporate Information:	Date Founded: 1955 Date Franchised: 1955 Parent Company:
Legal Agreements:	The franchisor may require you to sign the following agreement(s) as part of the franchise purchase: ACH Agreement Franchise Agreement Operator's Land Lease Operator's Lease Preliminary Agreement Promissory Note Security Agreement
Programs Offered:	In addition to its original concept, the franchisor also offers the following other program(s) for becoming a Franchisee in this system:

None

Business Types:	In addition to its standard program, the franchisor also offers the following other program(s) for becoming a Franchisee in this system: None
System Size:	The franchisor has 10732 operational domestic franchised location(s) and 1850 company-owned locations.
Initial Payments:	Initial Fee: A flat fee of $45000.00 per franchise. Payment Terms: Payment is to made in full when the franchise agreement is signed. Development Programs: No development programs are discussed in the offering circular. Reduction for Multiple Units? There is no reduction in Initial Fee for multiple franchise purchases.
Initial Investment:	The following minimum and maximum cost items are based on estimates provided by the franchisor. The actual amount may be determined by cost of living standards in your area. Higher costs of living usually relate to higher start-up costs.

Cost	*Minimum*	*Maximum*
Additional funds	$0.00	$25000.00
Initial franchise fee	$45000.00	$45000.00
Equipment	$50000.00	$175000.00
Travel & living expenses while	$2800.00	$8500.00
Initial inventory	$4000.00	$22000.00
Other working capital/miscellaneous	$18000.00	$33000.00
Total Excluding Real Estate	$119800.00	$308500.00
Rent	$3000.00	$97050.00

Total Including Real Estate	$591800.00	$1073550.00

Royalties: Not Available.

Advertising: The franchisor indicates in its offering circular that the following advertising expenditures may be required of the franchisee in addition to any independent promotion of the franchisee's Business:

National Advertising	4% of gross sales or revenues

Exclusive Territory Offered? No, territory limited to store

Term/Renewal: The initial term of the franchise agreement is 20 year(s).

The renewal term of the franchise agreement is 20 year(s). The number of renewals allowed are not disclosed.

Transfer:

Financing: Standard financing is offered for Initial Franchise Fee. The financing is available through the franchisor.

Search for a company:

Appendix F

BOND'S FRANCHISE GUIDE

FRANCHISOR QUESTIONNAIRE

If you wish to receive an autoconfirmation of your submission by E-Mail, please be sure to fill in the "E-Mail" field.

Franchise Trade Name:

Address:

City:

State:

Zip:

Country:

(800) Phone:

Local Phone:

Fax:

E-Mail:

Internet Address:

Contact:

Position:

President/CEO:

Title:

5. Description of Business: (Use the full space available to set yourself apart from other franchising opportunities, i.e. sell your system to the potential franchisee.)

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6. Company was founded in: [ ].

First year as franchisor was: [ ].

7. Actual number of Franchised Units as of [ ]: [ ] Units.

8. Actual number of Company-Owned Units as of [ ]: [ ] Units.

Total Operating Units as of [ ]: [ ] Units.

9. Of Total Operating Units listed above, [ ] were in the U.S.

[ ] were in Canada.

[ ] were in Overseas.

10. Of the Total Operating Units listed above, in how many States/Provinces did you have operating units?

[ ] Number of U.S. States

[ ] Number of Canadian Provinces

[ ] Number of Foreign Countries

What 3 States/Provinces had the largest number of operating units?

B) Top 3 States/Provinces	# Units in Each of B)
1. [ ]	[ ]
2. [ ]	[ ]
3. [ ]	[ ]

11. How many New Units do you plan to open in the next 12 months? [ ] Units.

12. Do you provide potential franchisees with an Earnings Claim

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Statement? ☐ Yes ☐ No

13. What is the minimum net worth required of the franchisee? $ ☐

14. Even though the cash investment may vary substantially by individual unit, what is the range of equity capital (up-front cash) required? $ ☐

15. What is the range of total investment required? $ ☐

16. How much is the initial franchise fee for a new franchisee? $ ☐

17. How much is the on-going royalty fee? ☐ % or ☐

18. How much is the on-going advertising fee? ☐ % or ☐

19. The following States/Province require a separate registration (or disclosure, indicated by an *) document. In which are you currently registered to franchise?

☐ All Below or	☐ IN	☐ ND	☐ WA
☐ CA	☐ MD	☐ OR*	☐ WI
☐ FL*	☐ MI*	☐ RI	☐ DC
☐ HI	☐ MN	☐ SD	
☐ IL	☐ NY	☐ VA	☐ Alberta

20. What is the term of the original franchise agreement? ☐ Years

21. What is the term of the renewal period? ☐ Years

22. Do you have Area Development Agreements? ☐ Yes ☐ No; If Yes for what period? ☐ Years

23. Do you have Sub-Franchisor Contracts covering specified territories? ☐ Yes ☐ No

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24. Can the franchisee establish additional outlets within his area? ☐ Yes ☐ No

25. Is passive ownership of the initial unit ☐ Allowed ☐ Allowed, But Discouraged ☐ Not Allowed

26. Do you encourage conversions? ☐ Yes ☐ No ☐ Not Applicable

27. Is financial assistance available? ☐ Yes ☐ No ☐ Not Applicable; If yes, ☐ Direct or ☐ Indirect

28. Do you assist the franchisee in site selection? ☐ Yes ☐ No ☐ Not Applicable

29. What square footage and types of sites do most of your franchise units require? ______ SF

☐ Free-Standing Building ☐ Storefront ☐ Strip Center ☐ Regional Mall

☐ Home-Based ☐ Other ______ ☐ Not Applicable

30. Do you assist the franchisee in lease negotiations? ☐ Yes ☐ No ☐ Not Applicable

31. Do you participate in co-operative advertising? ☐ Yes ☐ No ☐ Not Applicable

32. Including the owner/operator, how many employees are recommended to properly staff the average franchised unit? ______ Full-Time ______ Part-Time

33. How many full-time, paid personnel are currently on your corporate staff? ______

34. In qualifying a potential franchisee, please rank the following criteria from 1 (Unimportant) to 5 (Very Important):

Appendix F

	Unimportant				Very Important
Financial Net Worth	☐ 1	☐ 2	☐ 3	☐ 4	☐ 5
General Business Experience	☐ 1	☐ 2	☐ 3	☐ 4	☐ 5
Specific Industry Experience	☐ 1	☐ 2	☐ 3	☐ 4	☐ 5
Formal Education	☐ 1	☐ 2	☐ 3	☐ 4	☐ 5
Psychological Profile	☐ 1	☐ 2	☐ 3	☐ 4	☐ 5
Personal Interview(s)	☐ 1	☐ 2	☐ 3	☐ 4	☐ 5

35. What are the location and duration of any initial training sessions included in the franchise fee?

	Location	**Duration**
A.		
B.		
C.		

36. Which of the following on-going services do you provide to the franchisee?

Service	Included in Fees		At Additional Cost		N.A.
Central Data Processing	A.	☐	a.	☐	☐
Central Purchasing	B.	☐	b.	☐	☐
Field Operations Evaluation	C.	☐	c.	☐	☐
Field Training	D.	☐	d.	☐	☐
Initial Store Opening	E.	☐	e.	☐	☐
Inventory Control	F.	☐	f.	☐	☐
Franchisee Newsletter	G.	☐	g.	☐	☐
Regional or National Meetings	H.	☐	h.	☐	☐
800 Telephone Hotline	I.	☐	i.	☐	☐

37. Does your system have a franchise association? ☐ Yes ☐ No

If Yes, are you a member? ☐ Yes ☐ No

38. In which specific regions of the U.S. are you actively seeking new franchisees? For example: All U.S., or NW & SW, or NJ Only.

39. Are you actively seeking franchisees in Canada? ☐ Yes ☐ No

If Yes, in which Provinces? ☐ All or:

40. Are you actively seeking franchisees Overseas? ☐ Yes ☐ No

If Yes, in which countries?

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APPENDIX G

Franchise Owner A: Evelyn

Q. Please tell me how long you have owned the Muzak franchise about the selection process you used in choosing this franchise.

A. We have owned this franchise for 17 years, having purchased it in 1984. Frankly, we were not looking for a franchise. We were not necessarily even looking for business. My husband was vice-president of Westinghouse Broadcasting at the time, and Westinghouse Broadcasting bought a little company called Telecom, a cable company. Part of that purchase was a little company called Muzak. It just happened to be owned by Telecom. When they got it, it was in pretty bad shape. It had very weak management at the time, and the president of Westinghouse Broadcasting went to my husband and asked him to go over there and fix it. My husband said I don't know anything about Muzak, I'm in broadcasting. Well, the president said to have two choices: you can go fix it or you can go find another job. And so, we started going to their conferences and started meeting people and started to see their style of life, and what the business was all about, and we decided that we were on the wrong end of the business. And that's what interested us in Muzak. And so, we put the word out that if one of these comes up for sale that we would be interested in purchasing it. You have to understand that Muzak was 65 years old, was the first franchise ever, and it's geographically exclusive. The whole world was divided up in the beginning. So it's not like McDonald's, where you have one on every three corners. All the territories were already given out, so the only way to get into the franchise community was to be the son or daughter of the existing owner, or to buy one from somebody. It was different then than it is now, in those days they were very, very infrequently up for sale. And somebody one day called us and said that Charleston South Carolina was up for sale. We asked where is that?

Q. At the time, where were you living?

A. I was living in Raleigh North Carolina, and my husband was commuting from New York. We had a commuter marriage. So, we came down to Charleston. We looked at Charleston, and we looked at the business. We said this was great.

Q. So you did not evaluate any other franchises before choosing this Muzak franchise.

A. There were no other Muzak franchises to buy.

Q. Did you look at other franchises other than Muzak?

A. No. That really was not our vision. Buck [husband] had always worked for large corporations, and I had been consulting with small groups ... private, not-for-profit. We weren't specifically looking to own a business. But, we knew that we did not want to work for someone else forever.

Q. Do you remember if you got a UFOC and franchise agreement to review prior to buying the Muzak franchise?

A. Yes. What we had to do was this. Muzak has the right in their contract to accept or reject anybody who wants to buy a franchise. They didn't have to give us a contract. I remember seeing the Muzak contract, and I think the contract came with the UFOC, and the other documents, which was about 90 million pages. I frankly, if you want to know the honest to God's truth, I don't think we ever even read it. We read the contract, and we sat down with other franchisees, and asked is there any room to do anything within this contract one way or the other. They said no ... it's a take-it-or-leave-it contract. You read it, you review it, and that's the end. And that was it. By the time we bought the business ... it had probably been about two and a half years ... we had met a lot of people around the business, had very good friends in the business ... including other franchisees. The franchisees had told us what the business was like. What the corporate was like. At that time there is a good deal of chaffing between franchisees and the franchisor. And we were at that time kind of the good guys in the corporation ... so we learned a great deal about the business ... from both sides of the street. Maybe, we were too stupid or too green to know any better.

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Q. Most of your information came from franchisees?

A. Absolutely.

Q. Having been in this business for 17 years, tell me what role these documents [the UFOC and franchise agreement] play in the daily operation of your business?

A. The UFOC really plays no role. At one time we got into a big battle with corporate ... we meaning all the franchisees ... and we essentially learned that we have no protection under those documents. It did not do a thing for us. We learned that there is very little in the way of laws that protect franchisees, at all. You are kind of hung out there on your own, whatever you signed. The contracts themselves had been pretty well written. The franchise has a group, a trade association, who hired an attorney. This attorney has been with them for years. Before becoming the trade association's attorney, he was the corporation's attorney. So he also knows both sides of the street. He was the one that did most of the negotiating for us...he really did a very good job for us, on behalf of the whole franchise community.

Q. So if you had a problem with the UFOC or franchise agreement, you would likely go to the trade association attorney?

A. We would likely go to him first, for advice. He knows both sides, and he knew what he wrote when he wrote the documents. Yes, if there was any issue with the documentation, he is the one I would go to.

Q. When most people think of entrepreneurship, they think of creativity, innovation, and the like. On the one hand, the contract cannot cover all contingencies, which creates some 'holes' or gaps. As markets and competition changes, there may be empty spots. On the other hand, the detailed documents may create a culture of just following the rules, do what you're supposed to do. Are you aware of any 'holes' or gaps in the agreement that either you or someone else identified where you can use your own discretion? Or is your agreement rather loose, in that you are allowed to exercise your own judgment and discretion?

A. I think that our agreement is far less stringent than most franchise agreements. I say this because at one time...when our agreement was up for renewal...they [the corporation] brought in a franchise lawyer, who tried to make our agreement more like a McDonald's agreement. We all just sat there and laughed at it. We told them to go back to the drawing board, and give us something we can look at. Nobody would put up with that. It was nonsense. There are two things about this. There are O and O's, owned and operated, or franchises that the corporation owns, and then there are those of us that are the IA's, or independent affiliates. We are supposed to function the same. We don't...because they get all kinds of things from corporate that we don't get. On the other side of it, we as independent affiliates are not precluded from doing anything else...other than selling a direct competitor's product. I may not sell somebody else's music in this territory. I can sell somebody else's music in another territory. There is a gentleman's agreement among the franchisees that we don't do that...it is just not done.

Q. So, within your territory, you are not prohibited from being involved with other businesses.

A. Correct. And we do have other businesses. We started off being the Muzak franchise, and did not do anything else. We now do just about anything that involves sound or video.

Q. And that was your initiative...identifying the market needs, and acting upon it.

A. Two things happened. One, we identified the market needs, and two, we identified the skills that we had in the firm. Being a family franchise makes it a little more colorful. I have two engineers in the family, and I have a sales person in the family. With two engineers, one of whom is a PE, we are open to do a whole lot of things that other Muzak franchisees could not do, unless they went out and hired somebody.

Q. And Muzak receives no credit or royalties on this aspect of your business?

A. No. Absolutely not. We have another entire company that acts as a distributor of other products. And we do business in education and healthcare, lines that Muzak has nothing to do with. We do cross sell…if I have a hospital that I sell Dukane equipment to, I will try to sell them the Muzak as well. Muzak will get a piece of the music sale, but not the other. On the other side of that, we do sound systems and music systems. And because of the way that the franchise contract is put together, if I go to a store and put in a sound system, and I lease those things to them along with the Muzak, the corporation has a right to get a royalty on the whole thing. If you can explain that to me, I'd be thrilled. The copyright people have a right not just to the percentage of the royalties for the music they represent, but to any income I receive based on the fact that I have music in that place. So it's a huge chunk that goes out every month.

Q. So you have a lot of discretion in your franchise.

A. I have a lot of discretion over those things…I have no discretion over the kind of music that is played. That's all programmed and sent out. I have to use the music reception equipment that they tell me to use. As far as the speakers and amplifiers and the kind of wiring I use…its up to me.

Q. Because you've decided to branch out and customize your business, it appears that discretion and the ability to adapt is important to you.

A. You bet.

Q. So, do you think you would be happy in a McDonald's franchise?

A. No. That would make me crazy.

Q. Tell me about the times that you had identified opportunities, and acted upon them, other than the formation of the other business. Was there a time when you really wanted to do something, but felt that it would be in violation of your agreement?

A. There are products that the corporation sells…I could get equally good if not better products at a lower price…but I'm not permitted to do it. Advertising on-hold is an example. It's a big product for Muzak, and they charge us a lot of money for it. There are other providers who do a good job, but we are not allowed to use them. Those were not originally in the agreement. But with each contract revision or renewal, they are bringing in more products. It's not really a constraint, because we agreed to it, but indirectly it is. In general, where a product is named Muzak, we are prohibited from using something else.

Q. And these kinds of things were not in the original agreement?

A. The original agreement only dealt with the music product. We were obliged to use that music product. Then over the years, the means of delivering that music product came up. And in order to use those means, there had to be separate agreements, some with third parties.

Q. So, the corporation would come to you…

A. Right, they would come to us and say because of this change, we want an amendment. And the trade association acted as negotiator in these things. They almost act as a union for us. So instead of the individual franchisee fighting battles one at a time, we fight them as a group. We have the attorney that represents us, and it is a very strong group. It has become less strong over the years, because corporate has been buying up the franchises.

Q. So the number of independent affiliates is going down?

A. Yes. Where we used to be 80% of the total market, we are now about 40%.

Q. Are you saying that the distribution of territories within Muzak that used to be 80% franchisees and 20% corporate, is now 40% franchisees and 60% corporate?

A. Right. And corporate is trying to buy more of them up. There are some large franchisees who own several territories who are not about to sell. They [corporate] have to come to us if there is anything outside that contract, that they want to enter into, that would make us follow whatever side agreement they're considering.

Q. So, what you are saying is that if a new technology, product, or service that corporate wanted to become involved with, they would send you a contract addendum that would become part of your agreement.

A. And in some cases they have permitted us to become part of the negotiating wing with the third party, so that we have some say in how the contract is written with a third party, because it very much affects us. We had a group that came to us who was involved with sending in advertising to grocery stores. A third party came in and said we will be your arm to go out and sell advertising. We will do all the negotiating between the grocer and the other vendors and you supply the equipment and the speakers and everything through which we play it, and we'll give you a percentage of it. You just give us the right to play through your equipment. We'll get the large majority of it, and we'll get to work with your customers. So there were a lot of things at stake there...we did not want them dealing with all of our clients, but it looked as though there would be some good revenue in there for us. We were brought into that negotiation with the parent company and the third party. That would require an additional contract to make that a part of the Muzak contract.

Q. So the contract with Muzak has changed over its term.

A. They are all 10 year contracts. And during those ten years, there may be umpteen things that change and become side amendments. Once the amendments are signed, they are part and parcel of the contract. What's happened in some cases is that there are one or two affiliates who say no...I don't like that...I'm not going to sign it. There is not a damned thing anyone can do about it, and it holds everybody up. Unless the corporate people can negotiate something with those people, it can hold everybody up.

Q. It is either all or none?

A. It is all or none. They have no right to say majority rules, and fortunately, our contract states that. I don't think that most franchise contracts are like that. But ours is. I think the majority of them are just dictated to. Well, this is not. In fact, this is one reason why corporate is buying up franchises. They feel that their hands are tied, somewhat, in some of their negotiations with national contracts, because they cannot sign one without us. They cannot go into a national agreement without our OK...where they are competing with people who can...dealerships, not franchises. And there is a huge difference.

Q. Keeping it focused just on the Muzak franchise portion of your business, do you see competitive pressures in the marketplace?

A. There have always been competitors who nipped on our heels. A lot of the competition has been led by the technology. In the past, at the very beginning, Muzak was the only company who had the technology down pat to do this. And then there were tape companies who offered foreground music to compete with the background or elevator music. And that brought us into the tape business, following them. And then came satellites. With the advent of satellites, we have had much more competition than we had before, because it is no longer limited by geography. You can be anyone, anywhere...put a satellite dish in, and you've got it. There is a huge difference between the competitors that we have...the big difference between us and them is that they haven't figured out that we are not in the music business...we're in the service business. They don't have local representation, they don't have anyone who will respond to a problem. With the kind of customers that we have, customer response is huge. It's a big part of what we do. We've been able to keep people out, get them out, and get customers back, because when a restaurant with a music system has the music go out on a Saturday night for some reason, they do not want to wait two weeks for someone to come from three states away, which is what the competitors provide.

Q. Are your competitors primarily dealers?

A. They're dealers. We are the only franchised business in this type of business.

Q. One of the advantages of franchising mentioned in a variety of publications is the local implementation of a proprietary product or service. What you're saying is that in your business, the franchisee's ownership of the territory and commitment to service the customer functions better than a dealership arrangement, right?

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A. Absolutely. For several reasons. Number one, with a dealership, the vendor can pull its product tomorrow morning. If he decides that you are not representing him well, you're out of there. Our franchise agreement gives me ten years to fix it. That's pretty huge. And a dealer really has little control of his product line. Although he may have more leeway to go to other competitive products, he can lose them in a heartbeat. And I don't think he has the brotherhood or sisterhood that we have in our franchise community. And that is huge. That has been a major reason why we were successful, especially at the beginning. Since we are geographically exclusive, we are not competing with our other franchisees. We're able to pick up the telephone and ask we're having this problem, how did you fix this or what did you do. They [other franchisees] are all for helping you...they want you to be successful in the b usiness. Its really helpful to them to have another successful franchisee in another area. I can without hesitation say to a customer that I can cover them in any city, I can promise you that you can get service in any city. I can call up another franchisee, tell them that I sold a contract, ask them when they can get it done, and have it handled.

Q. So there is no competition among franchisees?

A. Right. I can't sell in their territory, and they can't sell in mine. I can sell an account for their territory, but I have to give it to them.

Q. So there is no financial gain to be made at another's expense.

A. And we've trained each other. Our franchisor does not give us much of anything. We don't get advertising free, we don't get training free...all that is something that we have to accomplish through our trade association. So, we train each other. And I don't think that happens in a dealership.

Q. Do you feel that you have the ability to exercise discretion over pricing and terms?
A. Yes, and it causes problems sometimes. I have a customer that I have provided Christmas music to for the past three years. My neighboring franchisee a few states away was selling it for a quarter of the price. My customer has a contract with me, and pay it every year. My client found out what the others were offered and called up to ask why. We said, OOPS...billing error. So it can go either way. Corporate cannot tell us what to charge, in some ways it is good, and in some ways it is bad, because we cannot tell them [corporate] what to charge either. When they do a national deal, they sometimes give away the store...they get 3,000 units and I only get 1/3000 of the deal. So, I am losing money on the one store, because I am forced to go along with their national deal. The good news is that I would not have gotten the account on my own. I cannot go out and make a deal with a chain like The Gap. They [The Gap] only makes national deals, so the fact that Muzak went in and made the deal with the Gap is wonderful for me...the sad part is, I only get $10 a month for it. I cannot start my truck for $10, literally. What I do get for it is tat I am able to walk into my clients "We do the Gap, we do etc." That alone is impressive. We do a lot of selling on that...we don't make a lot of money on it [The Gap].

Q. Would you say that your business would change significantly if, for some reason, the franchise arrangement was structured such that you did not have an exclusive territory?

A. Oh yes. I would have people marching through here every day selling Muzak. I would then have to kill people (laughing). In fact, its very interesting. One of those side agreements is with Echo Star, the DISH Network. Because we use part of their satellites. And they have dealers as well as us folks, and their dealers are allowed to go into commercial locations and sell our products. Which is the first time we ever committed to anything like that. It was a horrible deal. But we are supposed to get an override for any dealer of theirs that goes into one of our territories and sells our products. The problem is, there is no way to enforce that. We're not allowed in their books...we have no way of knowing, unless we see a dish sitting on someone's roof. So when you were saying would it be a problem, it already is a small problem. But very few of them sell commercial, most sell residential.

Q. But if Echo Star decided to sell commercial, which is a decision out of your control and the control of Muzak...

A. Yes, they could do that tomorrow morning. That would be big.

APPENDIX H

Franchise Owner B: Sue

Q. Tell me a little bit about your decision to purchase a franchise.

A. Before I bought the franchise, I worked with my husband, Steve, at the Entrepreneur's Source. My role there was calling total strangers, and my goal was to get an appointment for a meeting or a phone meeting with Steve. Once I got that, it was over for me...I no longer had any contact with that person.

Q. It was prospecting for clients?

A. Yes, but the people I called were leads given to me. There were no cold calls. They were people who had shown an interest in the service either over the internet or through corporate. I contacted them, told them the basics of the process, and would try to set up a meeting with him [Steve]. Once that meeting was set up, I was finished with that person. Typically, I would try to call a person, leave messages...keep track of when I called them, how many days between calls. I did this for a while, and to be honest, it wasn't very exciting. I needed to do more than just that set up. Steve said, "how about coming in and doing kind of what I do too?" But, I just didn't see that for me. So I started thinking about it...here we are working with different businesses, and I'm reading about some of them, and it got me kind of interested in the idea of owning a business.

Q. So, working with prospective franchisees got you interested in becoming one?

A. Yes, because I would hear Steve's stories, and I would read about the businesses that he was showing people, and they sounded interesting. So, I thought... what about me? And really, the business that I bought kind of fell in my lap. A friend of mine owned it for two and a half years. Our daughters were gymnasts together, and we were sitting at a gymnastics meet, talking about it. The more we talked about it, the more I thought, well, maybe I could do this. So, I went with her on a couple of sales calls, and got interested. He [Steve] was not so sure about Entrepreneur's Source...I wasn't too sure about my role in the business, so I thought, well, maybe this is something I should look into. So I went to him [Steve] and said "Look at this." So he did the due diligence thing for me, and explained it to me and discussed it with me, and explained how he understood it would run. I called corporate, and they sent the UFOC. Steve looked at the UFOC and did all that kind of work for me... I talked to corporate. Ours [franchises] are sold by zip codes, and the population within those zip codes. My friend had bought it two and one half years ago as a single territory, but it had grown to more than a double territory, so at the time I did spend more than what she had. I spent like a double territory, but it seemed fair, and we ran the price by corporate. I don't think they [corporate] could say "You must sell it for this price" because they never did that. They just listened, and said its OK...they learned a little bit about me...we had to pay a little transfer fee, but that was essentially it.

Q. So, you purchased an existing franchise.

A. Yes. She had run it for about two and a half years, after purchasing it from a man who had it for nine months.

Q. Had she grown the business during that time?

A. She had grown some, but the population had grown.

Q. And because the fees were based on population, you had to pay a little more for the market opportunity.

A. Yes. My friend was asking a little more...corporate never said anything. That was her price, based on what she had paid and what they [the franchises] were going for and the size it [the territory] had grown to. That's how she got her price. The territory had grown to be the size of two territories, based on the number of households.

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Q. So the zip code structure remained the same, but the number of households doubled.

A. Right, but as a zip code branched off (a single zip code geography was split into two codes) you inherit the other zip codes. I inherited a new zip code on Daniel Island.

Q. Did you evaluate some other franchises?

A. No. I mean I had looked. I had a couple of ideas, and say "Hmmm…maybe I should look at that." And he [Steve] would say "No, I don't think that one is right." So I really, truly did not look at any other one beside this.

Q. What was it about this one [franchise] that appealed to you the most?

A. Flexibility. Being a mom is first, and I needed something that would let me work from home. I could see that I decided when I would see customers. I set my own schedule.

Q. Was the potential to make money part of your consideration?

A. Part of it. I'm not really a person driven by money…I mean I am a little bit…but I'm not really focused on it. But the thing that really drove me was the flexibility. I could still pick my youngest up from school, and still do the 'mom things' that were important to me.

Q. You told me that Steve helped you with the UFOC review process. Do you know of any or have you discussed any other potential business opportunities that are not expressly prohibited by your agreement, to offer some other products or services to your customers?

A. The only thing we thought of was the [window] film. You mean related to the blinds business?

Q. Yes, or other things that your customers might need.

A. I have not approached that as of yet.

Q. Is that your choice?

A. Yes, and if I were to think of the rest of the company, nobody really does. We're very focused on windows. [Steve speaking] I think that the company has been very successful at doing just that. But the opportunity is certainly there to do other things. And we've talked a little bit about it, but have not really pursued it.

Q. One of the most noted benefits of franchising is realized in the economies of scale that a franchisor can bring through their negotiations with suppliers. Do you believe that you can buy products [from your franchisor] at a substantially lower price?

A. I should be able to, but just today I saw where some of these independent businesses are now manufacturing their own products, cutting their costs. I don't know if I'm going to get a job from a woman I just saw yesterday because of that very concept. We have great prices, but it is still hard to compete with somebody, an individual who has maybe two shops and they manufacture their own [product]. They get the parts, and they put them together themselves. They cut out the labor in the middle, and are able to offer products at a lower price. She [the customer] quoted me their prices, and they are lower than mine, or what I would typically sell for. Now, I have total control over what I sell my products for. I can sell them at cost, or even below cost if I wanted to help somebody furnish their house. I can mark it [the products and services] up however I choose. So in this situation…I told her that I would look at the numbers and see what I can do… and I will do that. Whether I will come down to that lower price…I don't think I will.

Q. Your franchisor is paid on sales?

A. Yes, they are paid on gross sales.

Q. So, when you discount, they [the franchisor] realize less?

A. They realize less [royalty fees], but we can sell at a net loss, and they still get their percentage. [Steve talking] They have a sales training program that they require all their franchisees to go through...and they strongly encourage a certain percentage of p rofit...they don't want you selling below that certain percentage profit level. And they train you to go after that or higher. There are mechanisms in place to help people increase their profit levels, which will help increase the royalties, but there is not a requirement to do so.

Q. Do you feel as though there is a conflict between your interests in profits and the franchisor's interests in sales, given the pricing discretion you have?

A. No. The only time I sense a conflict is when I try to tell them [corporate] that price is an issue, and they tell me "no, it isn't." I don't always agree with them. [Steve talking] Sometimes they tell her to go for a 70% profit margin, and if she did so, she would be out of business. Realistic for her...and we've experimented with this...is more in the 50% range.

Q. You are competing in a price conscious market?

A. Very much so.

Q. One of the interesting aspects of your franchise is that it is a fast growing one. They have been adding franchisees quickly. To what do you attribute their success?

A. Part of it has to be they're aggressive...they're after people. One indicator is that we [franchisees] get paid a finder's fee if we bring somebody. It is a good business, too. You know, I knew absolutely nothing about window treatment...I knew nothing. We did what I tell my customers not to do...we went to Lowe's [do-it-yourself store] and put them up. I just knew...own a business, flexibility, work from home.

Q. So, the product didn't affect your decision?

A. No. I thought...it could be fun. I think if people just look at it, it is a good business. Corporate support is wonderful. The five men that own the business are wonderful guys. And if anybody spent any time talking to them, they'll get that. What I liked about it was "Here's what has worked in the past...and we can follow it." It was a guideline, and I needed that. I'm not the entrepreneurial type that can just go and make it for themselves. To follow a system was something I needed. I think if somebody wants that kind of system, this is a good one...and they'll see it.

Q. [Question directed at Steve] In your evaluation of the UFOC, and because of your experience in evaluation hundreds of franchise documents, would you say that this one is a 'loose' one or does the franchisor have this one pretty tight?

A. [Steve] I think that its pretty loose.

Q. Are you restricted in the products that you sell?

A. I can buy from anyone. I can offer products from any vendor. [Steve] It's a bit surprising, because technically, we could go find a local vendor, never report it in our royalty report, and they would never know. Now, they know what we buy from their vendors, and the company that they formed to manufacture the blinds. I'm sure that they get a report from them, and match the royalties with the orders. But we could buy from...and we've done it...from those guys in Charlotte [North Carolina]...and because we're honest folks, we reported on our royalty report. They [corporate] would have no idea that we're buying from United Supply. [Sue] And other things. They want you to have this big, white van painted with Budget Blinds [company name], and I just have not been able to afford one yet. So, I don't have it. If they ask me, of course I'll tell them that I don't have one yet. But they're not going to say "well, then you cannot be a franchisee."

Q. But, it states in the UFOC that you must have this van.

A. Yes. [Steve] The UFOC states you will purchase a white van, has all the dimensions, specs, and everything.

Q. Did the previous owner have one [a van]?

A. No. But even Tony [one of the franchisor owners] said to me at training when I told him "I don't think I can afford this yet"...he said, "well, how often do we get to South Carolina?" We [the franchisor] don't see it...and they never ask me about it when I'm on the phone with them.

Q. How are royalties paid?

A. We send them a check every month. [Steve] Every month we do a royalty report, its all computerized...you list customers, sales, profit margins.

Q. So, in addition to sales, the franchisor knows your profit margins?

A. Yes.

Q. Does this franchise disclose earnings in Item 19 of the UFOC?

A. [Steve] No. What they have is the profit margin on the product...they do not know what your operational costs are, your overhead, and all the other costs. They [the franchisor] does not really know if you are a profitable business.

Q. Are all of the businesses home-based, operated out of vans, or are there some retail locations?

A. A few have a small retail location, most folks have a small home office and a van. Some of the more successful ones have a small office and several sales people with vans. [Steve] When Sue brought this to me and said let's look at this, one of the things that really attracted me to it was that there was a wide variety of people in this business. From the owner-operator...the one man show...where one person does everything from marketing to sales, to installation and administration...and there are other franchisees that have a whole operation. They've hired employees to do sales, they've hired others to do the installations, and they [the franchisee] run the business. Its kind of like you can bootstrap yourself up. Which is kind of the plan that Sue and I talked about. We'll take this thing on, and we'll bootstrap ourselves up. We will grow it into a business that allows us what we're looking for in a business...that sophistication that I didn't have a few years ago, I've got now. And this is the vehicle that we'll use to get there.

Q. Do they have area directors in your franchise?

A. No. But, they just started with...because they have so many franchises around the country...they have divided the country into regions...with a regional guy...that if you have a problem or a question, call the regional guy. And those regional guys will meet with corporate.

Q. Does your franchise have company-owned outlets or are they all franchised?

A. Their only company-owned store is in San Diego [the location of the franchisor headquarters].

Q. How big is the franchisor's headquarters operation?

A. There's the five owners...but then there's a couple office people, some training people, and someone who all he does is try to sell franchises...I think there are a couple of those now. I would say, no more than 15 employees. [Steve] I think it's a little unusual that they have five owners, including twin brothers.

APPENDIX H

Q. What do you think is the major reason for their success?

A. [Steve] I would say that it's the personalities of the guys running it. [Sue] They are very, very positive and upbeat...complimentary...how can we help you...they're just so positive, nothing negative. I like that about them. They're hard working and optimistic. I never feel as though they're the super guys up here, and we're the little pee-ons down here. Its not that I'm in contact with them a lot, but I don't feel that way. [Steve] I think that they are really interested in the success of their franchisees, every one of us. This is evidenced by the fact that they don't micro-manage your royalty reports. As long as you're sending in your royalty checks...I think they have a system with parameters that looks at an office that stays open, and they're [the franchisee] is only sending in $500 a month in royalties, something's wrong. They [the franchisee] cannot stay open that long and maintain that low level of sales. So I think they have some parameters. They do have the right...the UFOC states that they have the right to come visit you anytime they want. But interestingly, they also say that if you want them [corporate] to come visit and make an evaluation of your business, they will fly in and do it for free. They will spend time with you...and say here's the things that we think will help you with your business. [Sue] Yes, they will follow you for several days...I think that you may have to have a certain sales level....a minimal criteria. And they'll give you some pointers.

Q. On the one hand, you said that the franchisor is upbeat, positive, reinforcing and supportive. Yet, when you look at the UFOC, there are some pretty draconian terms in there...you must do this, you shall do this, etc. When you approached this franchisor with questions about the UFOC, how were your questions handled.

A. [Steve] Sue actually talked to them, I gave her a bunch of questions to ask. She asked Tony, one of the owners a question, and he said..."You know, I don't know the answer to that...I'm the owner of the company, and I don't know. I'll have to get back to you on that. I'll have to find out." And he did. But to me it was an indication...these aren't guys that are just going by the UFOC...it was an indication that these are guys who are going to do right by their franchisees. They are not sitting there with their UFOCs, stating "Wait a minute, according to the document, you're supposed to have a white van...you're not doing it...so we're going to shut you down." [Sue] They're real people. And they are truly interested in us succeeding. And they have their ideas on what we need to do. Now Tony and I butt heads a little there, because I don't want to do one of the things that he wants me to do, and I've told him that. And I think it probably annoys him, but only because he feels it is something that will help make me more successful if I do this. So, they [the franchisor] definitely has our interests at heart, definitely.

Q. You've shared a little about your lifestyle and the reasons that you purchased the franchise. Given that, do you feel constrained in any way by the terms of the agreement in any way that affects the daily operation of your business, and in your ability to serve your customers?

A. Absolutely not.

Q. That appears to be in contrast to the literal terms of the UFOC and franchise agreement.

A. [Steve] You have this whole relationship [with the franchisor] that's established over here. And its in sharp, sharp contrast to what you get when you get that UFOC. And when you read through the thing and they're telling you all these specifics.

Q. Where is your UFOC?

A. [Puzzled look, then laughter] [Sue] I think its in your office, Steve. In the drawer.

Q. When was the last time you looked at it?

A. When we bought the business...one year and nine months ago.

Q. Is there a detailed operations manual for your business?

A. Yes. I have the book we got at training.

Q. When was the last time you looked at that?

A. Well, it was about four weeks ago, because when I brought on my new sales associate, I wanted to give her part of it to read. [Steve] That's been my experience with franchisees as well with the operations manual. Initially, they use it quite a bit. When we first opened the business, we were using it all the time. After a while, it went on the shelf. We've now entered the new phase of us bootstrapping ourselves up...we've hired the salesperson. And so we asked ourselves...OK, what do we do? So, we pulled out the manual, and kind of went through it. [Sue] And I called Tony [franchisor]. So we got all this input on the steps we should take, to bring this person on, and help to make them and us successful.

Q. Did the guidance include how to provide incentives for the person?

A. Yes.

Q. Did you get helpful information at training?

A. Yes. One of the things was they taught us how to set our office up. [Steve] An entire session on how to set the office up, which was really helpful for Sue. [Sue] I'm not really organized, can't you tell?

Q. At this point in your franchise career, do you think that you made a good decision?

A. Yes. Overall, it has been good for us, and we're glad we did it.

APPENDIX I

Franchise Owner C: Joan

Q. Tell me a little about your decision to purchase a franchise.

A. Well, I was not very involved in the selection process. I'm an education administrator by background. My husband was laid off from his middle management job in the 90s, when everybody was downsizing. So he spent about a year and a half researching...looking around. I went to some franchise fairs with him...but he went to libraries and Small Business Development Centers, and so forth. We looked at things that ranged from Snap-on-Tools to... actually he [husband] looked, really. I thought I was going to continue my career, and advance to a superintendent position, and he would open whatever franchise near where I would be located. One of the franchises that seemed attractive to him was a mobile check-cashing service...I don't even know if that has survived or not. They would take a trailer...an armored car, I guess, to a mill, and cash people's paychecks. I'm not sure what all the ins and outs were of all the safety factors, but that was one of the interests he had. GNC at that time was the top ranked franchise in the country, it has since been near the top. We had an interest in nutrition and supplements for a long time, and had been a customer of GNC for a long time. Their home office is in Pittsburgh [where they lived].

Q. When did this take place?

A. It was the early 1990s. Howard [husband] did his research in 1991 and 1992, we made a decision in 1993, and we opened in 1994. It was a fit in terms of our interests. In the meantime, I was traveling all over the state interviewing...it became a second job, preparing for the interview, while keeping up my current job. I was offered a place in Erie [Pennsylvania], but I didn't like the idea of moving to an area with worse weather than we already had. So that went by the wayside, and I continued to search. Finally, I told Howard that this was the last interview I was going on. If that doesn't work out, how about if I join you in the business, and we choose a place that we'd like to live, with the climate and the amenities that we'd like when we retire. So, that job didn't work out...if it had, I'm not sure...because we kind of liked this idea. And we had been meeting with the franchise director for our section with GNC in Pittsburgh. We asked him they were looking at something in Hilton Head [South Carolina]. He said, as a matter of fact, we are. So we did a time share, and went down, and looked at the store, called back...it was a beautiful site...and he said that two men had just bought that franchise, and it was unavailable. He said, we have demographics and have found an area that we would like to open a store in Mount Pleasant, South Carolina. So we drove up here one day. We couldn't find Wando Crossing [the shopping center in which the store was to be located], and after getting better directions we found it. At that time, the Wal-Mart corridor had not yet been built. The center kind of ended right where we were. I didn't like that idea, but they showed us t he plans of what was to be built, and so on. With more investigation about the area, we decided to do it. We had a family friend who is an attorney look at the franchise agreement. He said, well, you know they are always written to the franchisor's advantage. But this is one of the better ones I've analyzed. And we were total neophytes. My background was in social sciences, and Howard's was in computers, with a business background in accounting. He always worked for big corporations. So we were brand new to this. I think our friends and family had a lot of trepidation about our decision, but I've always thought that if you work hard and learn, you can be successful.

Q. So, you have had the franchise for...

A. It will be eight years in March.

Q. In your franchise selection process, did you get a UFOC from any other franchise other than GNC?

A. I don't think so.

Q. So in Howard's research, he used secondary sources of information, such as Entrepreneur Magazine?

A. Yes.

Q. Having completed the UFOC review at the time of purchase, now that you have been in business for eight years, what role does the document play in the daily operations of your business?

A. Its always in the background, but we were fortunate to be early enough in GNC franchising that we had some rights or some omissions that newer franchisees don't have. Things were added later that did constrict newer franchisees more. Like not being able to negotiate their own leases, the requirement to participate in co-op advertising...those things come to mind.

Q. So, those conditions apply to newer franchisees but do not apply to you?

A. Yes. And I think GNC may have backed off the lease negotiation part, because they are trying to attract new franchisees. Negotiating our own lease is important, because we pay 1 percent less royalty each month.

Q. So GNC charges its franchisees for lease negotiation assistance?

A. Yes.

Q. Do you pay into an advertising fund?

A. Yes, which we were disappointed with at first. Charleston, I guess, was not a big market for them [the franchisor], but they have improved a lot in the last few years...especially with cable television. We also went into a co-op a few years ago. It was very restrictive in terms of the control we would have on what was advertised, and how it was done. We had developed a marketing philosophy early on with the advice of a consultant who continues to work with us, to restrict our advertising to East Cooper [geographic area]. Because otherwise, we were advertising for all the other stores, and most of them were corporate stores.

Q. So you developed a highly targeted campaign to attract just your potential customers?

A. Right. GNC was willing to back down on the national advertising if we used the co-op, and we decided it was not in our best interests. We had a feeling that we were footing the bill...it gets back into that corporate franchise split...that we were paying more than our fair share for it. We think we were right, because they did not institute it [the co-op advertising] without us.

Q. When you were thinking of buying a franchise, did you and Howard discuss non-franchised businesses as well?

A. No. We always thought that we needed the support.

Q. Looking back over the past eight years, do you think you've received it and would continue to get it today if you needed it?

A. Oh, yes. And there are things that we don't request...like the development of new products. And that is particularly important now because of Numico [Royal Numico N.V.]... because they are a researcher and manufacturer...we get products that other companies don't have, because they're proprietary. Numico does put a lot of research, and publishes a lot of statistics behind their products.

Q. So this gives you credibility in the marketplace?

A. Yes.

Q. The Dutch company Numico acquired GNC?

A. Right.

Q. When did the acquisition occur?

A. Probably three or four years ago.

Q. Are you required to buy your products from GNC?

A. We buy most of them, yes. They [franchisor] for a long time were very discouraging about franchisees getting third-party products. They don't seem to complain about that much anymore. We're satisfied with the quality. I have toured the plant in Greenville [South Carolina]. They like doing business in South Carolina...they moved the warehouse from Atlanta [Georgia} to Anderson, South Carolina...and now that it is so close to us, we can get an order overnight.

Q. You can products from anyone?

A. Yes, but I'm not sure how much control we'd have if we started buying too much from others.

Q. So you would perceive that there's a band of tolerance in which you can operate?

A. Yes. Our consultant keeps track of the percentage, and we've always been low enough not to cause a problem.

Q. Do you pay royalties on those third party products?

A. Yes. Everything that goes through the register.

Q. Even if you were to find something all on your own, and be very successful at selling it, you would still have to pay royalties?

A. Yes, and we really can't introduce something without their approval. And that would be part of the agreement. And its for our protection too, being in the field that we're in...if someone were to have an adverse reaction to something. You had asked if we felt that the market wanted something...melatonin when it first came out...other stores had it, and we could have sold bushels...but GNC wanted to do studies on it...and in the long run it was probably good. They wanted to be sure that it was safe, and what dosages it should be. Another thing, more recently, in that category would be the endro...that the athlete's are taking. Part of it is that they [the franchisor] doesn't want to be sued, but GNC being the big guy on the block in the country, we've had settlements with the FTC on what we can do...in labeling and advertising our products. GNC signed these agreements, without admitting any guilt, but it was my understanding was that the dispute was over third-party products labeling, making claims that weren't true. GNC didn't advertise it but we sold it with their labeling. Its at the point now where some companies...especially big companies...will put different labels for GNC. They also will make different formulas, because GNC will not sell products that have certain quantities of things in them...such as caffeine....in the diet and energy and sports nutrition drinks.

Q. Are those products a big part of your business?

A. Vitamins are the biggest. Sports nutrition is typically something that young men will be big consumers of from 16 to 30 or 35, and as that population moves on...vitamins are more for everyone. Other ways we're helped by the franchise is signage...they do marketing studies about the layout of the store.

Q. Do you receive printed materials as well?

APPENDIX I

A. Yes, a lot of it is printed materials, video and audio tapes...

Q. Given the schedule of operation at your store, would you have a difficult time producing these materials yourself?

A. No. They [the franchisor] also have regional consultants...we've had three of them, and one was good.

Q. These are employees of the franchisor who help you?

A. Yes.

Q. In the past year, a new vitamin retailer opened just two miles from you. What impact has this had on your business?

A. This is the first year that we have not grown our revenues, and we don't know if that's a factor or not. We talked to our consultant, when this new store opened. She has a store in North Carolina, and she said that Vitamin World has not had any effect on her store. So, that made us hopeful...but that was a couple years ago. I think we might need to take a fresh look at our market, and what we're doing. You know, we get into a routine, and it might be time for a fresh look.

Q. How do you think GNC and you have responded to things like the popularity of sports drinks? Have they introduced new products, and maybe re-allocated your shelf space?

A. Definitely. We've expanded the area from one section to four. The allocation within sports nutrition has changed, certain companies have come forward with their own advertising, in some cases publishing their own magazines. We trust GNC to study the market and make good suggestions.

Q. Does the franchisor provide a recommended layout for your store.

A. Yes.

Q. Are you required to follow that layout?

A. Pretty much, as best as we can. They do come up with different plans for different types of stores.

Q. Your agreement will soon be up for renewal...

A. Yes, and we've already begun our research on what the process is.

Q. You will likely be required to sign the agreement that the new franchisees currently have.

A. If we renew, yes.

Q. Under the new agreement, there will be some changes. How do you feel about that?

A. Unsettled.

Q. What would you say is your biggest concern?

A. Probably their [the franchisor's] ability to open competing GNC stores nearby.

Q. Do you have an exclusive territory?

A. We have a certain mileage written in to our agreement, and if there's going to be one nearby, we have first right of refusal.

APPENDIX I

Q. If you had to make a decision on a second store today, would you buy it?

A. Probably not, because of our age. My brother's comments on the subject carried a lot of weight with me. He said that you will more than double your worries and won't double your income. We think that we would just be serving a lot of the same customers. The new population centers around here are going to start to look attractive. Now, those people have to come down to our store.

APPENDIX J

Franchise owner D: Steve:

Q. Tell me about the selection process you went through in the purchase of your franchise. Tell me how you went about choosing your franchise, and what role did the UFOC and disclosure documents play in your selection?

A. In terms of how I went about investigating it, the number of franchises I considered was pretty limited. I really only looked at things that I thought I might have an interest in. I looked at an internet provider franchise, I looked at the Entrepreneur's Source, the franchise I eventually purchased, and then I looked at a couple of other franchises that were appealing to me because they required no retail space, that I could operate the business out of my home. The process I went through, as I evaluated franchises, there were two things foremost on my mind. Number one was what kind of earnings could I make running a business like this. And the second thing was what would my role be in a business like this. How much fun would I have. And, if I had to prioritize those two, that was the most important to me. Being someone that has a lot of schooling, and a lot of experience and background in my particular skill, I looked at how could I use those skills to springboard me into business.

Q. The nature of your business at the Entrepreneur's Source was helping other prospective franchisees choose a franchise, was it not?

A. The franchise I chose helped other people identify franchises that would be a good fit for them. Part of what was appealing to me about that was that I knew the struggle I went through looking at opportunities...I felt as though I was shooting in the dark. There were thousands and thousands of opportunities out there and I didn't know how to begin the selection process. There are far too many to take an in-depth look at even a small percentage of them. So when I got hooked up with the Entrepreneur's Source I thought, now here's a system, a system that makes a lot of sense, in terms of how you go about looking at franchises. Going through the selection process myself, I thought, this is a marketable product. I was experiencing the problem that this business would solve.

Q. Tell me what role the UFOC and franchise disclosure documents played in the selection process.

A. Actually, the way I became involved in the company...I was the first franchisee in the company...I actually joined the company before they began franchising. What we actually did is probably illegal from the FTC's point. They set me up as a "provider"...there was a two-page contract that I signed, basically a non-compete clause. The thing that made it illegal, in retrospect, is that they made me put up a $25,000 performance deposit. I put up the deposit, with the understanding that as I made placements, I would get that money back in $5,000 increments. That's how I entered the company. However, within three months from when I started, they were ready to launch the franchise. This was, I think, an interim way to bring me on-board, and not to lose me as a franchisee. Three months after I came on board I had the option to either come on as a franchisee or to continue under the performance agreement. At that time, I got a UFOC, and I evaluated it, and decided to come on as a franchisee.

Q. Part of your role as a franchisee of the Entrepreneur's Source was helping prospective franchisees review UFOCs. In your experience with them, how do prospective franchisees approach the UFOC review?

A. They're very intimidating. I would say that the majority of people I worked with never read the UFOC. I know that from questions they would ask me, or questions about the terms that I would ask them. Generally, I would say that 90% or more never read it.

Q. What role did the UFOC and franchise agreement play in your daily business operations?

A. In terms of running my business, very little. In fact, I can remember telling my clients " you want to have your attorney review it, you want to read it, and make sure that you understand everything that's in there. But once you operate your business, its going to go into the drawer and stay there unless there is a problem. And if there's a problem, that's when it comes out. So, make sure you know about everything that's in there. And that was my experience as well. I had an attorney look at it and he suggested some minor changes…after I signed that UFOC it went into the drawer and I never saw it again until I decided to exit the franchise. Then I said "OK let me pull it out and see what I'm supposed to do." Literally, I never saw it again. In fact, I had trouble finding it.

Q. Given your experience, do you think that what you described is typical?

A. I think so. It's a formality, because it's the law. You know, there were a lot of things in the UFOC that the company never followed, they never held me to certain conditions, such as the office set-up and office conditions. The UFOC was 'shockingly detailed.' That's one of the experiences I remember. When I first things when I first got the thing, and I think that everyone that goes into a franchise has a similar experience…they interact with people in the company…somebody from franchise sales or if it's a small franchise the CEO, and they develop this relationship with these guys. They start talking about the opportunity, what's involved with being a franchisee. Relationships are formed. And then at some point, the UFOC is 'plopped down.' The experience of seeing the terms in the UFOC is 'WOW, this is so different from what's been happening in our conversations." Prior to this, it was a conversation among friends, there may have been phone conversations and even visits to other franchisees. I've got a friendship with these people, and now they've put this legal document down here and tell me what time I have to have my phones on and answer them, what time do I open and close the office, what kind of signage I can and cannot have…all these specifics. It was like two whole and separate people. And I expressed that to the CEO of the company. He said, "Well, we do that because that's what our attorneys tell us we need to do." In fact, he said to me "Steve, if everything goes as we hope it will, you'll sign this thing, put it in the drawer and never need it." If you and I have a disagreement, that's when we use it. There were a lot of things in that UFOC that I was supposed to do, and I never did them. The company never said anything about it, and there were no problems.

Q. Did you feel in running your business that there were a lot of things that you would have really liked to do, to add to the value that you delivered to your clients, that you were prohibited from doing by the terms of the UFOC?

A; Yes, in fact it was one of the things that eventually caused me to leave the company. The company had a very narrow focus on the service they were going to provide. I think the CEO had a vision he was following, and he would not let people get outside that vision. This is the service we are going to provide, and you're expected to provide that service, nothing else. Now, if you want to get outside of that, then that's going to cause a problem. You know, when it came to the details, such as what kind of sign to have, and when to open and close my doors, they really didn't care, even though it was in the UFOC. When it came down to how do you earn your money, the big picture, they were pretty specific about what I could and could not do. One of the problems I had with that business was that my income was entirely based on a big purchase…a big decision. My only income and revenue stream was based on someone making a major life decision. I wanted to develop other avenues of income to allow me to have some cash flow between the big purchases.

Q. So you could not take on another line of business, or offer different services, that you knew professionally you could solve problems for your clients? You were prohibited from doing so by the contractual terms of your agreement?

A. Yes, that was one of the reasons why I left. The tools we were using had other applications. And I wanted to explore using those tools in those applications. Not even outside of franchising, like helping existing franchisees find good employees. And the company said no. Being the first franchisee, there were about 40 franchisees when I left, so I had a good relationship with the CEO. So I went to him and said that this is something that all franchisees could benefit from offering this service. He wouldn't let me do it, and when he sensed I was getting ready to leave because of it, he came back to me and said, "OK you can do it, and here's the royalty I'm going to collect on it." It was so…intense…it was too high, and it did not make sense to do it. I knew then, it was time for me to leave.

APPENDIX J

Q. You were in the franchise how long?

A. Two and a half years of a 10 year agreement.

Q. How did the separation occur? In strict compliance with the terms of the agreement?

A. It went actually very well. Part of it was because the company was experiencing a lot of turnover. They were concerned about how that would look on the UFOC. I was able to use that to get a favorable exit strategy for myself. To be honest, it does not fit what the UFOC stated. I was able to negotiate a favorable strategy. Its still pending, I still have a financial interest in my territory, but I will compensated when it sells, it just has not sold yet. That was something the UFOC did not address. Technically, when I walked away, the company did not owe me a dime. How I exited, and the relationship I had with them, they said OK if and when the territory sells, we'll reimburse you.

Q. Does your exit show up as a turnover on the UFOC?

A. Right now, it shows up as a closed office. So, technically, I am no longer a franchisee, but the agreement I have with the company is outside the UFOC. And I know that they have done that with a couple other people, but not everyone. How solid that agreement is, I don't know. There are some changes going on in the company, and all of a sudden, my territory is not as well defined as it once was. It may, in fact, disappear from under me. The defined marketing territories, such as the state of South Carolina, were the way it used to be. I could only market in that territory. If I got a call from Germany or someplace, I could take the call, but I could not market anywhere other than my territory. They have now shifted to a virtual territory distribution, based on a percentage of population. Leads and referrals from the national office are handed out based on the percentage of population.

Q. How would you rate yourself as a franchise buyer?

A. I think I made the mistake that I told all my clients not to make. I went into something that I had some experience with, and some knowledge and comfort level with. I would tell my clients, don't just look at what the business does, look at the business itself. I don't think I was a good fit for that franchise. In reality, what I thought it was, was an opportunity to use my assessment skills. It really was a sales position...and I'm really not a sales person. I had to sell that product, and I'm not good at that. It was too late when I discovered it.

Q. If you had to give advice to a prospective franchisee, what would you say.

A. Talk to as many franchisees as you can. Give the UFOC to your attorney, make sure your rights are protected, make sure you understand it at some level. "Tell me what do you do...the typical day. What do you have to do to make money?" What's interesting is, as a closed office, I get a lot of calls from people that are exploring the Entrepreneur's Source as a franchise. They want to talk to people that are no longer in the system...at least the good ones are. Its interesting...my current partner does the training for the Entrepreneur's Source...he knows the people that are coming into training, that are signing on board...and very few of those guys do I hear from. They haven't talked to the other franchisees. They only hear what the company says. If they did talk to other franchisees, they would know that there is a huge failure rate in this business. The level of sophistication of the people going into the business is very low...the level of sophistication of people calling me is very high. My advice, talk to people that are successful, and talk to people that have gotten out...they're a wealth of information.

APPENDIX K

Franchise Owner E: Heidi

Q. Please tell me a little about when you purchased the franchise and the events that led up to you becoming a franchisee, and how long you have a been a franchisee.

A. As you know, we are not a franchisee any longer. I guess it was the end of 2000 that a group of Maxcare franchisees bought ourselves out from the franchisor, who had declared Chapter 11 [bankruptcy]. This had been dragging out for over half the year...so a good part of 2000 was screwed.

Q. You knew about the financial woes of the franchisor?

A. Yes. It had been in the news that the chairman of the parent corporation was being investigated for possible financial wrongdoing. That came to light several months before the division problems happened. There were actually a couple of suitors [potential buyers] who were for our group [Maxcare franchisees], but I guess when they did their homework and saw what a mess the financials were in, and the negativity of many of the franchisees, they said "Whoa...don't need this." Back to your question. We did not just say "Hey, we want to buy a franchise." The opportunity was presented to us. My husband's sister and her husband were in the carpet business, and their parent corporation created this carpet cleaning franchise opportunity. Originally, [my husband] Seth's sister presented it as a partnership opportunity...they wanted to go into it.

Q. As an addition to their existing carpet business?

A. Right. Seth and his sister went to Atlanta, where the headquarters is, toured the facilities...spent the day there...I guess getting the cheerleading session, and they were impressed. Impressed enough for Seth to begin investigating it seriously. And that's when we took a trip to Charleston to see if it was a place that we wanted to live, and move my family.

Q. Charleston was a territory that was available?

A. Yes. This was the specific area that Seth's sister had the carpet business. I have never had this dream of owning my own business, but I think that at least in the back of his mind, Seth did. His parents were entrepreneurs, they had a family business...a shoe business in New Jersey for decades and decades. And actually, my father is an entrepreneur... I never thought of it that way...yes, he had his own business...he just sold it. At least we have it in the blood. But we never said, "OK we want to run our own business, and we want to buy a franchise." So, we never laid out different choices...the opportunity was presented...we thought it made a heck of a lot of sense, and we said OK.

Q. Didn't you tell me that your husband is an attorney?

A. He is. Not in corporate law, he was in environmental insurance.

Q. Would you consider him to be a more sophisticated buyer than the average franchisee?

A. We were totally out of the mold for franchisees. Another thing that was unique about us was when we decided to buy it...I think we bought it in March...and we didn't move and open the business until August. They had never had anyone take five months to go through the process. So we presented them [the franchisor] with all kinds of new questions. We probably had too much time to think about it...at least as far as they were concerned.

Q. What was your work background?

A. I was in human resources in a law firm. With our backgrounds, it was an easy pitch to our banker.

Q. What role did the UFOC and franchise agreement play in the process?

A. Seth read through it, I read through it...we circled questions for our attorney...one was about services outside of those specified in the UFOC...which came about later on. But the enforcement of anything in the UFOC and agreement was really poor.

Q. The franchisor's enforcement?

A. Yes. The collection of royalties and advertising funds was poor. We reached a point in the life of the organization...it was an annual meeting...and we won the franchise of the year award. We found out that we were one of a handful of franchisees that was up to date with our fees. Franchise of the year...whoopee doo. Number one, it indicated poor management. Number two...well, people [franchisees] couldn't pay their bills, so they didn't pay the franchisor. The franchisor may have wanted to help them succeed, but couldn't help them enough to succeed. And it was just reaching the point where they [franchisor] was starting to say "we're going to talk to those franchisees who we don't think are not going to make it, and start to get them out. Which, should have happened a year before...at least. No one wants to see somebody lose their life's savings.

Q. You mentioned the collection of fees. What about the other franchisor functions, inspections, quality control, and support?

A. There was a reporting requirement...theoretically... people [franchisees] didn't do it. Finally, after a year and a half or so...we started getting representatives assigned to different territories, and those people were supposed to call up and ask where the report was. That started to happen a little bit...but there was just no enforcement. The enforcement of quality control and support was just not unifo rm. We found out that we had not had anyone visit us during our first year. Maybe we were unique...because we didn't ask for somebody. We kind of knew how we wanted to do things...and we would call up and ask for help whenever we needed it...we were in touch a lot over the phone. We got our money's worth, I guess, with the questions we got answered over the phone, but nobody visited us. One of the new presidents...we changed presidents several times...was shocked that nobody visited us. We were doing OK, but there were others who had requested help...the ones that were recruited from another company, were the ones that got two or three visits a year. And when I heard about that...I was also on the advisory council for a couple years...I thought this was strange. What I later found out was that the parent corporation had made huge loans to some of these recruits... to get these guys in, they [the franchisor] financed them. Of course they had a vested interest in those guys [the recruited franchisees from another company]. Of course they visited them three or four times a year...they had a lot at stake. As far as following the guidelines...I mean, I guess if the model is really great...and it works, you're not going to want to break the rules. But if you don't have a strong model, then you want to do things to make the business work. For instance, we were very lucky in our first year. We got a very big client, Kiawah Resort. They were unhappy with their current cleaner...we went out and did a demo...and it turned into our largest commercial client. The [the client] also wanted us to clean drapes...which needs to be dry cleaned...and all we have is steam cleaning equipment. So we investigated what it would take, and I resisted at first...because I didn't want to break the rules.

Q. So you were prohibited from offering these other services?

A. Yes. There was a specific part [in the agreement] and we had asked about that part of the UFOC...we asked them [the franchisor] what happens if we want to go into janitorial services, for example. Seth said that we could create another corporation, to keep the businesses separate. So we talked to the vice president and said "Look, we've got this major client...we want to make them happy, and we don't want another cleaner going in there." We went back and forth a little bit, and finally he said, well if you get trained, and as long as you know what you're doing." Seth researched it, and you know, its not brain surgery. We do it...its an ancillary part of the business that allows us to clean upholstery and drapery.

Q. What this customer was looking for was one cleaning company that could handle all those needs.

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A. Yes. Another thing with this customer is that they had some buildings that were six floors up. The truck-mounted equipment will on ly stretch so far. So we asked about a portable. So we got a portable unit, which was different than the other 65 franchisees...we got it because we asked for it...and we told them [the franchisor] that it was what we needed to do our business.

Q. When you went into this...did you think that the ability to customize and adapt was important?

A. Oh God, yes. There were just a few places in the UFOC that had restrictions that we questioned...we were trying to look ahead, and we saw the places where there were restrictions. There were no big, big stumbling blocks.

Q. Were you required to buy supplies from your franchisor?

A. We started out ordering everything from them. There were certain things that we ordered through a supplier that was set up by MaxCare. But other things...like printed materials and advertising things we got from the parent corporation...uniforms, shirts, jackets...that sort of thing. They weren't really set up to do that sort of thing. You'd put the call in to so and so...they would e-mail so and so...they eventually outsourced most of this. But you know, sometimes we would call these suppliers and tell them that we needed this Yellow Rx, a de-browning solution, and they would tell us "That's not on the MaxCare list." I would tell them "I don't give a damn if its not on the MaxCare list...I have a particular situation...I'll call you up and tell you that I'm Joe Smith's carpet cleaning. To go outside the little mold, you have to make a lot of noise.

Q. When did your franchise agreement terminate?

A. The end of 2000.

Q. So you have been on your own for about a year. Do you still get your supplies from the same suppliers?

A. Some of them. One of the things I've been doing is trying to find other sources, for printed materials and the like. The printer who was doing the MaxCare stuff was stiffed by the parent corporation for tens of thousands of dollars...they wanted us [the former franchisees] as a group to sign an agreement and take over some of the remaining debt. Of course, we weren't willing to do that...so he burned all the goods that he couldn't sell at clearance. To try to get all of these independent organizations [the former franchisees] together for the common goal of even printing invoices...its been months in the making. It might be my poor motivational skills at getting people together...so if not everyone wants to cooperate, I'll find the few who do. But to try to get the discounts that you can get from ordering in quantity is tough.

Q. How many former franchisees are there?

A. At the time we bought ourselves out there were 40 individuals. Now, some owned more than one franchise territory. At the height, there were 72 or 74 franchise territories. Some of the people who bought themselves out did so that they would not have to pay o ff huge debts to the parent corporation. That's what motivated some of them to do it...they had unpaid fees, and truck lease payments, territory fees...some owned the truck lease payments to the parent. We got out of that for all but one truck...I'm kicking my self now because we would have been able to buy ourselves out for $12,500 per truck, that's half of what I would have to pay. But, who knew?

Q. What was the first indication that you had that the franchisor was in trouble?

A. We knew in some ways...the franchisor didn't seem to know their...from their... I personally had no knowledge about the parent corporation, because we never had any contact with the parent corporation, we just dealt with the home office of the MaxCare division.

Q. You're speaking of a parent company who had several concepts under their control?

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A. Right. The umbrella organization. MaxCare Corporate had as a president an industry expert, but he wasn't a franchising expert. They didn't have enough expertise there. They also had a corporate model...for a while they had one company-owned MaxCare, and that was in Atlanta.

Q. You mean a corporate owned territory, staffed with the franchisor's employees as opposed to a franchised territory?

A. Yes. That one lasted a year and a half or so. I think it is widely believed among franchisees and ex-franchisees that the lack of a corporate model [company-owned territory] was key in the downfall. Forget the financial mis-management...it was a part of the equation. Also, over-promising...people believed that they were going to be able to live off their business after a year.

Q. You had different expectations that you had built into your consumption plans where you were not going to extract the earnings from the business for a while?

A. I also worked on the side for my in-laws. They were very generous in helping to support us during that first year.

Q. This franchise system did not make an earnings claim under Item 19?

A. No. They stayed away from that. I don't know how they could have done that without having been in business for a certain number of years. And maybe that was the problem...on one hand you want to get in on a ground floor opportunity...and on the other, you leave yourself wide open for the unknown weaknesses.

Q. As you look back...you've established yourself in this community as MaxCare...you have a right to continue to use that name, in all of your marketing materials. And as you go forward, you are going to run this business the way you want to. Taking the best of the business model you had to start with, and adapting it going forward.. With a year of experience on your own, do you think you are better off?

A. Hell, yes! It is like us not missing the lack of visits in the first year. We knew what we wanted to do and how we wanted to do it. The actual 'how to' of carpet cleaning we depended on the franchisor for...and we really tapped those resources.

Q. The technical aspects of the business.

A. Right. So we learned the technical aspects of the business, and went on from there. We got the best of it, I guess...and now we don't have to pay any fees. And that's really beautiful. The one thing that the parent corporation was really weak in was advertising support. Their answer for advertising support was this pyramid...which, it makes sense, but "first of all you want to do all the footwork"...but that took time. There was no national advertising...because they couldn't afford to...we paid into an advertising fund...a few of us did...but there wasn't much to spend. They put it towards, theoretically, the brochures and printing.

Q. You are competing against both franchised and independent businesses. Who would you say are your stronger competitors?

A. That's an interesting question. I don't quite know how to answer it. There are a large number of carpet cleaners in Charleston. Some are low-end...they advertise $50 for a whole house. And then there are some independents and some franchisoes that are around us, price-wise. So I would tend to say more the franchises...just based on my narrow look at it.

Q. You must deal with customers who were dissatisfied with their previous service. Would you say that most were dissatisfied with independents or franchises?

A. And they [the customers] most often mention franchises.

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Q. Looking back on your original decision, are you better off?

A. When it became clear that we were going to buy ourselves out, and were no longer going to be franchisees...it kind of threw me for a little bit. I thought, gee...this is not what I signed on for. There were all these fabulous plans laid out for us...which I totally believed. This is not what we signed on for. We totally changed our lives...we moved from New Jersey...we uprooted our child and ourselves and moved from a loving community to someplace totally different. Which is lovely...but totally different. But then my husband reminded me...we don't have to pay fees anymore. We got the best of what they had to offer, we've got a viable business, and we're franchise of the year forever. We're in a good place. For a franchise system that could not offer us what a franchise system is supposed to offer...if they had been giving us what...now, I haven't talked with any McDonald's franchise owners...but presumably your profit margins are set...things are pretty well laid out for you...this is how you run a McDonald's...this is how much you're going to make, etc.

Q. You didn't get that?

A. Not at all...not at all. The things that were said in the last year of existence about the parent corporation...I mean...people's lives were changed. One of the guys [franchisees] who came over from another carpet cleaning company found out that his daughter had a life-threatening disease. He had to have health insurance. He could not take the risk of not having health insurance, and had to find a job somewhere. Although it was a painful transition, we did OK. There were people who lost a lot of money, although it could have been a hell of a lot worse if we had not been able to buy ourselves out as a group. We formed an LLC...its not doing much of anything.

Q. How did the group of franchisees get started?

A. People started talking about it. Some wanted to do it...just a couple of them...and bid against the others...but that didn't go anyplace. The parent did not even listen to their offer. Didn't even respond to it, which was stupid. Once the other suitors got involved, and the parent corporation started threatening the franchisees to collect the money due to them...they [the franchisor] were negotiating with each franchisee individually...how much of the debt they would write off. Theoretically, if you kept up with your fees, they would go easier on you.

Q. The value of the LLC formed by the franchisees is in the power to negotiate for supplies and printed advertising?

A. I wouldn't say its power, yet. I think its just having rescued ourselves from a crisis and potential bankruptcy.

Q. And you believe that you can be profitable even buying supplies and advertising on your own?

A. Right. And, we can go in whatever direction our particular situation propels us.

Thank you.

APPENDIX L

Franchise Owner F: Jarrod

Q. Discuss your selection process in choosing the Quizno's area director franchise.

A. Fortunately, we had some experience with the franchise already...with my dad having been a franchisee at the unit level. We had a comfort level with the chain, what it was about and where it was headed. We knew that our franchisees could be profitable. And we also looked at the other people who were performing this role in other markets...other area directors...and felt like they were doing well for themselves. We believed that we could outperform them, based on what our knowledge and skills are. Combined with that we felt very comfortable that we could develop and maintain a market. In a word...I guess it was our experience. We were fortunate in that we had an insider's view. If we had been on the outside looking in, it might have been a very different decision process. It was probably one of the easiest decisions that either of us had ever made. Other than internal experience, there was not a great deal of external research.

Q. In other words, you did not evaluate other area director franchise opportunities, and your decision was based solely on your internal knowledge of the concept?

A. Absolutely. In fact, what gave rise to the opportunity was that the prior area director in this market defaulted on his franchise agreement, in terms of development. He actually did some things contrary to the franchise agreement...namely, he sold the rights to his territory without first obtaining the frandhisor's approval. That led to some litigation...the parties severed ties, and after a year Quizno's resolved it and awarded the rights to us.

Q. So you purchased an existing franchise?

A. Yes, actually one that had been reclaimed by the franchisor.

Q. Technically, the actual owners of your area director franchise is a partnership or corporation, correct?

A. Absolutely. The official owner of the franchise is Zita, a South Carolina S-Corporation, owned by my dad and I. That entity has development and oversight responsibilities for Quizno's operations in roughly 65 counties in three states. My dad and I divide responsibilities. At this point, I am primarily responsible for most of the development and oversight work. He owns a store in North Carolina, which he has day-to-day responsibilities for. So we have a pretty clear split in terms of responsibilities...how each of us spends our days. Our long-term goal is to be in a position to move him down to Charleston (South Carolina) and open stores here while we are developing the market. So we can at least be in the same area to combine energies, and maybe share the responsibilities a little more equally.

Q. So, technically you are equal partners, but you pretty much are responsible for the duties of area developer?

A. Yes.

Q. How long was your dad operating the franchise outlet before you purchased the area developer franchise?

A. He purchased the franchise roughly four years ago, but it took a year to get up and running, so its been about three years. We purchased the rights officially in December 2000, we then attended training, returned in February or March...so we've been at this a little less than a year.

Q. There are only a few cases of pending litigation in Quizno's UFOC, but all of them involve area directors. What do you think are the reasons?

A. If you read in there, what is disclosed is very blatant area director misbehavior. My counterparts in other markets are doing things that are in clear violation of the franchise agreement or operating procedures. They almost always have something to do with monetary damages as well.

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Q. Your area developer UFOC is different from that of unit franchisees?

A. Yes. In the Quizno's system there are three UFOCs: one for individual store owners, one for area director development agreements, and then there is a third for master agreements...appropriate for someone who wants to develop an entire country, such as Canada or the UK. Typically, those guys are well-heeled, and they have a master franchise agreement.

Q. Reviewing your selection process, what role did the UFOC play in the selection?

A. The UFOC review process for the area directorship was nothing like the way we scrutinized the one at the franchisee level. At this point...we were experienced a little more in the world of franchising...realized that its not negotiable anyway. We also had a level of trust with the people who were making the decisions. Once again, that is a result of having an insider's view. We knew the company execs that were making the judgment calls in the event there was some sort of discrepancy. So, we had a feeling that everybody was going to be reasonable, and that in the event that something arose, we would be worked with...as opposed to being held to the letter of the law of the UFOC. What's so scary about the UFOC, whether you're at the franchisee level or any level, is that there are dozens of ways to loose your rights to operate the franchise. We have since learned that it is mainly for the protection of the other franchisees. You don't want one franchisee in an area doing things wrong...so that it ruins the brand name or the image...any of the attributes of the franchise. So, the UFOC has teeth, to take corrective action if necessary. In practicality, and I've got some experience with this, our franchise has taken a consultative approach...coaching franchisees to do things right rather than summarily citing chapter and verse, terminating agreements left and right. It's a much more different tone taken in practice.

Q. Were you able to negotiate anything in your area director franchise purchase?

A. I found that the UFOC at the area director level was much more negotiable than an the franchisee level. The most remarkable piece was the price. We actually negotiated down by 30 percent off of what the initial franchise fee was. Of course, nothing like that happens at the franchisee unit level. Part of that is driven by the number of people that are affected. With thousands of franchisees, the need for standardization is obvious, where at the upper levels, maybe there are 50 area developer agreements and just a handful of master franchise agreements. There's a lot more flexibility at those levels. No flexibility in terms of standards. Quizno's expects certain standards to be upheld and maintained. But some of the monetary and procedural issues seem to be negotiable at the higher levels.

Q. Have you found that your franchisor has taken a consultative approach with existing franchisees, especially those having problems?

A. When I came back from training several months ago, I inherited a couple of franchisees that were in trouble. I was very impressed with the steps my franchisor took in trying to coach and retrain...even going to the point of monetary help with marketing and food purchasing. Sending corporate people to help work the store along side the franchisee. In another instance, we had a poorly performing store set to be transferred from the previous franchise owner who really wasn't doing things right...and there was a lot of corporate support to affect that transfer to a new franchisee who seems to be doing things a lot better.

Q. In those cases, the franchisor had the right to step in and close the stores because of violations of the franchise agreement. They did not do that?

A. Not immediately. Only after things reached a pretty dire situation did the franchisor feel they had to step in...and that was to protect the brand and to protect the franchisor.

Q. When you present prospective franchisees with the UFOC, what is their typical reaction?

A. My perception is that they don't read the UFOC, and have no intention of ever reading it. In all actuality, it's a daunting task...its very intimidating. Its one or two pages thick...and every page is full of legalese. I've learned to do a good job of prefacing the UFOC...coaching them (prospective franchisees) through what they need to read...the parts that they need to be aware of. I coach them as to why the UFOC is written in the restrictive manner that it is. And why it is really there for everyone's protection. I think that after the 'soft peddle'...after you introduce it like that, it's a little more acceptable. I still think that most people don't read them...which is a shame, because it really dictates everyone's responsibility to each other.

Q. One aspect of the UFOC that differentiates Quizno's from the majority of others is in the area of disclosing earnings in Item 19. Can you comment on it?

A. It becomes an important item. One of the first questions I'm asked is *How much money can I make?* There are five or six questions I get asked religiously...How much money can I make, what does it cost to get started, do I get a protected territory, how do you help me, how do you choose sites...a lot of those issues are money related. The FTC regulates franchises, and its that governing body that mandates that we make certain disclosures. The result of that is the UFOC. The UFOC is to franchising what the prospectus is to the investment world. Its supposed to give people the information that they need. Back to your question about earnings claims. Its tough to say what our true motivation is in providing that. It just so happens that our earnings claim is very good. It helps me sell franchises, because if you compare our earnings to our closest competitors, that's one of our advantages.

Q. Do your closest competitors disclose earnings?

A. No, our closest competitors are Subway and Blimpie...and neither of them make earnings claims. Of course, if I were them, I probably would not make earnings claims either.

Q. So, you believe that unless there is good news, don't give any news?

A. Right. One alternative is that the list of names and contact information for each of the franchisees is in the UFOC. So, prospects are encouraged to contact franchisees that are in the business now, and ask the questions that would help them make a good decision. The FTC doesn't let people in my position make a lot of monetary or give a lot of monetary advice on what are average sales or cost of goods. It would be interesting to me to see that if our sales declined, would we still disclose that. One of our closest competitors, Subway, is coming on strong in terms of average store sales, same store sales this year compared to last year. It will be interesting to see...if that trend continues, will they add that (earnings claim), because it becomes a sales tool.

Q. Because there is an earnings claim in the current UFOC, doesn't mean that the claim is in there permanently?

A. Right.

Q. You have to present franchisees with the most current UFOC. How often are new UFOCs introduced?

A. Typically, we come out...and I think most franchises come out with a new UFOC every year. Especially those that are growing and have new information to present in terms of units they're adding and sales increases. Most of the information that changes is not material, its just more disclosure of information. Every once in a while, they do change materially. Two or three years ago, Quizno's took its royalty rate from six percent to seven. In last year's UFOC, we set forth restrictions on the amount of debt a franchisee could carry. And that had a big impact. There are changes that allow...in our instance, new needs arise. The changes we're going to see this year is an addendum that allows us to choose local market people, accountants and professionals to provide accounting services in a local service market. The first year of operations, our franchisees were required to use a Quizno's approved accounting service provider. You know, there are changes that come along. Most of the time, I think it's a function of growth or need or desire.

Q. Do you think your job would be harder if Quizno's did not make an earnings claim?

A. It's very possible. Personally, I like the fact that we disclose more information; it makes us appear more forthcoming. People like that. Certainly, if I can't earn someone's trust I'm not going to earn their business. Giving that type of information helps us to cut through some of the distrust that's inherent. The other good thing for us, is that our sales and earnings are leading the industry...for what we do. And so that makes it easier. Do I think I could still sell franchises? Yes...I would just go about it differently if we didn't make the earnings claims. We would have to encourage our prospects to contact franchisees directly.

Q. Do your nearest competitors offer area development agreements?

A. They have an area director structure...but I must tell you that I don't know much about the others. If you were to call to find out more about a Blimpie or Subway, there is someone in the local market that will answer the questions that a prospect might be interested in. So there is some structure on that level, but I don't know what it is.

Q. Your role is not only to sell franchises but to support and do quality inspections as well. This places you between the franchisor and unit franchisees. It's a question of perspective. To the franchisor, you are a franchisee. But to the unit franchisees, don't you appear to be a representative of the franchisor?

A. Yes.

Q. Isn't that at times a difficult role to play?

A. Yes, it's a delicate balance. Through the changes that the franchisor puts into place...they're not all easy. In our case, I think the franchisor keeps the franchisee in mind in virtually every decision. I think of myself more as a facilitator...to make one side talk to the other...and to work out arrangements that are mutually beneficial. Its not always easy to deliver information about changes that pop up as to what the franchisor is doing. But its my role to try to implement that in the best way possible. Not everybody that does what I do for Quizno's has the same attitude, I don't think. I think most of them try hard and work hard. Contractually, what an area director has to do is attract people to the system...help them through the opening process...in terms of choosing a site, and helping manage the design and construction process, and ordering equipment...all of the functional items. Contractually, I have to be there for the first 80 hours of the store's opening...then I have to be in there at least once a month doing a quality inspection, to make sure that Quizno's standards are being met. And outside of that, I don't have to do much more. It just so happens that I am paid off of my franchisee sales. It is in my best interests to do what I can to help them grow sales, and to help them stay profitable. The other incentive in my position is that as prospects contact prospective franchisees, you would like those franchisees...especially those in your market...to have good things to say about you and the franchisor. There is some pressure there, but it is indirect.

Q. And these duties are outside the contractual obligations?

A. Exactly. My hope is that I will continue as I add stores to add value at the unit level to make them better operationally and better sales and better internal control.

Q. What do you think has been the major reason for the exponential growth of Quizno's?

A. I think we were very product focused in the early days, and it wasn't until we reached the 1,000 store mark that we got scientific about what we did. Up to that point, I think it was almost dumb luck. We were very product focused, trying to go for a taste profile that included flavor mastery. When you take a bite of our sandwich, you have an explosion in your mouth. That's what we were going for. We have one advantage that not many people are doing in our industry...and that is an oven-toasted, oven-baked hot sub (sandwich). Its where the sandwich goes through a conveyor oven open-faced which allows the meats and cheese to be heated and the bread warmed and toasted. An by that process, we are seen as different from our competitors. So from the early days, we were very product focused, and we stumbled on this core competency that happened to work for us. Our market research, which we did not too long ago, confirmed a few things, and told us a few things that we could do a little better. The one thing that was confirmed that we're glad to see is that we need to continue to support the toasted image. Our customers see us as distinct and different and better than our competitors because of that. The areas that we could have done better on were in the areas of menu variety, in terms of having more light items (lower calorie) and more of a value menu, that had sandwiches consistent with our standards for quality and taste but a little less expensive than the average sub. We also did a very bad job with kids...kids couldn't stand our food. And we were getting the veto factor from kids, so we've implemented changes there. We're doing what we do a little smarter now. So, the more scientific you get, you're able to make more qualified decisions that help your chain grow. Our core competency hasn't changed through all of that...and that is the oven-baked sub with fresh ingredients. And I think that's why we're doing well. Plus, we seem to be very unit-level economic focused. We seem to spend a lot of time thinking about what we can do to drive franchisee level sales and profitability. And certainly, if people are not making money using our business model, that word is going to get out. And it will be hard to attract others to a chain that is not making much money. So, I think those are the reasons why we're doing well. In fact, by the end of the year, we will probably sell about 800 franchises this year (2001). For a chain with 1,300 or 1,400 stores open and an additional 1,400 or 1,500 already sold but not opened...the prospects are very strong.

Q. Can you describe how adaptation and innovation occurs in your system?

A. From what I can tell, there are not a lot of ideas that 'bubble up' from the field. Most of the innovation comes from research and development at the franchisor level. We introduce three or four new sandwiches each year that are tested in four test markets across the country. So we have a good feel on how the sandwich will be accepted before it rolls out. Then we test it in company stores, or in a pilot market, and then we roll it out nationwide. I am sure that little ideas come from the field, but most of it is top-down.

Q. Living in the South, where the tastes perhaps call for a little spicier food than in the Midwest, how would you handle a franchisee who wanted to introduce something different on the menu to accommodate his or her local patrons?

A. I would ask him to provide all of the details of the sandwich he wanted to offer...right down to brand-names, how he would get the product...who distributes it. And be prepared to submit samples, back to the franchisor. There actually is a process for new sandwiches to be considered from the field, but I don't know anyone who has actually gone through that process, but there is something in place. Based on what I know of the people who make those kinds of decisions, they would consider it. I think one of the reasons we don't see more bubbling up from the field is that there are so many coming from the franchisor level. A lot of our franchisees...some of them...actually complain about how much we change menu items. So when you're in an environment that doesn't seem to get very stale, that kind of keeps franchisees focused on managing what's coming down, not necessarily innovating. But I don't think that the franchisor would be opposed to innovation at the unit level, especially now that we are still comparatively small. As we add more franchisees, I don't know what the acceptance will be, because it just makes it harder to manage.

Q. If a prospective franchisee told you that the ability to change and adapt was important to them, would you view that as a positive or negative for someone entering your concept?

A. I would view it as a positive, but I would want to explore it further. Its important to me to attract the right kind of people up-front, rather than finding out on the back-end that these people really aren't suitable. Quizno's does offer its franchisees a good bit of flexibility, I think. Franchisees have local pricing freedom, and can price however they want to. Corporate does recommend pricing, based on what's going on in the market and costs, but if there are local competitive pressures they're allowed to price either upwards or downwards. Our franchisor does not seem to be very interested in running the franchisee's business, outside of does the franchisee meet the standards that Quizno's teaches. And so, for our prospects that express interest in that kind of flexibility, that's what I tend to focus on. But I make it clear that they're buying a system, and that innovation is great in the areas of marketing and promoting your business and managing your employees, but not when it comes to doing things outside of what our operations manual says, in terms of how to make a sandwich and what products to carry…all the health aspects associated with it, and keeping a clean place. And those are the areas we would not compromise on.

Q. You would look for creativity and innovation in they way that they market and promote the core concept?

A. Sure.

Q. The quick service restaurant business is a highly competitive one. What things have you seen to indicate that the franchise is responsive to changes in the competitive landscape?

A A couple things. We found in our marketing research that when Quizno's customers are not eating at Quizno's, they're eating Mexican (food). We think that is because we think that they crave a flavor profile that has a lot of flavor, spicy or otherwise. And on certain sandwiches we give flavor packets that come with it, whether customers ask for it or not. We have recently introduced a lite menu, that probably has a lot of competitive pressure from Subway's advertising that subs are healthy. And we think that's great. They (Subway) spent a lot of money convincing customers that subs are healthy. We are rolling out a value menu, that seeks to preserve the taste and quality, but offers sandwiches lower in price. So, we can still get customers that want to eat with us, but may be unwilling to pay the extra 10 to 15 percent that it typically costs. The trick is introducing a sandwich that tastes good, but doesn't cannibalize sales of higher-priced items. So, we know that people are sensitive to a number of things. We know that for Quizno's customers, price is probably second or third or fourth on their list of considerations. A lot of our customers are feeling flush, and want to reward themselves, so they are willing to pay the extra money to get what most people consider a superior-tasting sandwich. So we balance price in there somewhere, but it is not usually the primary consideration. Taste and flavor and perception of quality normally is.

Q. Considering the franchisees you've spoken with, if you had to judge how most of them would rank the product and the business model in order, how would they do it?

A. Most people come to Quizno's, in terms of interest in buying a franchise based on a couple of things. Either they've eaten at a Quizno's in another market, or they've seen our advertising. A key component of our advertising at the end of each ad is a 'beauty shot' of a sandwich rolling out of a hot oven. Ones that see that are very inclined to call in order to find out more. I think people experience it either personally or through our advertising, and that intrigues them. And after visiting us, it confirms that it is a good-tasting sub…I like it, I think other people will like it, or I can sell this to somebody else. So I think they approach it much the same way a customer does…do I like this place? Then, once they hear about the business model, their suspicions are confirmed that if I do a good job of managing, I can make money. I have not talked to one person yet…who is a prospect…that did not agree that our product was better than our competitors…not one time. Even the competitors such as Schlotsky's (deli) that is a lot more expensive to get into, and has much higher sales volumes compared to what we do. Very few people don't like the sandwich.

Q. Your franchisees are not offered an exclusive territory?

A. Correct. And that's a big question early on.

Q, As an area director, you have an exclusive territory, correct?

A. Right.

Q. One of your roles is in site selection. Do you see the absence of an exclusive territory as more of an emotional fear or is it real in the minds of unit franchisees?

A. Its probably a split…70 percent emotional and 30 percent real…especially for people who have done a lot of research in our industry, particularly those that have looked at a Subway UFOC that is riddled with litigation on encroachment. My prospects that have called franchisees in other markets have expressed concerns about the franchisor putting units too close to them. Whether its real or perceived, I don't know. The typical mindset of an existing Quizno's franchisee is that if you put one within ten miles, that's encroachment...because they may get one customer from that ten-mile ring. So for me, it's a very emotionally-charged issue from an existing franchisee's perspective. When I'm asked about that, I take a lot of time to explain why there is not a protected territory offered. The main reason for that is that there is a big difference in markets, and there is one UFOC that goes out, whether you're in New York City or rural South Carolina. There is no way to write in one clause that is suitable to all of those markets in a single document. The other thing is that demographics change over time. An area that could only support one, in five years may support two. So if you had that kind of language, even the franchisee could not locate a unit within that territory, not being able to take advantage of those changes. Its an issue that comes up a great deal, and one that I explain using the trust factor. They have got to trust me to make a good decision on where to place it (additional outlets). Part of trusting me is to make sure that they (existing franchisees) are given the courtesy of being offered the new location first. And the second thing is that they are shown the courtesy of me providing evidence of why a new location in an adjacent market would not hurt them.

Q. These courtesies are not contractual obligations, are they?

A. No. Of course, there is always recourse...back to the franchisor, and legally, if it came to that. So its best to do the due diligence up front, and coalition build. But not everybody in my position does that or feels that way about it. In exchange for them trusting me on those issues, I've got to trust them to put in their best effort to operate that location, because in a market there may be room for 12 stores, and so at some point it becomes a scarce resource. So I've got to have the best 12 people, because my income is derived from having them run their store better than anyone else. I explain it as one of the trust factors.

Q. Following the line of best efforts, does Quizno's set operating hours?

A. We set minimum operating hours, but we do try to apply the common sense rule. If, after a franchisee has exerted his best efforts to get business, if he still is unable to attract business during certain hours, then we look at approving shorter hours.

Q. What level of financial assistance is provided by the franchisor?

A. The franchisor has made arrangements with third-party lenders that are approved Quizno's lenders. All of that goes through the SBA (U.S. Small Business Administration) loan guaranty program. The effect of that is to mitigate or soften the underwriting requirements that franchisees may face at a normal commercial lender. So our franchisees get financed earlier because of the franchsor's relationship with that lender. And that lender has come in and analyzed our operations, where we're going, and the support that's offered, and has a comfort level with us. Despite the strength or weaknesses of the franchisee, the concept, if operated at a baseline level should perform well enough to repay the debt. The other financial assistance offered comes in the way of pre-negotiated deals in terms of pricing on equipment, food, and services...such as Muzak, that are far better than could be negotiated by the individual by themselves.

APPENDIX M

Franchisor A: Patrick E. Meyers, Vice President and General Counsel, Quizno's Corporation

Q. Aside from following a normal template, can you describe the franchise agreement creation process. Specifically, how are the language and terms generally chosen?

A. It evolves. Typically, when a franchisor is just starting out, its going to go to a franchise lawyer and use basically whatever form that franchise lawyer is comfortable with. And that's basically what we did. As time goes on, and either circumstances in the company change or you go through something that makes you feel like you need to change the agreement. In our case, we started with a firm in the early '90s, then we switched over to a Denver franchise lawyer in the mid-1990s and used their form, and then when I came on board I tailored the form. And so, our franchise agreement is now a compilation between what some lawyers thought was good and what I thought was good.

Q. So it evolved over time? And that's kind of typical of most franchises?

A. Yes, I think so.

Q. How are these documents likely to differ among franchises?

A. Franchise agreements really differ depending on the industry. That's what's probably going to drive a franchise agreement. All of them are going to have the boiler plate stuff in it, they're all going to license the mark, they're all going to license the system, they're all going to take control of the system to varying degrees. They're going to have dispute resolution provisions in them, they're going to have choice of law provisions in them, they're going to have in-term and post termination covenants not to compete and confidentiality provisions. Those are going to be universal in virtually any agreement. What's going to change is that a quick service restaurant is a lot different than a hotel and different than a car rental agency, and there's going to be terms within each of those types of franchise agreements that are going to be specific to that industry. That is probably the biggest driving force in the change of a franchise agreement, along with the philosophy of the franchisor's legal counsel.

I tend to have a philosophy of having a very tough franchise agreement. The reason is because as long as the system is working...as long as we are working well with the franchisee and the franchisee is complying with the system standards, we never look at the franchise agreement - we never worry about it. The only time we look at the franchise agreement is when there is a problem. And so, I want it to be as enforceable and tough as possible. Other franchisors don't necessarily share that same philosophy. That's probably the other driving force. That's kind of how you generally approach a franchise agreement.

Q. So if I wanted to find the things that are associated with that, I would find it in the language?

A. Yes.

Q. So I would have to read the entire agreement?

A. It's probably easier to work with the UFOC. Because the UFOC has to describe all of those types of things in plain English, as opposed to franchise agreements which don't have to be written in plain English. It's easier to look at the UFOC to figure out what the franchise agreement is saying.

Q. You would say, then, that because you believe in the strength of this agreement, which would be used should litigation result, that you would find yours to be very tough?

A. I would find ours to be on the tougher side. It is a stronger agreement in favor of the franchisor than probably some others.

Q. I found some differences in the terms of your agreement than what I would call the typical: the 15 year term of the agreement, the other is the manner of dispute resolution, and the other is earnings claims. Can you comment on those?

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A. The difference in the length of the agreement dates back to the late '80s, I don't know that there was any particular reason why we chose that. That choice predates me. In restaurants, I don't think 15 years is the norm, but it's not way out of the park either, and our non-traditional agreements, like airports, those are five-year agreements. But, otherwise, if we have a good franchisee in the system, and they're operating well, and they're up and profitable, the difference between 10 and 15 years is not really significant.

The dispute resolution provision, that comes from my philosophy. My philosophy is that, in order of preference, I do not want the company to be put before a jury...because I don't like the jury dynamic. When you have a small mom-and-pop operator, which is what we cater to, and a large corporation on the other side of the table- not that juries are bad- but that particular dynamic is not a good one for franchisors. So we have jury waivers in all our agreements.

I don't like arbitration. So, I try to avoid arbitration. So the forum I like the best is before a judge. There are now I believe nine or 10 states which either have statutes or traditional pronouncements that forum selection clauses, which say that you have to resolve a dispute in the franchisor's state are void in that state, and are against public policy. The way to circumvent that, if you want to circumvent it, is through an arbitration provision. The U.S. Supreme Court has said that Federal arbitration pre-empts those kinds of state laws. So if you have an arbitration provision, and the arbitration provision says that you're going to arbitrate in Denver, that trumps a state law that says that the forum selection clause is void. And from a practical standpoint, corporate resource standpoint, it is better to be here in Denver for us than it is to be in another state. So, in those handful of states where forum selection clauses are void, we have arbitration provisions. And, just as an aside, the franchisee community, particularly the American Franchisee Association, take the position that franchisors want to litigate in their home state because they have some judicial advantage. I don't think that that is true. That's not true and there is no empirical evidence of that. It's a resource-if you have to take... if you are litigating against a franchisee, typically the franchisee will counterclaim your claim against you with a multiple of claims, everything from misrepresenting the franchise system when you sold it, or you did not give me support what you sold it or you encroached or, on and on. To deal with all those claims have the witness to talk about that particular claim. So we take 10 corporate officers from Denver Colorado and fly them to Michigan to sit around and wait for an arbitrator to witness them ... it's a huge resource problem. It's not the we think the judges and Denver are biased in favor of us, in fact is not true at all. But it is a resource problem. So that's why franchisors I think it want to litigate in their home state.

The last time I looked, I think 80 percent of franchisors' offering circulars did not contain earnings claims. We choose to. For one reason, the first question that comes up in a franchise sale is the prospect saying, "how much money am I going to make." It's very difficult to put a sales person in the position of saying "I can't tell you anything, I can't share any number with you, at all." I think that probably there is a tendency, if you had no earnings claim at all, for sales people to cross the line. And as you know, the largest number of enforcement cases from the FTC, and the largest number of civil lawsuits, have at least an earnings claim in them. And so, I think frankly, it's dangerous for franchisor not to give their salespeople anything to use. We choose to use a fairly limited earnings claim which is tied to sales, average sales. But that at least gives the salespeople the tool that they can use. We've had years when it's gone down, so it hasn't always been good. And, if a franchisee later comes back and says " your sales guy said this was going to generate $450,000 to $500,000 a year in gross sales, we can point back to the earnings claim and say "Well, we say right here what our average unit volume is", and we have specific disclaimers about it. We think that its been helpful, both from a legal standpoint, and frankly from a litigation standpoint, and from a sales standpoint.

Q. In your opinion, do you think that [earnings] disclosure should be mandatory?

A. I go back and forth on that. Most franchisor lawyers don't think it ought to be mandatory, but as I said, I came from the securities world...and securities was exactly the opposite. In the securities world, you had to disclose every financial item that could be of any importance to a prospective investor. And so, it wouldn't bother me if it were mandatory. I think one of the problems with mandatory disclosures is trying to have some sort of a set guideline on what kind of disclosures to make. Again, the hotel industry, their type of earnings claim is going to be much different than the other industries. Theirs will involve room-nights, room rates, average occupancy. Average gross sales of the hotel is not that important. And so, that's where it gets a little bit dicey. But, I wouldn't be against mandatory earnings claims.

Q. We touched on franchise associations, with the AFA previously. Can I have your opinion on franchise associations in general, both in the U.S., the IFA and the AFA, and also, it appears as though you've embarked on an aggressive international expansion, your comments on the roles of franchise associations overseas.

A. We've never dealt with a franchise associations overseas, so I have no history. We're members of the IFA. I think the IFA is a good organization. As far as a selling tool, I'm not sure whether its been that helpful for us or not. I know that there is some validation, because you go on the IFA website, and can see that we're an IFA member. I think that has some message that it sends to a prospect, although I'm not sure. The IFA, I think, is a good forum, its helpful to get together. I go to the IFA symposium every year, I speak at it every other year. Its helpful, you learn a lot, or you can learn a lot. You meet with people who have thought of some way of approaching something that I haven't thought of, and I think that its lobbying efforts have been very good, particularly at the state level. Obviously, we're not members of the franchisee association. I have no problem with the franchisee association, but disagree often times with their positions, but generally they haven't posed a problem for us.

Q. One of the hot legislative debates that went on, then went away for a while, and now appears to have re-surfaced is the Coble-Conyers [Small Business Franchise Act]. Can you give me your comments on that.

A. Well, I hope it never passes. Coble-Conyers is a...well, I'm not sure...I don't want to be unfair. I think, that to some extent, it's a product of one very aggressive lobbyist, who had a significant problem with the Holiday Inn system, and has pushed and pushed and pushed...and luckily, the bill has never got anywhere. Now it gained about 40 co-sponsors when it was introduced in the last session...which worried, I mean, that really got our attention. So, a number of us went out through the IFA, I think about 150 people went out and did this blanket lobbying effort against it in Washington...that was two years ago. The problem with Coble-Conyers, at least in the forms that its been introduced, it is, I think, and obviously I'm coming from my personal bias, it is very draconian, and would make franchising very difficult. The missing concept in Coble-Conyers is that, I believe, it comes from a philosophical position that franchisors are inherently unfair to franchisees, and over-reaching. I don't believe that that's true. And it misses what I think is true, that franchisors, in order to protect all of the franchisees, not just the franchisor, have an inherent reason to enforce system standards. If you have a McDonald's in the middle of a city, that has bugs in the shake machine, that's the Robinson case, and you have a law out there that says, you know, that may not be good cause for termination. Even if it is good cause for termination, you're going to have to wait 90 days to terminate that person, and you may have to pay them compensation...that store is hurting every other franchise operator in that city. There is no question in my mind about that. And that's what Coble-Conyers does. Coble-Conyers approaches things from a standpoint that we're out there beating on people just for the sake of beating on them.

Q. Using the power...

A. That's right, and unfairly. And I don't think we do that. We make decisions that are not popular. We made the decision six or seven years ago to auto-debit our franchisees, as opposed to letting them continue to pay by check. That was not a popular decision...but I'll tell you what...it was the best decision we ever made. It is one of the reasons why this system has run the way it has...its one of the reasons why we have a very low default rate. That's just an example. We make a decision to change our POS [Point of Sale] system. Franchisees don't want to change the POS system... they don't want to spend money on something else...I understand that. But it helps the system...there are multitudes of reasons why we're making that change. And its not because we've got some interest in IBM, and that we're going to make a lot of money from changing our POS system. Its because it's the right thing to do for the system. Not to say that franchisors don't screw-up and make bad decisions, sometimes they do. But, by and large, I think that franchisors are out to make the decisions that are going to help the system. Bills like Coble-Conyers make it difficult to make those decisions, and to keep a franchise network viable, particularly against competition.

Q. Can you talk a little about the Codes of Ethics that are in place in Australia and parts of Europe?

A. Australia is pretty new, and they just changed it…they just revised it. And you know that the IFA also has a code of ethics, though obviously its not imposed…not mandatory…but IFA members are supposed to adhere to it. I think codes of ethics are fine…I don't have a strong feeling about them one way or the other. Australia has not been any kind of a problem for us.

Q. You covered a couple of things about disputes, encroachment and bargaining in good faith, and those kinds of things. What, in your opinion, can be done to minimize the number of disputes that occur between franchisors and franchisees?

A. Focus on unit profitability. If a franchisee is making money, you won't have a dispute. They might get angry at you if you make a change that they don't like, but that will be a 20 minute conversation, and usually go away after that. If a franchisor loses sight of unit profitability…and the units start to lose money…you're going to have disputes all day long.

Q. If you're looking at a foreign country in which to expand, can you compare the importance…if you had to rank them…of the trademark laws of the country, the anti-competitive laws, such as the tying contracts, or the dispute resolution laws.

A. I think trademark is the most important, just because you typically have more of a problem with third-party piracy than your have in contract difficulties with your franchisee. So, it's important to get a trademark registered if you are going to go into a country. We haven't really experienced any problems with anti-competitive laws, trade laws or tying laws. It could, potentially, be a problem for a franchisor that is large, or a franchisor that has a lot of vertical integration. But we really haven't experienced any problem with that.

Q. Do you think, if I had four or five franchise agreements and UFOCs in front of me, and I focused on the amount of litigation, do you think that a small number of disclosed disputes is an indicator of harmony in the system or franchisor strength?

A. It can be. There's also a variance. You have to disclose material cases. Some franchisors will take the position, that its not material because, even if they have theoretically material claims, their system is so large that one piece of litigation is not material.

Q. You mean its relative…compared to the size of our system…

A. Yes, compared to our system, this is small, and we therefore do have to disclose it. We tend to go the other direction. We tend to disclose. I think that…I'm certainly very pleased with our amount of litigation compared to the size of our system. And I would be very displeased if we had a lot of litigation compared to the size of our system. And I think if you're looking at a system that has a lot of cases disclosed, that could be an indication of a systemic problem, not necessarily, but it may be a problem. And it is probably, nice to see…its virtually impossible not to have any litigation. You have independent business people…and some will fail. Some people are not going to be able to operate a business. Its not their fault…but they're going to be in a tough position. They're going to owe the bank money, they got a lease to make, and they have personal liability on that. And they often times don't feel like they have any choice but to file something against the franchisor, just to try and get out of the problem. So, I think you're always going to have some litigation, but a low number is probably a good sign.

Q. What do you see as far as the legal environments of the future? More reliance on disclosure documents, or more shifting more toward franchise associations and their codes of ethics?

A. Franchise associations and codes of ethics are never going to be something that… well, codes of ethics if its mandated through a government regulatory agency will be imposed…

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Q. Like Australia?

A. Like Australia. But in the United States it's a voluntary thing, and I think its going to remain a voluntary thing. I think that the legal environment will be…well the FTC will adopt its new rule at some point. Its going to change the format of the offering circular [UFOC], and its going to change some nuances, but its not going to be a big change to franchising. I think you're going to see more and more states shifting away from regulation…its very costly and states, I think, are beginning to view franchising as not a big problem. Business Opportunities, that's a big problem. And so they're focusing more on Biz Op [Business Opportunities] . Indiana, for example, just did away with their whole registration process, and its now a file of notice state, like Wisconsin. Probably overseas, there are more and more countries that are adopting some form of franchise regulation, and that will continue. Whether it's a code of ethics, or registration process, or disclosure process, or a myriad, I think we'll continue to see that. That seems to be kind of a wave right now.

APPENDIX N

Franchisor B: John L. Gallivan, Chief Financial Officer, Treasurer, and Assistant Secretary, Quizno's Corporation

Q. You've got extensive franchising experience in two different industries. Can you talk about how they were similar and how they were different and, common success factors, based on your experience in those two industries.

A. Well, they're not that dissimilar. They were both retail franchisees and both selling retail products. There was cost accounting, and the finance was common between both of them. The Quick Lube franchises cost considerably more to develop than the sandwich shop franchises, but the problems are still the same-And that's sourcing competitive financing for our franchisee's to be able to purchase the franchise, and start up the business. And in any franchise organization, I think that's critical to the success of the company. A franchise company I don't think can even expect to succeed without having good solid financing sources for its franchisees. It's like car dealers today, you used to go to the bank to get your car loan and then go buy the car. Today you stop on the way over to your aunt's house and buy a car and get it financed and still be on time. The financing is right there, and it's done very, very quickly. Its the same with franchising. You have to have those financing sources available to continue to grow, irrespective of how good our product is. We have to have those financing sources available. Probably the most common thing in my career has been dealing with the financing. Accounting for franchising is the same, for every industry there some unique accounting rules, with respect to revenue recognition. Franchisors were one of the first industries to abuse certain recognition standards in the accounting profession and as a result were the first to get whacked with very definitive guidelines on how recognize revenue. And that's basically deferral of all revenue until the related unit opens for business. That's not what the GAAP says, but that's what it says when you get through interpreting the rules. This makes it a little more difficult for us to get to the positive financial results. Even though our cash flow is tremendous because of franchise sales, that doesn't show up on the income statement until the unit opens. A banker will have to understand that. They will have to look more closely at our cash flow statement than our income statement.

Q. Can you please clarify that? You have 700 or 800 outlets that have been sold but not yet opened. Does that mean that they don't show up in your corporate financials?

A. On the balance sheet, but not on the income statement. We collect about $20,000 per franchise on the 700 that haven't been opened, and that's all sitting on our balance sheet in an account called deferred franchise revenue; which is on the liability side of the balance sheet. When we show the financial statements to bankers, we say this amount is not a debt...we do not owe that money...it's a non-refundable franchise fee. But, it's also not recognizable as income: it's there in limbo. And in doing your analysis, you need to move that down into the equity category- its not debt. But we have to fight those battles with lenders, although they're becoming more familiar with dealing with franchisors, an understanding the accounting principles that are unique to franchise companies. The quick lube, we were a smaller company, when I left we had 200 franchises opened, where here we have 1300 and so it's getting much more rapid rise, and much more successful here-we're doing a lot more here faster.

Q. So, how you handle that? From a corporate standpoint, cash flow in growing companies straps them.

A. The first years were difficult. We've always had pretty good cash flow. But, we were very, very earnings conscious-even though we had the cash, but we wanted to get positive earnings as quickly as possible as we could after our IPO. For that reason, we pinched pennies, until we started making money regularly and consistently, we pinched pennies. We doubled up hotel rooms, we rented the cheapest cars, our people would stay with area directors or friends when they would travel. We monitored office supplies, we used purchase orders for every single purchase, we'd have our area directors meetings on college campuses in the summer if it were un air-conditioned so we could get it cheap. A lot of penny pinching, to get to the financial results that we wanted. And, we still pinch pennies, we still run this thing by the budget.

Not to jump ahead, but the budgeting process, the planning process, we do a thorough job of that. Every fall, will have a group meeting where will go off for three or four days, and will identify opportunities and challenges coming up on the horizon, both internally and externally. And then we'll identify what we need to do to deal with those throughout the next year. And that will come back, and will put numbers to all of that, get our budget and will determine if that's where we want to be. If it works for us, if not will go back and refine and modify. You know, cut projects that we've put on the bottom of the priority heap. And then by the beginning of December, we agree on the final firm budget for next year. And set line item by line item for every single department and p rofit center. Every single employee in here has their own budget, for the next year. And then we go off into the next year and we stick to that budget. We very seldom vary. And it's reviewed every month with every department, with myself and the CEO of the company, to look at performance against budget. And that's how we control it. We put a lot of time into the budget, and we start out the year we say " OK it's your department, your budget here going to achieve these goals and we all agree that you need these resources to achieve these goals"... and off you go. And we don't need to talk again, as long as your achieving your goals, and you're not using any more resources. You can spend that money according to the budget, within the timing of the budget. You don't have to go back to get things approved again. And that works pretty well for us. Right now, I could show you our budget, and it even amazes me how close we are seven months into the year, and how close we are on the budget items both revenue and expenses. Its because we put a lot of time into it, and the CEO supports it. These people can't go to the CEO and circumvent the process. He's behind it, and he sticks with the budget, and he tells other people if it's in the budget, do it; if not, figure out something else. We just don't have the money laying around to do other things.

Q. Do you think that one of the reasons why some younger franchisees get into trouble might be because they don't have that kind of financial control?
A. Oh, yes. I think a lot of companies don't have the discipline to do that to make a budget and stick to it. I also think a lot of companies don't have the passion that we have here. We're fortunate in that we've got the founder involved, and he's well-educated, a good business person and by the numbers person. He was also a franchisee of the company, prior to becoming the owner of the company. So he knew from three or four years of owning one and then three franchises, what it is like to be a franchisee, and what it takes to make money in this business. And he's got the passion for it. So when we plan things and we do things, what always comes first is the quality of the product to the customer, and the delivery of the product, the freshness and a taste, and the environment, always comes first. Next, [is] the profitability of the franchisee. The franchisee has to be profitable- has to be making money in this business. Way down the line comes the value of the stock, where it's trading at on the market, and our profitability from day-to-day. We all know if we serve a good product, and our franchisee's are profitable, everything else will eventually work. We may make some mistakes, we may sign some bad leases, we may make an acquisition that turns out to be the wrong thing to do-but we'll always recover from that, just as long as our franchisees are making money. The CEO here, having been a franchisee, approaches it that way. As opposed to other franchise companies whose tally of success is how many franchises they've sold. We like to have a backlog, but that's not as important. When we get them open, we've got to make them profitable...and that's when we know we're successful.

Q. You touched upon it being tough in the early days. Unlike some of the other concepts that were born into a market that was virtually wide open, you came into a market with established competitors with significant market presence. Can you talk about how you build share and how you were able to attract franchisees?

A. I don't think anybody would ever sit around and say " boy I think it would be a good idea to get in the quick service restaurant business, and compete against Subway with 13,000 units, Blimpie with 5,000 units, and every other person in the world would tell us that that didn't make any sense. It doesn't sound like a smart decision to make. But, it is a tough business, its volatile. Successful restaurants can quickly become unsuccessful restaurants because suddenly in three weeks' time two competitors pop up within walking distance, where there used to be no competition. That's tough, it's tough to compete in this business. We do compete by keeping our costs down, and our break-even points below, so that our franchisees can continue to make money as long as possible, without having a high debt service from a large unit. When Rick bought the chain, there were 19 units in Denver, and it did have a niche in Denver. It was known as a specialty, high quality sub sandwich. So there was a culture built already. We've tried to continue that. Our prices are higher than Subway and Blimpie, higher than our competition for the same size sandwich. But because our sandwiches, our meats and vegetables and the rest of the ingredients are the highest quality you can get. Subway are generally just more economic. Our decor is a little more upscale, and more conducive to the business eater. So we've tried to maintain that image. And I think we've done that. I looked at the focus group results that people looked at Quizno's in a lot of cases, as a place to go out to dinner. You know, with their family. So we've got that niche above Subway and Blimpie. We're very successful in downtown areas, and office buildings, in airports, tech Centers, employment centers-we're real success ful at these. Blimpie and Subway, our competitors, on the other hand, are more out in the suburbs near the high schools, you'll always see one or two of them usually right across the street from the high school. So, they're going for the more price conscious, and we're in a niche above that.

Q. I spoke with Pat Meyers [Legal Counsel] about this. Quizno's makes an earnings claim based on sales in its UFOC, which is unlike most of your competitors. Your same store sales are above that of your competitors, which should make it very attractive to potential franchisees. You find that to be the case? That potential franchisees will look at that?

A. Yes. If the franchisee is doing their job, they will do those kinds of comparisons. I'm not sure that the majority of them actually do that much due diligence. But the ones that do, will choose Quizno's. And those are the ones that we want it anyway. In the absence of an earnings claim, they're still getting the information by talking to franchisees, which we encourage them to do. Our startup costs are a little higher than Subway's -I think we are about 170,000 [dollars] to 200,000 [dollars], where theirs is 110,000 [dollars] to 120,000 [dollars] in start-up costs. So, somebody might decide that that is a good trade off- that for lower startup costs they can buy a Subway, but their sales are going to be lower, but it doesn't take as much money to get into the business.

Q. You've touched on profitability at the franchisee level. What do you think are the main reasons for low franchisee profitability within a successful system?

A. Cost control. Franchisees not controlling their costs properly. We emphasize ... We recognize that that is a weakness of any franchisee-not just our franchisees in our chain...to be able to control costs and manage their business from the checklist. In our training, and in every meeting we have, we require our franchisee's to attend profitability seminars, cost seminars, to determine their break-even point etc.... and it has started to work. We had an interesting thing a number of years ago. We were telling our franchisees that food cost should be 30%, labor should be 20 [percent], discounts should be 5 [percent], right on down the line. And they weren't believing us. And so we said, "well, here's our company stores, we do it in our company stores,"and they still didn't believe us. They said, well, you keep the books in those company stores, so you can do what ever you want. So, we started something that is unique to the franchisee world, and we have a thing called blast fax-and this also helps us to collect our royalty information- but, we didn't start it for that information. Every franchisee in our system is required, everyday, to call in their sales from the previous day-both before discounts and after discounts. At the end of each week, they call in their sales for the week, along with their food costs percent, paper costs, and labor costs for the week. Every day, we take all that information, from all 1300 stores, we capture it, we split it by area, and we fax it back out to everyone of them, and we put their name, their store number, and their location, what their sales were, and what their costs were. We send it back out to all of their peers. Every franchisee in L.A. Knows what the guy down the street is doing, who's doing better who's doing worse. And we did that so that they can see what their fellow franchisee's are doing. They can say " well, that guy's doing 30%, and 19% labor-that's what Quizno's told me-I know that guy, I'll call him up and see what he's doing." And so that worked- that created peer pressure to improve your results. It also created credibility of the numbers. And we continue to do that to this day. It's a valuable tool. A franchisee ... It's human nature the first day they open the store, they don't know how much businesses is going to come in. So, you wind up being overstaffed-which is probably a good business practice. You may be overstaffed your first week or two, until you get a feel for how your business is going to go. And then, theoretically, you should be cutting back to the model. At that point, you should know what your losses are going to run, when you pick up and when you drop-off, you know the patterns at that point. But its human nature for franchisees to not let go of those people, to keep them around, because "I'm going to have a very busy day." Or another problem is, if I don't keep Joe on the payroll, he's going to quit. So, even though I've got nothing for him to do, I have to give him the hours today, so he doesn't quit. And we try to get them past that-that's part of business-replacing people. You just can't keep people on your payroll when you don't need them, just because they may go find another job. To answer your question, controlling labor costs is the weak point in the franchise system if they're not making the right amount of money.

Q. That was my next question...how important is labor management?

A. Labor management, from a cost standpoint and also from a resource standpoint, is the most important thing.

Q. Because that's very visible to your customers as well, isn't it? If they can't get service...

A. Its visible to our customers, its also the hardest thing to do-to find labor. I talked to our most successful multi-unit franchisee, and asked him what the most important thing he did. He said, there's only one thing I do, and I do it everyday-and I'd do it 10 hours a day, and I'll continue to do it seven days a week, 365 days a year-And that's recruit people. That's all I'm ever doing is looking for people. He's said, I wake up every morning and I picture in my mind the weakest link have in my stores right now. And even though everybody might be doing a good job, I identify who the weakest pers on is, and I start trying to fix that. I identify where I don't have the right kind of back-up-and so if I should lose somebody-always recruiting people. As opposed to the franchisee who will say "I finally got a good crew, and I can stop looking." That person will ultimately fail-you've got to keep looking. If you're in the restaurant industry, or anything in the service industry, you're dealing with minimum wage employees. You're in crisis mode. They're talking about lifting the immigration laws for Mexico in order to get workers to come up here.

Q. I hear that from non-franchised businesses as well. Now with a tighter labor market, they are hiring people that have never worked before. They don't know what it's like to have to show up for work. That's something where the system cannot do everything. It's up to that individual franchisee, to be looking for good people.

A. Right. That's their job-recruit and hire people. As much as we'd like to, we can't ultimately do it. We can give them the tools are, and we do have pretty good hiring tools. We've got ... we've just come out with a bunch of Spanish language recruiting radio ads to run on Spanish radio stations that seem to be working. And referral fees to other employees.

Q. There is what I call the "official" environment of franchising-the UFOC and franchise agreement and all the documentation-and then there's the informal environment-the labor management. Looking at the official side, if I were to lay out these documents from Subway, Blimpie, your other competitors, and Quizno's, is there something in there that you can point out to prospective franchisees that would make them choose Quizno's?

A. If I were a buyer, I would look first at the earnings. I would look at that, and if I had a UFOC without an earnings claim, I'd go get information. That would be one of primary things I do. I'd look at the litigation, and then I'd tried to get a feel for why they're having a lot of litigation. You know, it may not be that bad-but if it's a surge of litigation, that would tell me that the system's in trouble. Maybe their sales are going down, maybe their food supplier is not working or something is going wrong. Then I'd look at the people running the company, I'd look into their background, because I want people who had been in the service business ... that knew service ... not just service to the customers but converts to service of the franchisees. I looked at the franchise's financial statements, to see that they're well-capitalized- to make sure they spend their time building a good system ... not all their time trying to raise money to pay the bills. And I think we stack up pretty well in all of those areas with our offering circular.

Q. Quizno's went public in '94. Are you trying to buy the stock back now?

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A. Were buying it back right now. We did a tender offer last December and bought back about half. The tender offer was voluntary, so we still have about half out there that we wanted to get. So now we're doing a merger, which requires all the shareholders ... the remaining public shareholders to surrender their stock at about $8.50 per share, which is a pretty good premium. And that should be completed within the next 30 days. Right now we're waiting for the last round of comments from the SEC, which we should get any day. And at that time we'll be ready to file our proxy, and schedule a shareholders meeting, and then we'll be private.

Q. And all of this has been going on in the midst of your exponential growth? Aachen

A. For the last year it has, right. And that was preceded by raising the money for the tender. I spent last year it this time from the end of August through the middle of December, 6 and a half days a week, Pat [Meyers] and I both getting the financing done to get the money to make the deal. But we've got that all done, it's just a matter of going through the mechanics of the SEC approval, and we'll be private within the next two months. Ha

Q. Your thoughts on fees, royalties, transfer fees and the development of the UFOC, the franchise agreement terms. What I've read is that franchisees see the value up -front, but once they get in the system and see how it works, these fees and continued royalty payments tend to be an aggravation. Can you just comment on how the fees are established?

A. Both the initial franchise fee and royalties are established by what the industry is charging. We're at $20,000 for the initial franchise fee, which is about the average of every franchise, I think it's about clo se to McDonald's franchise fee if I'm not mistaken. And then the royalty is the big nut, though. The royalty and the advertising fee. The mistake many franchisees make is that they add them together. They say " a 7% royalty and a 4% ad fee means that t hat's 11 percent I'm paying the franchisor." The advertising fee, in our case and in most cases, goes directly into a trust account that's accumulated among all franchisees and is spent right back out on advertising. That money is where you get the real t rue benefit and synergies of being a franchisee, by combining your money with those others to buy advertising. So, I think it's a mistake, and I hate to see it when franchisees say that my royalties are 11%. It's not. Its 7%, plus, you're a participant in this trust account for advertising, and you pay 4 percent into that. The 7% in the 4 percent are ... two things ... it's looking at the competition, whatever other franchisors are charging, and looking at our own unit models for our stores. You can't have royalty that makes the unit unprofitable. By operating at 8% before royalties and we charge 7% royalties, you know they can't make just one percent, it won't work. But we look at what the unit economics will bear, we look at what we bring to the table, in terms of reduced cost for insurance, the cost of food ... through our buying we think we can demonstrate that they are buying at 4 or 5% less than if they were independent... and so you're paying 7% for royalties but you're getting 5% off of your food. If you were independent, you'd be paying that. And so we look good those things. But, the franchisees still have a hard time writing that check. When I was with the quick lube, one half or better of my job was spent collecting royalties. The franchise agreement with that company required them to pay once a month. And they would pay by check when I got over here, we said, we're going to make it once a week, and require it by auto-debit. As a result, I spend maybe one half a day per month on receivables. Because they're all paid. We don't have any receivable problem ... is collected on the same day from franchisees every week ... on Wednesday we pop into our bank a million dollars in royalties, and it's great. It's great for cash flow. We don't have to wait until the end of the month for them to write a check. It's also psychologically ... when the franchisee has to write that check every month, you're giving him an opportunity to sit and say " my month was real good, and here I am writing a check for $3,000 ... what did I get for $3,000?" Pretty soon, I put aside and say " I don't think I got anything ... I'm not going to pay them for a while." Here, it comes out of their bank account, the same day every week. And so, they don't miss it ... they're not thinking about the money going out. That's one of best things we did in building the strength of this company. Up front, saying this is how we're going to collect our royalties. And, it's been salable to our franchisees. At first, there was a little push back, but they are a generation that used to paying their health club dues or their child care and their loan payments by having their account debited. They are a lot different from me, I think giving somebody the right to get into my bank account and take money out is the worst possible thing I could never do. But that's been a wonderful thing for us, it's really given us good cash flow and no receivable problems.

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Q. I'm sure that those calls to collect royalty payments are not pleasant ones, to chase the royalty payments.

A. That's right. You know, I don't like the ads that you guys ran on TV, so I'm not going to pay my royalties. You opened a store 9 mi. away from me, and it's taking a lot of my business away.

Q. You touched on this before, about the need to get earnings going. As a publicly traded company, those earnings must be divided among all the stakeholders: the shareholders, the corporation, and the franchisees. Is balancing the needs of the stakeholders more of an art or science?

A. It's probably most difficult with franchisees. You know, balancing their interests. Making sure were treating them fairly, and they're still making money. Especially because we dictate a lot to them. We tell them they can only buy from one food vendor, they can only buy one kind of food, they have to buy everything that we tell them from the suppliers that we tell them. And that's everything that goes in the store from the beginning, and all the food that goes in the store from then on. Balancing the interests between shareholders of the companies and lenders, you know, they have a common interest. They want to see the profitability of the company. They want us to pay back their loans, #2 to create value. Our shareholders never bought the stock as an income stock, they bought it as a growth stock. So, if our shareholders ... if we have to take a dollar and pay down debt a dollar, they see that as the same benefit as giving them a dollar ... we've grown by a dollar and created an additional dollars worth of net worth. But, that hasn't been much of a problem. The question is, how much true service does a franchisee get. We struggle all lot, because we like our franchisees ... you get to know them ... and you meet them at gatherings. And sometimes we struggle ... one gets in trouble and they're losing money, then they're out of money. It's human nature to all get together, have an emergency meeting and decide what we're going to do the help this person, and get them out of trouble. Jarrod [Brooks, Area Director of Quizno's in South Carolina] and I are dealing with one down there with Jimmy Johnson. You know, we struggle ... what do we do ... what can we do to help this guy, to make this thing work, to get his loan paid, to make the lender happy ... and so, what we're doing, we're taking our resources and focusing our resources on something that's one 1300th of the company. And that's where we have to really discipline ourselves, and we have to say ... and Rick keeps reminding us ... you have to look at the universe, you have to help everybody. And, hard as it is to let this one unit fail, you got to let it fail. Because you can't spend your time ... if we're going to try to save every unit, we're never going to grow ... we're never going to be able to create benefits for the whole. It's admitting that ... and letting those units fail ... and going on and putting our efforts into building the other 1299 stores, and doing something that would be good for them. And recognizing why that person failed ... and if that was a mistake in the business model, to correct that, so that we don't do it again.

Q. Can you talk a little bit about company stores. Some of the research suggests that these stores are more profitable than franchisee owned outlets.

A. I think that may be true in some situations, but I don't think it's true for us. Company stores do create cash flow, good cash flow for us. But not necessarily profits after depreciation and amortization. But they do generate cash flow, they give us a good place to try out new ideas, a place to train new employees to become new representatives for us. They give us places to do shows, to have open houses. The serve a lot of purposes. With our business, though, because of the low sales volume, $400,000 to $450,000 per year, and the relatively tight margins ... a mistake in one of our company-owned stores has an exponential effect on our bottom line. Whereas, you take a Ruby Tuesday [restaurant] doing $1.5 million to $1.8 million per year in sales, and operating on 12 percent margin ... they can make a few mistakes and recover. Are they can also afford to have a fulltime, professional, general manager in that store to avoid those mistakes. At our level of volume, its well-suited to an owner-operator. Company-store ownership is difficult because we can't afford to hire people to put them in there with professional managers and get them motivated the same way a franchisee works. A franchisee will work 12 hours a day, seven days a week and he'll love it. Our paid people would never do that, no matter how hard we try. So we're drifting away from company-owned stores. We've actually ... in the last 90 days with taken our Denver company stores about 17 or 18 of them, and we formed four limited partnerships. And we put three four in each limited partnership. And then we took company store supervisors, and we made each one of those ... offered them 51 percent of one of the partnerships. And now, you got four partnerships with a 51% owner, being one of our company store supervisors. And we took the other 49 percent. And we basically gave them a franchise, we lease them the equipment. And it's 51 percent yours 49 percent ours. And you get to keep your salary and no bonuses, but at the end of each month we split up the profits, 51 percent to you, 49% to us. Was started that in April, and I think that any of them believed, they thought that it was just a scheme. And then, at the end of May we handed them some checks, and we did it again in June, and then again in July. Now, guess what. Those four people are working 12 hours a day, seven days a week, they're trying to figure out their food costs, they're changing people, moving people, hiring people recruiting people. This shows you the power of ownership.

Q. What do you think are the biggest challenges you've overcome in the past couple of years?

A. Being consistently profitable ... That was our first goal. We had to get this thing where it was not only profitable, but where we were covering our G&A [general and administrative expenses] with our royalty stream. That was my first goal. And we said if we can get this thing where when the royalty comes in every Wednesday, cover the rent, the salaries, the taxes ... all the G&A, then we can step back and relax a little bit. We know then that our other sources of income will become our profit, like initial franchise fees, some of the other miscellaneous stuff will become our profit. So that was our first challenge. Other big challenges have been, even in this company has been finding people. We've been very fortunate getting staff, but we've had some turnover even at the highest levels of the company. But getting the right people in the right slots, especially in this environment it gets chaotic. And, when you find a weakness, it's hard to discipline yourself to take the time to do what I believe is right to do. And that is to write very thorough job descriptions, write down exactly what skills sets you need, write exactly what you want this person to do, and then to find the person, to do that job with those skills, rather than just say "well, I know a guy who's out of a job."

I think the greatest risk we have going forward is credit for our franchisees for startup capital. Startup financing loans, small business credit is pretty tight right now. Regardless of what the Fed [the U.S. Federal Reserve Bank] has been doing, our rates are going up. And they're getting more picky about who they choose to finance, rates are going up, costs are going up. That's a result of what's happened with defaults. Lenders have either gone out of business or are dormant or have been acquired ... there's just not the pool of competition ... it's much smaller than it was just two years ago. And they feel they can get these higher rates, and they can have stiffer underwriting criteria, so they're just doing it. My greatest fear is that credit gets so tight that people stop buying, like it was in the 1980's, when interest rates were in the high teens. At that point, you couldn't sell franchises if your life depended on it. Because nobody was making any kind of capital decisions for a long-term. That's the fear on the horizon, the challenge. So we're spending our time trying to figure out ways that we can lock up money, so if that happens, we've got a free ride four or five months into it, until we exhaust our commitment. But we're trying to see if we can find a way of convincing a lender to give us a commitment of $30 or $40 million for our franchisees that will carry us through. So if the rest of the world goes nuts, we'll have this, at least until we run out of it, enough until hopefully the problem goes away.

Q. Do you think a franchise company's business model changes over time, similar the product life-cycle model of growth, maturity, and decline?

A. Yes, I think so. When you live around a lot of franchise companies, and you can see the mistakes that they make. Dairy Queen is a good example. Back in the 1960's, Dairy Queen was one of the biggest franchisors in the country ... probably in the world. It was huge. But they lost their system. I mean, they lost their niche. Its because they just did not have the mechanics in place to upgrade and change their image, and keep up with the times. The franchisees were just put in there, to run their business for 15 or 20 years, suck all they could out of it, and then retire to Florida. Because Dairy Queen had no ability in their franchise agreements that required upgrades or improvements. And, as a result, you just saw the chain kind of become dilapidated, the stores getting dirty, and unpainted. And I think that's the biggest mistake. Especially in the restaurant business, where everybody expects that there is a new concept, a new theme every week. You've got to be able to require your franchisees to make upgrades ... new wallcoverings, new floors, all the aesthetic stuff ... to upgrade that and keep that image new all the time. I don't think we need to change our food. I think a lot of franchisors, including us, made some mistakes. We diversified, we tried pizza, home delivery pizza, gourmet pizza, we tried smoothies, we tried everything, we always come back and wind up admitting to ourselves that where we make money is on our core concept. I think a lot of franchisors, when they see their system getting into trouble, think let's sell something else. I think that's when you get in trouble. To save ourselves, rather than make our core concept work, we'll forget about that ... and we'll do this. And they don't do it well, and the core concept fails, and then the whole thing fails. And we've stuck ... Rick [the CEO] has stuck ... even though he's ventured into some things, we've never ... we've ventured in, and ventured out ... and stuck with the core concept. We make the sandwich ... we have LTOs [Limited Time Offers], and that's how we tweak the menu. We think up new sandwiches from a number of different sources. We have a flavor consultant, we have staff that come in trying these things ... we'll do the LTO for 90 days, and we'll advertise it. If it's not spectacular, then it's gone and the next LTO will come out, but if it's spectacular it will go on the menu, and then one comes off the bottom of the menu. And that's kind of how we evolve our menu. But we just do it very, very slowly. There's never any big changes in our core concept.

Q. Some franchises have grown through acquisition. Some have been successful, while others have failed. If Quizno's was to make an acquisition, would be to diversify or to gain market share?

A. Penetration. We've actually done a couple of acquisitions. We would never acquire another franchise chain, with the thought that we could convert it to Quizno's. We know that that does not work. We have acquired company-owned chains that we've converted to Quizno's. And really, those are just real estate plays. What we're doing is we're getting good locations, and that's it. We're not getting any goodwill from that chain, we're just creating Quizno's locations. We've dabbled in it, what it boils down to is this. We're opening one a day. A 20-unit chain that comes through the door might take us two months to negotiate, a month to do due diligence, and then take a ton of money ... in 20 days we will have duplicated that. So why bother? Why not just build more ourselves ... We know how to do it ... find good locations, rather than go through acquisitions. Acquisitions are pretty far down our scope. Although, we are looking at Wall Street Deli ... I think they're in Chapter 11 [bankruptcy] ... but that's just again a real estate play ... they've got great locations that we'd love to have. We put in an offer for about half of their locations ...all the good ones.

APPENDIX O

REQUIREMENTS FOR PREPARATION
OF A UNIFORM FRANCHISE OFFERING CIRCULAR

COVER PAGE: The state cover page of the offering circular must state:

1. The title in boldface type: FRANCHISE OFFERING CIRCULAR

2. The franchisor's name, type of business organization, principal business address and telephone number.

3. A sample of the primary business trademark, logotype, trade name, or commercial label or symbol under which the franchisee will conduct its business. (Place in upper left-hand corner of the cover page.)

4. A brief description of the franchised business.

5. The total amounts in Items 5 and 7 of the offering circular: Franchisee's Initial Franchisee Fee or Other Payment and Franchisee's Initial Investment.

6. The following statements:

Information comparing franchisors is available. Call the state administrators listed in Exhibit ____ or your public library for sources of information.

Registration of this franchise by a state does not mean that the state recommends it or has verified the information in this offering circular. If you learn that anything in the offering circular is untrue, contact the Federal Trade Commission and (State or Provincial authority).

7. Effective Date: (Leave blank until notified of effectiveness by state regulatory authority.)

Cover Page Instructions:

i. Present information in the required order. Except for risk factors or when instructed by the examiner, do not capitalize or underline.

ii. The estimated cash investment should agree with the Item 7 total. This total should represent the franchisee's entire initial investment minus only exclusions allowed by Item 7. Do not state what the total includes.

iii. Limit the cover page disclosure to one page unless risk factors require additional space. Disclosure on the cover page should be brief. Limit the description of the business to the product or service offered by the franchisor. Unless required by a state regulator, do not disclose financing arrangements or the franchisee's right to use the trademark. Exclude non-required information unless necessary as a risk factor or required by a state regulator.

iv. If applicable, disclose the following risk factors using the following language on the cover:

1. THE FRANCHISE AGREEMENT PERMITS THE FRANCHISEE (TO SUE) (TO ARBITRATE WITH)__________ ONLY IN___________ . OUT OF STATE (ARBITRATION) (LITIGATION) MAY FORCE YOU TO ACCEPT A LESS FAVORABLE SETTLEMENT FOR DISPUTES. IT MAY ALSO COST MORE (TO SUE) (TO ARBITRATE WITH)__________ IN __________ THAN IN YOUR HOME STATE.

2. THE FRANCHISE AGREEMENT STATES THAT LAW GOVERNS THE AGREEMENT, AND THIS LAW MAY NOT PROVIDE THE SAME PROTECTIONS AND BENEFITS AS LOCAL LAW. YOU MAY WANT TO COMPARE THESE LAWS.

3. THERE MAY BE OTHER RISKS CONCERNING THIS FRANCHISE.

v. In addition to the above language, disclose other risk factors required by a state regulator.

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vi. Use capital letters for risk factor disclosure.

vii. In multistate offerings in which the franchisor uses a single offering circular, refer to an exhibit to the offering circular for a list of State or Provincial authority.

Sample Cover Page:
(Logo)

Franchise Offering Circular

Belmont Mufflers, Inc.
A Minnesota Corporation
First Street
Jackson, Minnesota 55000
(612) 266-3430

The franchisee will repair and install motor vehicle exhaust systems. The initial franchise fee is $10,000. The estimated initial investment required ranges from $132,700 to $160,200. This sum does not include rent for the business location.
Risk Factors:

THE FRANCHISE AGREEMENT REQUIRES THAT ALL DISAGREEMENTS BE SETTLED BY ARBITRATION IN MINNESOTA. OUT OF STATE ARBITRATION MAY FORCE YOU TO ACCEPT A LESS FAVORABLE SETTLEMENT FOR DISPUTES. IT MAY ALSO COST YOU MORE TO ARBITRATE WITH US IN MINNESOTA THAN IN YOUR HOME STATE.

Information about comparisons of franchisors is available. Call the state administrators listed in Exhibit ___ or your public library for sources of information.
Registration of this franchise with the state does not mean that the state recommends it or has verified the information in this offering circular. If you learn that anything in this offering circular is untrue, contact the Federal Trade Commission and (S tate or Provincial authority).

Effective Date:

TABLE OF CONTENTS: INCLUDE A TABLE OF CONTENTS BASED ON THE REQUIREMENTS OF THIS OFFERING CIRCULAR.

TABLE OF CONTENTS INSTRUCTION:

i. Refer to UFOC Items and state the page where each UFOC Item disclosure begins. List exhibits by letter. Use the following format:

APPENDIX O

TABLE OF CONTENTS

ITEM **PAGE**

SAMPLE TABLE OF CONTENTS:

TABLE OF CONTENTS

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<u>Exhibits</u>

APPENDIX O

Item 1

THE FRANCHISOR, ITS PREDECESSORS AND AFFILIATES

Item 1 Instructions:

i. Use the word "we," initials or one or two words to refer to the franchisor. Use different initials or a different one or two words to refer to other persons contracting with the franchisee under the franchise agreement. Except in the 23 Item titles, us e these initials or the word(s) to describe these persons or entities throughout the offering circular.

ii. Define the franchisee as "you" and use this description throughout the offering circular. If the franchisee could be a corporation, partnership or other entity, disclose whether "you" includes the franchisee's owners.

iii. "Predecessor" in Item 1 means a person from whom the franchisor acquired directly or indirectly the major portion of the franchisor's assets.

iv. The disclosure regarding predecessors need only cover the 10 year period immediately before the close of the franchisor's most recent fiscal year.

v. Affiliate in Item 1 means a person (other than a natural person) controlled by, controlling or under common control with the franchisor, which is offering franchises in any line of business or is providing products or services to the franchisees of the franchisor.

DISCLOSE IN SUMMARY FORM:

A. THE NAME OF THE FRANCHISOR, ITS PREDECESSORS AND AFFILIATES.

B. THE NAME UNDER WHICH THE FRANCHISOR DOES OR INTENDS TO DO BUSINESS.

Item 1B Instruction:

If the franchisor does business under a name different from the name disclosed in Item 1A, state that other name. If not, state that the franchisor does not do business under another name.

C. THE PRINCIPAL BUSINESS ADDRESS OF THE FRANCHISOR, ITS PREDECESSORS AND AFFILIATES, AND THE FRANCHISOR'S AGENT FOR SERVICE OF PROCESS.

Item 1C Instructions:

i. Principal business address means "home office" in the United States, not in the state for which the offering circular was prepared. If appropriate, also disclose the location of an international "home office." The business address can not be a post off ice box.

ii. In a multi-state offering in which the agent for service of process is required, the franchisor may use an
exhibit or the acknowledgement of receipt to disclose this agent.

D. THE BUSINESS FORM OF THE FRANCHISOR

Item 1D Instruction:

i. Disclosethe state of incorporation or business organization and the type of business organization.

E. THE FRANCHISOR'S BUSINESS AND THE FRANCHISES TO BE OFFERED IN THIS STATE.

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Item 1E Instructions:

Disclose the following:

i. That the franchisor sells or grants franchises;

ii. Whether the franchisor operates businesses of the type being franchised;

iii. The franchisor's other business activities;

iv. The business to be conducted by the franchisees;

v. The general market for the product or service to be offered by the franchisee. (For example, is the market developed or developing? Will the goods be sold primarily to a certain group? Are sales seasonal?)

vi. In general terms any regulations specific to the industry in which the franchise business operates. It is not necessary to include laws or regulations that apply to businesses generally.

vii. A general description of the competition.

F. THE PRIOR BUSINESS EXPERIENCE OF THE FRANCHISOR, ITS PREDECESSORS AND AFFILIATES INCLUDING:

(1) THE LENGTH OF TIME THE FRANCHISOR HAS CONDUCTED A BUSINESS OF THE TYPE TO BE OPERATED BY THE FRANCHISEE.

(2) THE LENGTH OF TIME EACH PREDECESSOR AND AFFILIATE HAS CONDUCTED A BUSINESS OF THE TYPE TO BE OPERATED BY THE FRANCHISEE.

(3) THE LENGTH OF TIME THE FRANCHISOR HAS OFFERED FRANCHISES FOR THE SAME TYPE OF BUSINESS AS THAT TO BE OPERATED BY THE FRANCHISEE.
(4) THE LENGTH OF TIME EACH PREDECESSOR AND AFFILIATE OFFERED FRANCHISES FOR THE SAME TYPE OF BUSINESS AS THAT TO BE OPERATED BY THE FRANCHISEE.

(5) WHETHER THE FRANCHISOR HAS OFFERED FRANCHISES IN OTHER LINES OF BUSINESS, INCLUDING:

(A) A DESCRIPTION OF EACH OTHER LINE OF BUSINESS;

(B) THE NUMBER OF FRANCHISES SOLD IN EACH OTHER LINE OF BUSINESS; AND

(B) THE LENGTH OF TIME THE FRANCHISOR HAS OFFERED EACH OTHER FRANCHISE.

(6) WHETHER EACH PREDECESSOR AND AFFILIATE OFFERED FRANCHISES IN OTHER LINES OF BUSINESS, INCLUDING:

(A) A DESCRIPTION OF EACH OTHER LINE OF BUSINESS;

(B) THE NUMBER OF FRANCHISES SOLD IN EACH OTHER LINE OF BUSINESS; AND

(B) THE LENGTH OF TIME EACH PREDECESSOR AND AFFILIATE OFFERED EACH OTHER FRANCHISE.

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Item 1F Instruction:

Limit disclosure about predecessors to the time before the franchisor acquired the predecessor's assets. Thus, under the 10 year limitation, if a franchisor acquired the assets of a predecessor 8 years ago, the disclosure about the predecessor should cove r only the 2 year period before the acquisition.

Sample Answer

To simplify the language in this offering circular "Belmont" means Belmont Mufflers Inc., the franchisor. "You" means the person who buys the franchise. Belmont is a Minnesota corporation that was incorporated on September 3, 1963. Belmont does business a s Belmont Muffler Shops. Our principal business address is 111 First Street, Jackson, Minnes ota 55555.

Belmont's agent for service of process is disclosed in Exhibit _____.

Belmont currently operates 12 Belmont Muffler Shops and sells pipe bending machines and mufflers to various muffler shops.

Belmont franchises the right to sell and install mufflers for the public. You must honor our guarantee to replace mufflers or exhaust pipes that wear out if the vehicle ownership has not changed. Belmont's franchisees often operate their muffler shop fran chise with their service stations or tire center. Your competitors include department store service departments, service stations and other national chains of muffler shops. Exhibit is attached to this offering circular and contains a summary of the special regulations for muffler installation in your state.

During the past 5 years Belmont has operated 7 muffler shops that are similar to the franchised shops being offered. All these shops are located in urban areas, have approximately xxxxx square feet of floor space and are located on busy streets. An additional 3 muffler shops were opened in 1990. From 1968 to 1973, Belmont offered franchises for "Repair-All Transmission Shops." "Repair-All" franchisees repaired and replaced motor vehicle transmissions under a marketing plan similar to the franchise in this offering circular. Belmont sold 40 of these franchises primarily in the states of Minnesota, Michigan, Wisconsin and Illinois. In 1973, Belmont sold this transmission repair company to CTF Inc.

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Item 2

BUSINESS EXPERIENCE

LIST BYNAME AND POSITION THE DIRECTORS, TRUSTEES AND/OR GENERAL PARTNERS, THE PRINCIPAL OFFICERS AND OTHER EXECUTIVES OR SUBFRANCHISORS WHO WILL HAVE MANAGEMENT RESPONSIBILITY RELATING TO THE FRANCHISES OFFERED BY THIS OFFERING CIRCULAR. LIST AL L FRANCHISE BROKERS. STATE EACH PERSON'S PRINCIPAL OCCUPATIONS AND EMPLOYERS DURING THE PAST FIVE YEARS.

Item 2 Instructions:

i. Principal officers include the chief executive and chief operating officer, the president, financial, franchise marketing, training and franchise operations officers.

ii. First disclose the position and the name of the person holding it. Underline this information; then skip one line.

iii. Disclose the beginning date and departure date for each job held in the five year period whether or not this dat e is within the past five years. Disclose the location of the job.

iv. Do not disclose home addresses, home telephones, social security numbers or birth dates in this Item.

v. Disclose the required information concerning the franchise broker's directors, pri ncipal officers and executives with management responsibility to market or service the franchises.

vi. In a multi-state offering in which the franchisor uses a single offering circular and franchise brokers and executives with direct management responsibility to the franchisees differs from state to state, use an exhibit to refer to these personnel.

Sample Answer

President: Jane J. Doe

From June, 1978, until April, 1986, Ms. Doe was Vice-President of Atlas Inc., a Houston, Texas based manufacturer of automobile wheels. In April, 1986, she joined Belmont as a Director and Vice President. She was promoted to president in June, 1987.

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Item 9

FRANCHISEE'S OBLIGATIONS
DISCLOSE THE PRINCIPAL OBLIGATIONS OF THE FRANCHISEE UNDER THE FRANCHISE AND OTHER AGREEMENTS AFTER THE SIGNING OF THESE AGREEMENTS.

Item 9 Instructions:

i. Disclose obligations in tabular form. Refer to the section of the agreement that contains the obligation and any Item of the Offering Circular that further describes the obligation.

ii. The table should contain a response to each category listed below. If the response to any category is that no obligation is imposed, the table should state that. Do not change the names of the categories. Fit all obligations within the listed categories. If other material obligations fall outside the scope of all of the prescribed categories, add additional categories as needed. The categories of franchisee obligations are:

a. Site selection and acquisition/lease
b. Pre-opening purchases/leases
c. Site develop ment and other pre-opening requirements
d. Initial and ongoing training
e. Opening
f. Fees
g. Compliance with standards and policies/Operating Manual
h. Trademarks and proprietary information
i. Restrictions on products/services offered
j. Warranty and customer service requirements
k. Territorial development and sales quotas
l. Ongoing product/service purchase
m. Maintenance, appearance and remodeling requirements
n. Insurance
o. Advertising
p. Indemnification
q. Owner's participation/management/staffing
r. Records and reports
s. Inspections and audits
t. Transfer
u. Renewal
v. Post-termination obligations
w. Non-competition covenants
x. Dispute resolution
y. Other (describe)

iii. Before the table, state the following:

THIS TABLE LISTS YOUR PRINCIPAL OBLIGATIONS UNDER THE FRANCHISE AND OTHER AGREEMENTS. IT WILL HELP YOU FIND MORE DETAILED INFORMATION

APPENDIX O

ABOUT YOUR OBLIGATIONS IN THESE AGREEMENTS AND IN OTHER ITEMS OF THIS OFFERING CIRCULAR.

Sample Answer 9

THIS TABLE LISTS YOUR PRINCIPAL OBLIGATIONS UNDER THE FRANCHISE AND OTHER AGREEMENTS. IT WILL HELP YOU FIND MORE DETAILED INFORMATION ABOUT YOUR OBLIGATIONS IN THESE AGREEMENTS AND IN OTHER ITEMS OF THIS OFFERING CIRCULAR.

Obligation	**Section in Agreement**	**Item in Offering Circular**
a. Site selection and acquisition/lease	Section 2A of Franchise Agreement	Items 6 and 11
b. Pre-opening purchases/ leases	Section 3D of Franchise Agreement	Item 8
c. Site development and other pre-opening requirements	Sections 3A and 3B of Franchise Agreement	Items 6, 7 and 11
d. Initial and ongoing training	Section 5 of Franchise Agreement	Item 11
e. Opening	Section 4 of Franchise Agreement	Item 11
f. Fees	Section 6 of Franchise Agreement	Items 5 and 6
g. Compliance with standards and policies/ Operating Manual	Section 8A of Franchise Agreement	Item 11
h. Trademarks and proprietary information	Sections 7 and 11 of Franchise Agreement	Items 13 and 14
i. Restrictions on products/ services offered	Section 12 of Franchise Agreement	Item 16
j. Warranty and customer service requirements	Section 8B of Franchise Agreement	Item 11
k. Territorial development and sales quotas	None	
l. Ongoing product/service purchases	Section 9 of Franchise Agreement	Item 8
m. Maintenance, appearance and remodeling requirements	Sections 8C and 10 of Franchise Agreement	Item 11
n. Insurance	Section 13A of Franchise Agreement	Items 6 and 8
o. Advertising	Section 15 of Franchise Agreement	Items 6 and 11

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p. Indemnification	Section 13B of Franchise Agreement	Item 6
q. Owner's participation/ management/ staffing	Sections 4, 5and 14 of Franchise Agreement	Items 11 and 15
r. Records/ reports	Section 17A of Franchise Agreement	Item 6
s. Inspections/ audits	Section 17B of Franchise Agreement	Items 6 and 11
t. Transfer	Section 18 of Franchise Agreement	Item 17
u. Renewal	Section 20 of Franchise Agreement	Item 17
v. Post-termination obligations	Section 22 of Franchise Agreement	Item 17
w. Non-competition covenants	Sections 11,18 and 22C of Franchise Agreement	Item 17
x. Dispute resolution	Section 24 of Franchise Agreement	Item 17

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Item 17

RENEWAL, TERMINATION, TRANSFER
AND DISPUTE RESOLUTION

SUMMARIZE THE PROVISIONS OF THE FRANCHISE AND OTHER AGREEMENTS DEALING WITH TERMINATION, RENEWAL, TRANSFER, DISPUTE RESOLUTION AND OTHER IMPORTANT ASPECTS OF THE FRANCHISE RELATIONSHIP.

Item 17 Instructions:

i. Begin Item 17 disclosure with the following statement:

This table lists certain important provisions of the franchise and related agreements. You should read these provisions in the agreements attached to this offering circular.

ii. Respond in tabular form. Refer to the section of the agreement which covers each subject.

iii. Use a separate table for any other significant franchise-relate agreements. If a provision in any other agreement affects the provisions of the franchise or franchise-related agreements disclosed in this Item (for example, the term of the franchise w ill be equal to the term of the lease), disclose that provision in the applicable category in the table.

iv. The table should contain a "summary" column to summarize briefly the disclosed provision. The summary is intended to provide a concise overview of the provision in no more than a few words or a sentence. Do not specify in detail all matters covered by a provision.

v. The table should respond to each category listed below. Do not change the names of the categories. List all contractual provisions relevant to each category in the table. If the response to any category is that the agreement does not contain the relevant provision, the table should so state. If the agreement is silent concerning a category but the franchisor unilaterally offers to provide certain benefits or protections to franchisees as a matter of policy, a footnote should describe this policy and state whether the policy is subject to change. The categories are:

a. Length of the term of the franchise

b. Renewal or extension of the term

c. Requirements for franchisee to renew or extend

d. Termination by franchisee

e. Termination by franchisor without cause

f. Termination by franchisor with "cause"

g. "Cause" defined - curable defaults

h. "Cause" defined - defaults which cannot be cured

i. Franchisee's obligations on termination/non-renewal

j. Assignment of contract by franchisor

k. "Transfer" by franchisee – defined

l. Franchisor approval of transfer by franchisee

m. Conditions for franchisor approval of transfer

n. Franchisor's right of first refusal to acquire franchisee's business

o. Franchisor's option to purchase franchisee's business

p. Death or disability of franchisee

q. Non-competition covenants during the term of the franchise

r. Non-competition covenants after the franchise is terminated or expires

s. Modification of the agreement

t. Integration/merger clause

u. Dispute resolution by arbitration or mediation

v. Choice of forum

w. Choice of law

Sample Answer 17

This table lists important provisions of the franchise and related agreements. You should read these provisions in the agreements attached to this offering circular.

Provision	Section in Franchise Agreement	Summary
a. Term of the franchise	Section 1, (also Section 1 of Lease, Exhibit F)	Term is equal to lease term - 10 years
b. Renewal or extension of the term	Section 20	If you are in good standing you can add additional term equal to renewal term of lease (10 years max.)
c. Requirements for you to renew or extend	Section 20	Sign new agreement, pay fee, remodel and sign release
d. Termination by you	None	
e. Termination by Belmont without cause	None	
f. Termination by Belmont with cause	Section 21	Belmont can terminate only if franchisee defaults
g. "Cause" defined - defaults which can be cured	Section 21B	You have 30 days to cure: non-payment of fees, sanitation problems, non-submission of reports and any other default not listed in Sec. 21A
h. "Cause" defined - defaults which cannot be cured	Section 22	Non-curable defaults: conviction of felony, repeated defaults even if cured, abandonment, trademark misuse and unapproved transfers
i. Your obligations on termination/ nonrenewal	Section 22	Obligations include complete deidentification and payment of amounts due (also see r, below)
j. Assignment of contract by Belmont	Section 18	No restriction on Belmont's right to assign
k. "Transfer" by you - definition	Section 19A	Includes transfer of contract or assets or ownership change
l. Belmont's approval of transfer by franchisee	Section 19B	Belmont has the right to approve all transfers but will not unreasonably withhold approval

APPENDIX O

m. Conditions for Belmont approval of transfer	Section 19C	New franchisee qualifies, transfer fee paid, purchase agreement approved, training arranged, release signed by you and current agreement signed by new franchisee (also see r, below)
n. Belmont's right to first refusal to acquire your business	Section 19F	Belmont can match any offer for the franchisee's business
o. Belmont's option to purchase your business	None, but see policy described in Note 1	
p. Your death or disability	Section 19D	Franchise must be assigned by estate to approved buyer in 6 months
q. Non-competition covenants during the term of the franchise	Section 11	No involvement in competing business anywhere in U.S.
r. Non-competition covenants after the franchise is terminated or expires	Sections 19C and 22C	No competing business for 2 years within 20 miles of another Belmont franchise (including after assignment)
s. Modification of the agreement	Section 8A	No modifications generally but Operating Manual subject to change
t. Integration/ merger clause	Section 29	Only the terms of the franchise agreement are binding (subject to state law). Any other promises may not be enforceable
u. Dispute resolution by arbitration or mediation	Section 24 Except for certain claims, all disputes must be arbitrated in ________, ____________	
v. Choice of forum	Section 27	Litigation must be in ____________________
w. Choice of law	________________ law applies	
Section 28		

Note 1 - Franchisor is not obligated by the Agreement to do so, but, if the franchise is terminated, franchisor's policy is to buy back inventory at fair market value. This policy is subject to change at any time.

These states have statutes which may supersede the franchise agreement in your relationship with the franchisor including the areas of termination and renewal of your franchise: ARKANSAS [Stat. Section 70-807], CALIFORNIA [Bus. & Prof. Cod e Sections 20000-20043], CONNECTICUT [Gen. Stat. Section 42-133e et seq.], DELAWARE [Code, tit.], HAWAII [Rev. Stat. Section 482E-1], ILLINOIS [Rev. Stat. Chapter 121 1/2 par 1719-1720], INDIANA [Stat. Section 23-2-2.7], IOWA [Code Sections 523H.1-523H.17], MICHIGAN [Stat. Section 19.854(27)], MINNESOTA [Stat. Section 80C.14], MISSISSIPPI [Code Section 75-24-51], MISSOURI [Stat. Section 407.400], NEBRASKA [Rev. Stat. Section 87-401], NEW JERSEY [Stat. Section 56:10-1], SOUTH DAKOTA [Codified Laws Section 37-5A-51], VIRGINIA [Code 1 3.1-557-574-13.1-564], WASHINGTON [Code Section 19.100.180], WISCONSIN [Stat. Section 135.03]. These and other states may have court decisions which may supersede the franchise agreement in your relationship with the franchisor including the areas of termination and renewal of your franchise.