

The franchise relationship in China: Agency and institutional theory perspectives

Introduction

The number of franchise outlets in China is estimated to grow to 800,000 by 2016, creating more than 10 million jobs (China Daily, 2011). These figures rival current US statistics where franchising accounts for more than 50% of retail and service revenue and 14% of private sector employment (Franchiseeek, 2011). Franchising in China is a relatively new phenomenon (Wang, Zhu and Terry, 2008); the franchise relationship, and the resulting constructs of power, control, support and conflict, remain under-researched.

Franchising theory has been developed in the context of franchise systems operating in market economies with established institutional structures (Dant, 2008; Holmberg and Morgan, 2003; Kedia *et al.*, 1994; Meek *et al.*, 2011). The economic perspective provided by agency theory (Jensen and Meckling, 1976) dominates the literature (Barthelemy, 2008; Castrogiovanni *et al.*, 2006a, 2006b; Combs *et al.*, 2004a). A sociological viewpoint such as that provided by institutional theory has the potential to explain elements of the franchise relationship which the economic perspective alone overlooks (Shane and Foo, 1999; Combs *et al.* 2009; Barthelemy, 2011).

In this paper we seek to discover aspects of franchise relationships in China that are not fully reflected in current theoretical understanding. By employing both economic and sociological approaches we provide a holistic understanding of the franchising relationship in a dynamic, developing economy. By providing evidence from both franchisors and franchisees we offer a more robust view of the franchise relationship. This contributes to redressing the imbalance in extant research which is dominated by the franchisor viewpoint.

The Franchise Relationship

Grunhagen and Dorsch (2003, p.367) contend that “the franchisor-franchisee relationship represents a partnership conducted as a form of relational exchange”. Relationship building

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3 involves sharing of benefits and costs. The formal basis of the relationship is the franchise
4 contract. The franchisor provides the franchisee with the right to sell products or services. In
5 business format franchising this includes use of a brand name owned by the franchisor. In
6 return for a lump sum payment and an annual royalty fee based on sales, the franchisor gives
7 the franchisee the right to use this intellectual property for a specified time period. The
8 franchisee, in return for franchise fees, expects to operate in a supported and assisted
9 environment (Fulop and Forward, 1997). Rahatullah and Raeside (2008, p.27) describe
10 relational exchange relationships as “durable, dynamic, and adaptable”, emphasizing that the
11 relationship constructs of support, power and control, facilitate “an effective, efficient, and
12 long-lasting dyadic relationship”.

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21 The foundational work on power by French and Raven (1959), and later work by Lusch
22 (1976) and Gaski (1984) provide the basis for understanding power within the franchise
23 channel. This early franchise research is US market focused, while later authors explore
24 relational constructs in the franchise relationship in developed markets outside of the US:
25 Australia and the UK (Quinn, 1999; Quinn and Doherty, 2000; Frazer *et al.*, 2007; Brookes
26 and Roper, 2011). These authors emphasize controlling the franchise relationship through
27 non-coercive power sources, such as support mechanisms, rather than coercive sources of
28 power, such as the contract (Quinn and Doherty, 2000; Brookes and Roper, 2011).

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36 In international franchise relationships, communication, trust and the choice of franchise
37 partner are important sources of power (Doherty and Alexander, 2006; Doherty, 2009).
38 Moore *et al.* (2004) support Lusch (1982) in finding that cultural disconnection is a key
39 source of conflict with international partners. They also find that channel members’
40 willingness to exert coercive power does not encourage healthy channel relationships (Moore
41 *et al.*, 2004). Doherty and Alexander (2006) and Quinn (1999) assert that non-coercive power
42 sources, particularly collaborative decision making, produce better franchise relationships.

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49 In exploring sources of conflict, Frazer *et al.* (2012) highlight the tensions which emanate
50 from expectation gaps at the outset of the relationship, distrust in the relationship, relational
51 dissatisfaction and perceptions of conflict. However, these authors further perpetuate the
52 focus on developed market economies with established legal and social frameworks. Detailed
53 consideration of the dynamics within the franchise relationship in markets with emerging
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3 economies, evolving legal frameworks and rapidly changing social expectations remains
4 under-researched.
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7 8 **Theoretical Frameworks** 9

10 Agency theory (Jensen and Meckling, 1976) is based on the concept of the principal-agent
11 relationship: the principal delegates work to the agent to be carried out on the principal's
12 behalf on a day-to-day basis. Two agency problems arise in this context: horizontal and
13 vertical agency (Combs *et al.* 2004a). The horizontal agency problem concerns the franchise
14 brand and the potential for free riding by franchisees (Brickley and Dark, 1987; Kidwell *et*
15 *al.*, 2007). The vertical agency problem concerns the potential for employees to act self
16 interestedly against the wishes of management (Combs *et al.*, 2004a; Jensen and Meckling,
17 1976). Franchisees are not employees and will not shirk because income is directly related to
18 effort: they are profit motivated. Employees require closer monitoring than franchisees;
19 therefore, franchising is expected to reduce monitoring costs (Rubin, 1987). However, the
20 potential for opportunism and moral hazard remains. On the double agency problem Combs
21 *et al.* (2004a, p.912) conclude: "geographic dispersion creates two problems for chain
22 managers. They must motivate and monitor outlet managers to solve vertical agency and they
23 must insure that investments in the brand are maintained to solve horizontal agency."
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36 Control, power, monitoring and the resultant potential for conflict are implicit in agency
37 theory. A hierarchical, dependent relationship characterizes this theoretical perspective.
38 Barthelemy (2011) concludes that agency theory alone does not fully explain how the
39 franchise relationship operates in practice. Franchise relationships may be further explained
40 by institutional theory, with its emphasis on the institutions and culture which shape the
41 business environment (DiMaggio and Powell, 1983; Scott, 1995, 2008).
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50 North (1990), Di Maggio and Powell (1983) and Scott (1995, 2008) are the key protagonists
51 of what is known as new institutionalism. Scott (1995, 2008), taking a sociological
52 perspective, defines institutions as comprising "regulative, normative and cultural-cognitive
53 elements that, together with associated activities and resources, provide stability and meaning
54 to social life" (Scott, 2008, p.48). These regulative, normative and cultural-cognitive systems
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3 are known as Scott's three pillars of institutions and form the basis for legitimacy. These
4 systems may be in conflict at any one time and are not necessary mutually reinforcing. Here
5 it is worth quoting Scott (2008): "The regulatory emphasis is on conformity to rules:
6 legitimate organizations are those established by and operating in accordance with relevant
7 legal or quasi-legal requirements. A normative conception stresses a deeper, moral base for
8 assessing legitimacy. Normative controls are more likely to be internalized than are
9 regulative controls, and the incentives for conformity are hence likely to include intrinsic as
10 well as extrinsic rewards. A cultural-cognitive view points to the legitimacy that comes from
11 conforming to a common definition of the situation, frame or reference....[it] is the "deepest"
12 level, because it rests on preconscious, taken-for-granted assumptions" (Scott, 2008, p.61).

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21 Shane and Foo (1999) find that new franchise system survival is better explained when
22 employing institutional explanations alongside economic reasons. In their US sample,
23 franchise survival is more likely where there is cognitive legitimacy; that is, taken-for-
24 grantedness derived from an established shared understanding (Shane and Foo, 1999).
25 'Certification by the media', that is, socio-political approval by the media in the form of
26 published franchisor rankings, plays a key role in legitimizing franchisors. Those US states
27 which have disclosure and termination laws help franchisors attract franchisees by protecting
28 them against opportunistic and/or financially risky franchisors (Shane and Foo, 1999).

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35 Combs *et al.* (2009, p.1270) also find that "social forces described by institutional theory add
36 explanatory power beyond that offered by economic explanations". Barthelemy (2011)
37 provides evidence of mimetic isomorphism, that is, franchise chains imitating the behaviour
38 of competitors which moves the system towards a taken-for-grantedness position. Like the
39 work of Combs *et al.* (2009), Barthelemy's contribution is focused on the *decision* to
40 franchise and the mix of franchise and owned stores in a franchise chain. Shane and Foo
41 (1999) and Combs *et al.* (2009) explore these ideas in a US context; France provides the
42 location for Barthelemy's (2011) contribution. In both countries franchising is a long
43 established organizational form operationalized in the context of legitimizing frameworks.
44 However, Combs *et al.* (2009, p.1283) assert that "institutional theory is most relevant when
45 uncertainty is high, relative to economic imperatives."

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56 The developing nature of franchising in China presents a pertinent site to explore economic
57 and social influences within the franchise relationship. Therefore, we consider the developing
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3 franchise relationship, rather than issues such as the decision to franchise or move to
4 company outlets, which have dominated the franchise debate. In China, institutional
5 mechanisms are still evolving: private enterprises were legalized in 1988 (Lu and Tao, 2010).
6 As Tan *et al.* (2009: 546) note “the formal, regulatory, coercive institutional mechanisms that
7 under gird a market economy like property rights, company law and contracts, legal
8 frameworks for managing and settling disputes, and concomitant sanctions are still evolving,
9 or in some instances non-existent.”
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14 **Franchising in China**

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20 Dant (2008) highlights the North American dominance of franchising research. The challenge
21 of emerging economies has attracted researchers (Welsh *et al.*, 2006), although research to
22 date has provided very little primary data collection and analysis of how the franchise
23 relationship in China operates. Establishing an understanding of the regulatory pillar is the
24 first step in providing a context for the current work.
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30 Wang *et al.* (2008) provide a concise historical account of how franchising has developed in
31 China. They distinguish three stages of franchise development: stage one (1987-1992), the
32 introduction of the franchise concept with the arrival of US fast food pioneers; stage two
33 (1993-1997), the adoption of franchising by local enterprises; stage three (1998-2006), the
34 rapid growth of franchising and associated problems. As franchising developed, problems
35 arose “from a lack of understanding of franchising and the intricacies of the
36 franchisor/franchisee relationship” (Wang *et al.*, 2008: 172/3). Table II outlines consequent
37 development of franchise regulation in China.
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49 With some ambiguity in the 2005 Franchise Measures, the 2007 Franchise Regulations were
50 introduced to address a range of issues including full disclosure of information to franchisees
51 by franchisors and the combating of fraud. The importance of support for franchisees is
52 highlighted in the 2007 Regulations. It is seen as fundamental to the long-term development
53 of franchising in China. Having provided this background, the paper now presents the
54 methods employed, data collection and analysis techniques.
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Methodology

Research position

Elango and Fried (1997, p.77) advocate fine grained approaches to franchise research: “the actual operations of a franchising system have rarely been directly examined”. The last decade witnessed a growth in the use of qualitative methods in retail franchising research: ethnography (Quinn, 1999), case studies (Doherty, 2009) and in-depth interviews (Moore *et al.*, 2004). By employing in-depth interviews with franchisors and franchisees in the retail sector in China we seek to develop an understanding of franchising in a dynamic economic and social environment. Qualitative research is particularly challenging, especially with regard to company access. The access achieved is deemed to be a particular strength of the work presented here.

Sample selection and securing access

When conducting research on business activities in China it is important to establish a relationship, usually through referral, with potential respondents (Bruton and Ahlstrom, 2003). Two institutions were deemed to be central to advancing the work; the China Chain Store and Franchise Association (CCFA) and the government authority in the region where the research was carried out, the Guangdong Provincial Administration for Industry and Commerce.

The China Chain Store and Franchise Association (CCFA) provides a range of information and services on retailing generally, and franchising specifically. It deems itself to be the official representative of the retailing and franchising industry in China, with a membership that includes domestic retailers, international retailers, franchisors, suppliers and other related organizations (CCFA, 2011). The CCFA membership database provided the best opportunity for identifying those retail franchise organizations which would fit with the case selection criteria:

Selection Criterion 1: Operate in China in the retail sector via franchising

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3 **Selection Criterion 2:** Operate within a confined geographical area in order to minimize
4 variation from external influences. The area of the Pearl River Delta was chosen for the
5 current work
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8 **Selection Criterion 3:** Have experience of at least one year franchising in the retail sector
9 in China. Both international and domestic retailers were eligible.
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13 The CCFA has many divisions operating on a provincial basis in China and CCFA
14 Guangdong represents the CCFA in this province. Guangdong Provincial Administration for
15 Industry and Commerce is the key governmental department mainly responsible for
16 regulating the circulation of goods, investigating and enforcing any trade mark infringements
17 with responsibility for all trademark management for all industrial and commercial
18 enterprises. In the chain store and franchise industry, the department works closely with the
19 CCFA to regulate the franchise companies in the area of Guangdong province.
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26 Initial contact was made with the CCFA and Guangdong Provincial Administration for
27 Industry and Commerce. Via personal contacts, two CCFA Guangdong consultants were
28 already known to the research team. While both contacts had been working closely with the
29 member companies of CCFA in Guangdong province, they could not directly access
30 companies without the authorisation of the higher administration of CCFA Guangdong. In
31 order to approach the higher administration, it was advised that it was necessary to seek
32 support from the government. The government department was initially approached through a
33 different personal contact. Once senior officers understood the nature of the research project
34 and offered their consent for support, the two CCFA Guangdong consultants were then
35 authorised to help make initial contacts with target companies.
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44 Using the CCFA database twenty-five retail franchisors were found to fit with the preceding
45 criteria and were contacted via telephone to explain the purpose of the research and request
46 interviews with key personnel. Five companies refused to participate in academic research
47 due to concerns over the protection of sensitive commercial information. No response was
48 received from two organizations leaving eighteen retail franchisors. Following initial phone
49 calls to the franchisors by the CCFA consultants, phone calls were then made by one of the
50 researchers to specific personnel to confirm the time, venue and form of the interviews.
51 Following this process twelve franchisors gave their final agreement to participate in the
52 research.
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5 Franchisee access was secured via franchisors. Some franchisees were reluctant to participate
6 in interviews, therefore it was not possible to secure access with both franchisors and
7 franchisees in all twelve companies. As the work focuses on the franchise relationship, only
8 the nine retail franchise organizations where access to both franchisors and franchisees was
9 secured are included in this paper. Given the nature of doing research in China it was deemed
10 appropriate to secure access to firms at the outset, but during the course of the research a
11 consistent picture of the franchise relationship in China began to develop, reflecting a
12 replication logic as advanced by Eisenhardt (1989). Details of the nine retail franchise
13 organizations are provided in Table III.
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24 *Data collection and data analysis*

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26 The broad research objective is to identify the central tenets of the franchise relationship in
27 China. The setting of this objective follows the guidance of Eisenhardt (1989) on the
28 collection of qualitative data. Table IV highlights the key thematic issues explored in both
29 franchisor and franchisee interviews. To ensure consistency of structure during the course of
30 interviewing, interviews were guided by an inventory of issues tightly pertaining to the
31 research objective. As the interviews progressed, further questions and prompts followed
32 when there were additional and complementary issues raised by respondents.
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43 Interviews were held in Chinese and detailed hand written notes were also taken. Interviews
44 were tape-recorded upon the consent of the informants and each interview was transcribed in
45 Chinese and carefully translated from Chinese into English. To ensure the reliability of
46 transcription, two transcribers who are indigenous mainland China nationals with business
47 studies qualifications carried out the task of transcribing the interviews. The transcribers were
48 instructed to independently translate the tape-recorded content of each interview word-by-
49 word using exactly the same wording as originally used by respondents. Transcripts were
50 compared and when there were differences the original interview tape was listened to again
51 and the hand written notes were double checked. This procedure continued until full
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3 agreement was reached. In order to ensure confidentiality, companies were coded A to I and
4 their names replaced in the transcript.
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8 The final transcript was then translated into English. To ensure that the translation was
9 precise and closely adhered to the original Chinese wording, five independent translators
10 were instructed to carry out the task. They were all doctoral level Chinese native speakers and
11 had been residents in the UK for more than three years. To ensure the consistency of
12 specialised terms in translation, translators were provided with a reference that stipulated the
13 Chinese and the corresponding English, such as “特許行銷” for “*franchising*”, “物流系統”
14 for “*logistics system*” and so on. The five translated transcripts were then scrutinized and
15 compared side by side. A final version of English translation was then attained for each
16 interview.
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25 Following transcription interviews were analyzed using manual analytic coding by which the
26 integrity of the data and findings were protected (Doherty and Alexander, 2004, 2006).
27 Following Saldaña (2009), the coding process leading to the emergence of themes from the
28 data developed in three stages: (1) Pre-coding; (2) Developing analytical coding (3)
29 Categorizing. Pre-coding is intended to capture a sense of the various issues embedded in the
30 data during the first reading of the texts (Saldaña, 2009). Pre-coding was followed by
31 descriptive coding. Descriptive coding is given as the notation of the basic information and
32 context of respondents (Miles and Huberman, 1994). The descriptive codes are included in
33 Table III.
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41 Analytical codes can be either developed in advance based on existing literature or
42 framework, or in an *ad hoc* fashion, where codes are driven by immediate materials and data
43 (Kvale and Brinkmann, 2009). To conform to the primary purpose of the study, analytical
44 codes were developed according to emerging themes and issues from data rather than
45 predetermined. The procedure for analytical coding followed the guidance provided by
46 Saldaña (2009) by firstly generating preliminary codes and then achieving analytical codes.
47 Categorizing was carried out after analytical coding. Saldaña (2013, p.9) employs Grbich’s
48 definition, noting it is a process that permits data to be “*segregated, grouped, regrouped and*
49 *relinked in order to consolidate meaning and explanation*” (Grbich, 2007, p.21). Codes that
50 share similar concerns, similar topics or indicate similar patterns were then organised and
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3 sorted into the same category. During the course of the categorizing process, themes emerged
4 from constant cross-dyad comparison between categories and codes. Emerging themes were
5 then compared to generate the recurring themes which were most revealing of data and
6 pertinent to the central research question. These themes are presented in the findings section
7 below.
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11 12 13 **Findings and analysis** 14

15 16 17 *Franchise forms*

18 The type of franchising practiced by the case companies proved crucial in determining how
19 the franchise relationship operates. In the literature, business format franchising is taken to be
20 the accepted franchise form. This is not found to be the case in this study as two different
21 forms of franchising are being practiced. Of the nine companies, five practice business format
22 franchising (A, B, C, G and I) where business systems, brand and retail format are key
23 characteristics. A, B, and C are shopping goods chains; G and I are convenience store chains.
24 Company A is the only international franchisor. The other four are domestic franchisors.
25 Companies, D, E, F and H, convenience store franchisors, do not employ business format
26 franchising. They employ a franchise form focused on product supply and distribution.
27 Business systems, characteristic of business format franchising, are absent.
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37 38 39 *Motivations to enter the franchise relationship*

40 For the franchisor, there are five driving forces behind engagement in franchise relationships.
41 These are: an accelerated rate of store replication and market expansion through the injection
42 of resources from the franchisee, competitive advantage facilitated by the franchisee's
43 embedded local knowledge and property base, the opportunity to focus on core business
44 competencies, creation of economies of scale and, in some cases, opportunism. For
45 franchisees, the key motivating issues are: lack of entry and withdrawal barriers, benefits
46 derived from partner resources, saving time and effort in developing own store networks,
47 relevance of the business to the franchisees' prior experience and strength of the brand.
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53 Above all, both franchisors and franchisees recognize the importance of a strong brand in
54 attracting franchisees:
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3 *We believe that our brand is the main reason for the franchisees to come to us... a*
4 *brand built on tradition and reliability, good products and loyal customers.*
5 *(Company B, franchisor respondent)*
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9 *Power and control in the relationship*

10 *Franchisor power.* Franchisor power, and potential lack of power, is derived from a range of
11 dimensions: the contract, the brand, possession of market information and system
12 infrastructure. The presence of a recognised brand allows franchisors to be confident in
13 recruiting franchisees. Franchisors operating a strong brand via business format franchising
14 are more likely to use coercive power to control franchisees:
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19 *When franchisees get caught behaving outside the rules and regulations, warning*
20 *and coercion will be given to the franchisee. (Company I, franchisor respondent)*
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23 Franchisor power is enhanced through the acquisition of market information. Where the
24 franchisor lacks market information the firm is much more dependent on the franchisee,
25 creating an imbalance in the relationship:
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28 *The franchisee knew that we relied on his contacts to get into the market. As a result,*
29 *he thought he had the privilege to challenge or even refuse our instruction... I thought*
30 *any company like us at an early stage of market entry would inevitably encounter the*
31 *same situation we did. (Company H, franchisor respondent)*
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34 Stable franchise system infrastructure strengthens franchisor power and is crucial in the
35 development of franchise relationships. The opposite is also the case: failure in franchise
36 system infrastructure encourages non-compliance behaviour:
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39 *We know that some franchisees purchase products from other suppliers behind our*
40 *backs. Punishment and threat are definitely not the right way to eliminate their*
41 *activities... What we can do is to keep learning from others and improving our*
42 *systems... If you are not good enough at performing your responsibilities well, you do*
43 *not have the position to enforce franchisees' compliance with instruction. (Company*
44 *F, franchise manager)*
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47 *Franchisee power.* A key determinant of franchisee power is information exchange between
48 franchisees:
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51 *The company has to be aware that we franchisees would communicate with each*
52 *other. If they (the company) did something bad to us, it would be soon known by all of*
53 *us (the franchisees)... (Company G, franchisee respondent)*
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56 Information exchange as a source of franchisee power deters some franchisors from
57 organising meetings of franchisees:
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3 *We have every reason to be proud of the arrangement of the annual meeting, because*
4 *not so many franchisors can do this, because this requires a lot of confidence in the*
5 *company's performance on operations and the quality of the relationship with*
6 *franchisees... I know some franchisors have never organised a franchisee gathering,*
7 *because they are afraid that franchisees would spread negative comments. (Company*
8 *I, franchisor respondent)*
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12 Company E's experience indicates that franchisees with prior business experience are more
13 difficult to manage. Company G suggests experienced franchisees are "*too smart to control*".
14 Franchisors, particularly from the convenience store sector, prefer franchisees with no
15 previous experience of franchising. While a franchisee possessing stores in key locations is
16 attractive to the franchisor, a very profitable store operation is an important source of power
17 for the franchisee, impeding franchisors from adopting a punitive approach to non-
18 compliance.
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25 *Monitoring.* Monitoring mechanisms mirror those found in previous franchise studies: the use
26 of a regional supervisor and technological equipment. Franchisors in the convenience store
27 sector place more emphasis on control compared with their counterparts in the shopping
28 goods sector. The use of technological equipment as a means to control the franchisee is
29 emphasized in this sector.
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36 For the franchisee, monitoring is a controversial issue. A large proportion of franchisees are
37 unhappy with the frequent change of regional supervisor, insufficient help and inefficient
38 response of the supervisor. Furthermore, some franchisees believe that the presence of a
39 regional supervisor indicates they are not trusted by the franchisor.
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44 *Sources of conflict in the relationship*

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46 *Franchisee non-compliance.* The major example of non-compliance in these franchise
47 relationships is the unethical behaviour displayed by some franchisees who sell products not
48 approved by the franchisor. It is particularly common in the convenience store sector. Even if
49 franchisees do not use these unauthorised channels, they are aware of their existence. The
50 franchisee owner in Company G says it is "*too complicated*" and he is unwilling to "*get into*
51 *trouble with the company*" because he perceives that he and the company "*have been getting*
52 *on well*".
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3 Company H provides a telling example of a franchisee deliberately ignoring the franchisor's
4 instructions in a remote market unfamiliar to the franchisor:
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6 *I am the one who has personal connections, knowledge of the market, and helps to*
7 *promote the brand into the market... I was a wholesaler in this market before I started*
8 *operating a franchise business, so I knew this industry and this market very well... As*
9 *a franchisee I respected their advice most of the time, but sometimes when I knew*
10 *their way was not going to work in my business I would just ignore them. (Company*
11 *H, franchisee respondent)*
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15 Non-compliance also occurs when franchisees are sceptical of franchisor arrangements. This
16 includes system improvement. Franchisees are often suspicious of new systems and unwilling
17 to bear the cost related to the installation of new equipment and to participate in further
18 training.
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23 *Logistical problems.* Price competitiveness is the main reason convenience store franchisees
24 purchase product from unauthorised suppliers. The franchisor CEO from Company G
25 indicates that the main impediment to offering competitive prices remains the high cost of
26 logistics and the lack of bargaining power to negotiate a lower price with upstream product
27 suppliers.
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33 Franchisors' logistics capability is found to be strongly influenced by two issues: poor
34 delivery capacity across large geographic areas and an inability to accurately estimate
35 fluctuations in product demand. Notably, the larger, more experienced, franchisors receive
36 fewer complaints from franchisees. The importance of the issue is succinctly expressed by
37 one franchisee: *'All I want from [Company E] is to deliver the products on time.'*
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42 These logistical problems demonstrate a franchise system growing rapidly in geographic
43 terms but lacking infrastructure and economies of scale. This causes dissatisfaction amongst
44 franchisees and the potential for conflict in the system.
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49 *Counterfeit goods.* Particularly important in the shopping goods sector is the presence of
50 counterfeit goods in the marketplace. This issue is different from the behaviour discussed
51 above, in that franchisees do not source these products for their own stores. Franchisees
52 remain concerned that franchisors are not doing enough to protect the brand from
53 counterfeiting.
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3 To protect franchisees from counterfeits, most franchisors claim that they are prepared to
4 resort to legal action but they cannot act until they catch a counterfeiter. To counteract
5 counterfeiting, Company A encourages customers to shop at its legitimate outlets. Company
6 B emphasises that is not only the responsibility of the franchisor to act against counterfeiting:
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10 *The company has responsibility to protect its franchisees from suffering loss from*
11 *piracies and counterfeits.... Franchisees should also be responsible for protecting*
12 *themselves and our brand.* (Company B, franchisor respondent)
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15 *Managing non-compliance.* Case company franchisors employ coercive and non-coercive
16 sources of power to manage franchisee non-compliance. Franchise contracts stipulate a series
17 of punitive measures that will be taken if either party breaches the contract but, in practice,
18 franchisors seldom invoke the contract to modify franchisees' non-compliance behaviour.
19 Franchisors prefer to employ non-coercive power, mainly through communication; however,
20 if non-compliance continues they are prepared to employ much stronger coercion and
21 possible contract termination.
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28 Acknowledging that franchisees sometimes engage in non-compliance behaviour as a result
29 of poor infrastructure and support, Companies F, G, H and I addressed non-compliance
30 through system improvements. Company G equipped franchise stores with an inventory
31 management system which helps franchisees to better manage their stock and allows the
32 franchisor to closely monitor franchisees. To improve the monitoring system, Company F
33 installed a data transmission system. Company I invested in improving their logistics
34 infrastructure by developing a company-owned logistics centre and company-managed teams.
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41 For the franchisor respondent in Company A, *“rigidly enforcing franchisees to correct their*
42 *non-compliance by threatening and fining can achieve nothing but complicate the*
43 *relationship and make future communication harder”*. For Company F the balance of power
44 lies with the franchisees that have good store locations, therefore impeding the taking of
45 punitive action:
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50 *Franchisees that break the rules and regulations, such as selling things that are not*
51 *on our approval list in the shop, change the store layout and purchase products from*
52 *other suppliers without our permission, are mostly those former grocery store*
53 *owners... Cancelling the franchise contract is definitely not an option...* (franchisor
54 respondent)
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57 *Support mechanisms*
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3 Franchisors provide franchisees with a range of support mechanisms: marketing, specialized
4 training, product improvement and development. Marketing support, as stipulated in the
5 contract, takes the form of promotion of the brand, organization of marketing campaigns and
6 the management of public relations. Shopping goods franchisees particularly emphasize the
7 importance of support for product improvement and development.
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13 *Legal requirements and their impact on the franchise relationship*

14 *Estimations of ROI.* As required by legislation, franchisors provide estimations of franchisees
15 potential investment returns at the pre-contractual stage. The aim of estimating return on
16 investment is to help set franchisee expectations at a realistic level from the outset. Business
17 format franchisors prove to be more conservative in estimating return on investment. Over
18 exaggerating return on investment will increase franchisees expectations and has the potential
19 to cause conflict in the relationship when they are not met.
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26 *Secure opt-out system.* The second legal requirement is the secure opt-out system whereby
27 franchisors provide a simple secure opt-out system when the franchisee wants to withdraw
28 from the existing franchise business. Before the contract set up stage, franchisors receive
29 frequent enquiries from prospective franchisees regarding withdrawal procedures. Since most
30 franchisees are new to franchising, and risk averse, they require financial reassurance. The
31 simple and safe opt-out system is more likely to enhance franchisees confidence in the
32 venture and attract more franchisees.
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39 *Social factors*

40 Development of emotional bonding is important within franchise relationships. The
41 franchisor garners franchisee support by organizing periodic gatherings for immigrant
42 franchisees new to a particular city. Some franchisors hold outdoor activities for their
43 franchisees to meet company staff. For the franchisor, these activities enhance franchisee
44 sense of belonging to the company. Franchisors consider that the relationship between the
45 franchisor and the franchisee is not a purely financial one. The development of emotional
46 bonds facilitates problem solving at the social level through negotiation and communication.
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53 Franchisees welcome these trust building periodic gatherings. It allows them to build a much-
54 needed sense of belonging to their new home town. The time franchisees spend with
55 franchisor representatives is a source of emotional affiliation which pre-empts conflict:
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3 *The supervisor is quite nice. She is a woman of my age. We feel like a friend to each*
4 *other. As a result I dare not say anything about my opinions to her... I do not want to*
5 *destroy the relationship with the company... (Company I, franchisee respondent)*
6
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8 This time spent together engenders tolerance and comprehension, as highlighted by the
9 franchisee from Company I:
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11 *Although dissatisfaction and misunderstandings happen sometimes, I emotionally feel*
12 *closer to the company, as we get to know each other more. (Company I, franchisee)*
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15 The longer the relationship the more likely it is that the franchisee will build an emotional
16 attachment to the franchisor. This is more prevalent in the business format franchising
17 context because these franchisors have a longer term vision and will put a greater effort into
18 promoting the franchisee's sense of belonging to the company.
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24 Discussion

25 TAKE IN TABLE V HERE
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29 Table V details the main sources of power, control, support, and conflict in the franchise
30 relationship in China, from the perspective of both franchisors and franchisees. While the
31 sources of power and control for franchisors largely conform to established understanding,
32 that is, control through the contract, brand, support and so on (Doherty and Alexander, 2006;
33 Frazer *et al.*, 2007; Lusch, 1976), it is the franchisee sources of power and control which
34 exhibit fundamentally different characteristics. Those franchisees which possess important
35 locations for their retail outlets are able to exert significant power and control in the
36 relationship, resulting in franchisors not wishing to exert contractual power. Support services
37 offered to franchisees, such as marketing, training and monitoring have also been explored in
38 previous studies (Doherty, 2007; McIntyre, 1996; Quinn, 1999). It is support via prior
39 disclosure and the secure opt-out system which provides important insights, as these are
40 support issues which the franchisor must provide to franchisees following the implementation
41 of franchise legislation in China. Franchisees in this study derive extra confidence and
42 reassurance from the legally required support mechanisms when making the decision to enter
43 into a franchise relationship.
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55 Sources of conflict in the franchise relationship serve to highlight the rapidly evolving nature
56 of franchising in China. Convenience store franchisees, regardless of the type of franchising
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3 being operated, are likely to cause conflict in the franchise system by purchasing product
4 from unauthorised sources, acting against franchisor recommendations by using the market
5 knowledge they possess as a result of previous experience in retailing and being unwilling to
6 bear the costs of improving systems. Convenience store franchisors acknowledge that in
7 many cases such franchisee behaviour is a result of underdeveloped franchise system
8 infrastructure. For the shopping goods sector, the presence of counterfeit goods in the
9 marketplace causes conflict as franchisees feel that the franchisor should be doing more to
10 combat the problem. Franchisors acknowledge they have very limited ability to deal with the
11 issue. The prior disclosure and estimation of return process and the secure opt out or 'cooling
12 off' period embedded in the franchise contract mitigate against the type of conflict evident in
13 the recent work of Frazer *et al.* (2012) which resulted from an expectation gap at the outset of
14 the relationship. Likewise, conflict is mitigated through the various social events franchisors
15 organise for franchisees and the building of relationships with the regional supervisor.

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26 Theoretically, horizontal agency problems in the form of free riding (Combs *et al.*, 2004a;
27 Kidwell *et al.*, 2007) do not emerge as a problem within these franchise relationships: even
28 within the business format franchise systems where it is most likely to occur due to the
29 presence of strong brands. The franchise brand was highlighted as being very important in the
30 initial decision to franchise for both business format franchisors and franchisees. Free riding
31 infers a franchise system which is centered on a well established brand. It may be the case
32 that these franchise systems are still developing, therefore brand strength is also evolving.
33 However, what is witnessed in the franchise market in China is free riding occurring outside
34 the franchise system in the form of counterfeiting. Using agency theory, free riding is viewed
35 as an internal concept within the franchise system. The developing institutional context in
36 China provides a view of free riding which is external to the franchise system but which has a
37 positive effect within the system. In effect, the presence of counterfeiting outside the
38 franchise system may well act as a barrier to free riding within it. This leads to the first
39 proposition:
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50 **P1: In a developing institutional environment which offers limited brand protection,**
51 **free riding outside a franchise system will mitigate against the occurrence of free riding**
52 **within the system**

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55 By employing institutional theory we can explain aspects of the franchise relationship which
56 lie outside the explanatory power of agency theory. While institutional frameworks are
57 characterised by their dynamic and evolving nature, this is particularly so in an environment
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3 which witnessed its first piece of franchise legislation as recently as 1997. This legal
4 framework continues to evolve, and the contract, which underpins other theories of
5 franchising, is at an earlier level of development and maturity in China compared with other
6 institutionally developed franchise contexts such as the UK, US and Australia where much
7 previous research has been located (Shane and Foo, 1999; Brookes and Roper, 2011; Meek *et*
8 *al.*, 2011; Frazer *et al.*, 2012). It is also within this developing institutional framework that
9 counterfeiting thrives and franchisors have very limited recourse. The latter is a particular
10 issue for the shopping goods franchisors which rely on their brand and the quality of their
11 products to develop their franchise networks. The normative pillar (Scott, 2008) suggests
12 behaviour is constrained by values and norms: transgression produces shame or disgrace. In
13 China, a developing institutional context, the widespread existence of counterfeiting is a
14 relatively accepted 'norm' in society. Counterfeiting is taken for granted behaviour, from
15 which the developing franchise system needs protection. However, with a regulatory pillar in
16 its relatively early stage of development, protecting franchisors and franchisees against
17 counterfeiting remains a particular challenge. Further, there is a taken for grantedness which
18 helps to explain convenience store franchisees buying product from unauthorised sources. As
19 with counterfeiting, only when the regulative pillar is further established, and the 'norm' in
20 the system means franchisees understand that they must abide by the legal requirements of
21 the franchise contract, will this cultural cognitive norm reverse. Following North (1990), the
22 political structure must provide the foundation for the enforcement of the contract. In some
23 way, the cognitive legitimacy evident in the work of Shane and Foo (1999) is reversed in
24 China, that is, the long standing shared understanding in China allows for counterfeiting and
25 purchasing of product from unauthorised sources. This leads to the second proposition:

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41 **P2: In a developing institutional context, where cultural cognitive norms have the**
42 **potential to undermine the power of franchise contracts, a stronger regulatory pillar**
43 **will overcome deviant taken for grantedness behaviour**
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46 While evidence of horizontal agency does not emerge from the findings, agency theory is
47 shown to have explanatory power when viewed in terms of the vertical agency problem.
48 Opportunism and moral hazard are prevalent within these franchise relationships, particularly
49 within the convenience store sector. There are numerous examples of franchisees operating
50 opportunistically by purchasing product from suppliers other than the franchisor. According
51 to agency theory, power resides in the franchise contract and by inference the franchisor is
52 more powerful than the franchisee (Combs *et al.*, 2004a; Jensen and Meckling, 1976;
53 Mathewson and Winter, 1985). However, in China, when franchisees possess prime
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3 locations, franchisors are largely unwilling to invoke the contract punitively. This is a
4 particular problem where franchisees derive market knowledge from previous experience
5 within the retail sector. This leads to the following propositions:
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8 **P3: Vertical agency problems are more likely to arise when franchisees possess previous**
9 **retail experience and prime retail locations**

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11 **P4: The lack of a developed regulatory institutional environment results in the potential**
12 **for vertical agency problems**

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15 Within a rapidly evolving franchise network some franchisors admit that their infrastructure
16 is not sufficiently developed, particularly in terms of logistics and replenishment, which
17 makes contract enforcement difficult. Convenience store franchisees are particularly price
18 driven. When they think they are not receiving sufficiently competitive prices from their
19 franchisor there is a greater likelihood that they will source from other channels. Franchisors
20 have recourse to the contract but they acknowledge that sometimes it is the limitations of
21 *their* systems which instigate franchisees non-compliance. This leads to the fifth proposition:
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27 **P5: Vertical agency problems will occur in a rapidly evolving franchise market when**
28 **franchisors lack sufficient franchise network infrastructure**

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31 In order to attempt to minimize vertical agency, monitoring occurs via the regional supervisor
32 and technological equipment. Convenience goods retailers monitor via information systems
33 to ensure franchisees are adhering to their contract and not sourcing product from
34 unauthorized channels. Many convenience store franchisors monitor with limited success.
35 Shopping goods retailers, with their emphasis on the brand and business format franchising,
36 do not exhibit the same vertical agency issues; therefore, franchise form and retail sector are
37 important in this regard. Convenience store franchisees are more likely to behave
38 opportunistically and therefore cause conflict in the system. The franchise relationships in
39 this sector tend to operate at the discreet transactional end of the relationship continuum. In
40 contrast, shopping goods business format franchisors operate in a context where the longer
41 term relationship is more important than the individual transactions which occur (Kaufmann
42 and Stern, 1988). Evidence from the business format franchisors in the current work supports
43 Spinelli and Birley's (1996) contention that support is central to relationship development
44 and tolerance. This leads to propositions six and seven:
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54 **P6: Agency problems are contingent on franchise form and retail sector**

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56 **P7: Transactional franchise relationships are more likely to lead to conflict in the**
57 **franchise system**
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3 Following Giddens' (1984), DiMaggio (1991) emphasizes the importance institutional theory
4 places on government agencies and trade associations (DiMaggio and Powell, 1983). These
5 agencies and associations are crucial to the definition of an industry and the emergence of
6 networks, both formal and informal which support, police and/or set policy with regard to the
7 industry. The data collection phase highlighted this defining process within the franchise
8 industry in China. The CCFA and government agencies give a legitimization to franchising in
9 the country and as such provide a key basis for understanding institutional development. This
10 leads to the eighth proposition:

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16 **P8: Defining the franchise industry in a developing institutional environment leads to**
17 **legitimacy and provides a basis for institution building within this context**
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20 The implementation of key elements of the legal framework noted in Table One (Franchise
21 Measures 2005 and Franchise Regulations 2007) is highlighted in the findings. Franchisors'
22 prior disclosure of return on investment estimations and the secure opt out or 'cooling off'
23 period are all evidenced here. Their importance in giving franchisees confidence at the outset
24 of the relationship cannot be underestimated. This echoes the work of Shane and Foo (1999)
25 who find that disclosure laws encourage potential franchisees into the franchise system, with
26 regulation providing important legitimacy for the industry. The Franchise Regulations 2007
27 note that franchisors must provide support to franchisees, but the legislation is quite general
28 in terms of support expectation. Findings reveal a range of support mechanisms in operation
29 within the case firms. Therefore, while the evolving nature of the institutional environment is
30 acknowledged, the legislation which does exist is being implemented.
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40 The nature and importance of personal connections and information exchange also emerge as
41 important cultural-cognitive dimensions of the franchise relationship, as are the social factors
42 emphasised by both franchisors and franchisees. When franchisees begin to develop closer
43 personal bonds with their regional supervisor they begin to feel closer to the company as a
44 whole. Periodic gatherings organised by franchisors help to build trust with franchisees.
45 Many franchisees have moved from the countryside to the cities, therefore such gatherings
46 and involvement with the franchise system provide a sense of belonging. Further, information
47 exchange between franchisees acts as a source of power for them. On a negative note, those
48 franchisees with previous retail experience also draw on their personal networks to procure
49 product from outside the franchise system. This leads to the penultimate proposition:
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57 **P9: Personal connectivity present in the franchise relationship moderates cultural-**
58 **cognitive dimensions within the institutional environment**
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4 Combs *et al.* (2009) emphasise the pressure to conform inherent in institutional theory which
5 bring isomorphic pressures to bear on firms within the same industry. If we take the two retail
6 sectors considered here, we can see evidence of isomorphic pressures. The convenience store
7 sector is more concerned with price and its implications whereas the shopping goods sector is
8 more concerned with brand and product quality. This leads to the final proposition:
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13 **P10: In a developing institutional environment, isomorphic pressures present**
14 **themselves at the retail sectoral level rather than the industry level**
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17 Combs *et al.* (2009) acknowledge that their study only explored institutional theory's
18 explanatory power for firms' propensity to franchise. The current work explores the franchise
19 relationship holistically and therefore offers a further extension of their work in terms of the
20 role institutional theory can play in our understanding of the ongoing franchising relationship
21 outside the traditional economic perspectives which have dominated the literature for more
22 than four decades.
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28 **Implications for franchising practice**

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32 Franchisors and franchisees already operating or considering entering into a franchise
33 relationship in China must be aware that while franchising as an organizational form is
34 growing, it is still at an early level of development. Franchising legislation does exist and it
35 requires franchisors to provide support to franchisees, as well as financial reassurances which
36 come from prior disclosure and the secure opt-out system. These issues encouraged
37 franchisees in the current study to enter into the franchise system. That said, the institutional
38 framework remains relatively weak and contract enforcement is difficult, particularly in the
39 convenience store sector for those firms not practicing business format franchising.
40 Franchisors would be advised to build and develop strong brands which would allow them to
41 develop a business franchise format. This attracts franchisees that understand the power of
42 the brand and are therefore less likely to act outside the system. Without a strong brand, many
43 convenience store franchisors are simply employing franchising to distribute product and are
44 reliant on a distribution system without strong infrastructure. This weakens their position vis-
45 a-vis franchisees in a highly competitive, price-driven market place.
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3 Across sectors and franchise forms, support mechanisms help to develop the franchise
4 relationship. Investment in these support mechanisms is crucial for long-term success.
5 Franchisors should be aware of the important role the regional supervisor plays in
6 maintaining stability in the relationship and reducing the potential for conflict in the system.
7 Potential franchisees would be advised to explore the support mechanisms a prospective
8 franchisor purports to provide. Only prior disclosure and the secure opt-out system are
9 specifically detailed in the legislation.
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16 **Conclusion, limitations and areas of future research**

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20 This is an exploratory qualitative study and is therefore subject to the limitations of the
21 method. The study is not intended to be generalizable but these data are deemed to be of
22 value in themselves, providing thick descriptions and rich details (Cope, 2011). That only one
23 geographic area of China is addressed could be deemed a limitation of the current work.
24 However, the Pearl River Delta is a very developed area of China and it is a region which has
25 been the site of previous related studies such as Bruton and Ahlstrom's (2003) work
26 exploring the differences between western venture capitalism and that which occurs in China.
27 Franchisee informants in the current work were secured via their franchisor. There is the
28 potential that franchisors chose their 'best' franchisee. However, with the assurances of
29 confidentiality we are confident respondents discussed issues honestly: that a range of
30 conflict sources were found is testament to that. Finally, this study is focused on two sectoral
31 groups within retailing, shopping goods and convenience stores. This was a result of the
32 sampling procedure (Cope, 2011) and all participant companies met the criteria set for
33 inclusion in the study.
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45 On the basis of this work carried out in an under-researched marketplace, several areas are
46 recommended for further study. First, much franchise research assumes business format
47 franchising is being practiced. The current work reveals that in an emerging franchise system
48 this cannot be assumed, as in the case of some of the convenience store franchisors in the
49 current work. Much franchise research is characterised by theoretical positions that explain
50 the initial decision to franchise rather than the mechanisms of the franchise relationship. The
51 current work supports Doherty and Alexander (2004) and Meek *et al.* (2011) in their calls for
52 researchers to consider the process of franchise relationship development. In the context of
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3 China, two areas of research could prove particularly rewarding: a longitudinal study which
4 explores how franchise relationships develop over time within the changing institutional
5 environment; a study which explores relationship terminations and conversion from one
6 franchise system to another.
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11 This paper contributes to our knowledge of franchising in numerous ways. First, it provides
12 an account of the legislative context within which franchising in China operates. Secondly,
13 through securing access to nine franchise networks and providing evidence from both
14 franchisors and franchisees, the findings presented demonstrate that power, control, support
15 and conflict are all present in the franchise relationship in China. This work supports the
16 shared view of Shane and Foo (1999) and Combs *et al.* (2009) that institutional theory can
17 provide social explanations for franchising. This is particularly relevant in an environment
18 where the institutional framework is still evolving. However, it is also important to note the
19 robustness of the explanatory power of agency theory (in the context of vertical agency) in a
20 market environment outside which it is normally applied. The lack of horizontal agency in
21 the form of free riding is particularly interesting when viewed in light of institutional
22 weakness where brand protection is limited and where counterfeiting is endemic. A dedicated
23 study of business format franchisors across sectors would elucidate whether free riding is not
24 an issue generally in China and whether the endemic counterfeiting present in the market
25 does act as a barrier to free riding in franchise systems in this developing institutional
26 context. Moreover, an exploration of this 'external' free riding issue in the form of
27 counterfeiting as it occurs in other developing institutional contexts outside China would
28 further our understanding of horizontal agency issues in alternative settings to those which
29 currently dominate the literature.
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45 As the regulatory environment becomes more firmly established, it is important to understand
46 how cultural cognitive norms change and how this changing institutional environment
47 impacts on deviant taken for grantedness behaviour. In addition, an in-depth study into the
48 social factors which moderate the franchise relationship could prove particularly insightful. A
49 larger quantitative study could discern whether the particular vertical agency issues
50 highlighted in the current work are prevalent across other franchise sectors such as hotels. It
51 would also be valuable to understand how isomorphic pressures present themselves across
52 other franchise sectors. Studies which explore these issues in other countries where
53 institutional frameworks are at an early stage of development could have further theoretical
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3 implications. Understanding the process of how franchise industries achieve legitimacy and
4 definition would be particularly useful.
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8 Finally, it is clear that the addition of institutional theory provides a more holistic
9 understanding of the franchising relationship in an emerging franchise market. This has
10 implications for our understanding of developed markets. Therefore we would caution against
11 assumptions that traditional economics-based franchising theory fully explains franchise
12 activity in developed economies.
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18 One of the major strengths of the current work is deemed to be the securing of access to both
19 franchisors and franchisees in order to explore the franchise relationship. The complexity and
20 difficulty of continuing work in this vein should not be underestimated by the academic
21 community. The paper has detailed the process of accessing these franchise networks and it is
22 hoped that this will aid researchers in their future endeavours to research franchise issues in
23 China.
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Table I: Key Tenets of Agency Theory and Institutional Theory

Agency Theory	Institutional Theory
Key concepts (Jensen and Meckling, 1976) <ul style="list-style-type: none"> • Principal-agent relationship • Information asymmetry (IA)* • Moral hazard • Monitoring costs • Contracts 	Three pillars of institutionalism form the basis for legitimacy (Scott, 2008) <ul style="list-style-type: none"> • Regulative • Normative • Cultural cognitive
<ul style="list-style-type: none"> • Horizontal agency problem: potential for free riding 	<ul style="list-style-type: none"> • Regulative systems must be enforced by a legitimate state • Coercion key control mechanism • Has much in common with agency perspectives
<ul style="list-style-type: none"> • Vertical agency problem: potential for employees (agents) to operate in their own self-interest against the interests of management (principal) 	<ul style="list-style-type: none"> • Normative systems involve values and norms that impose constraints on society • ‘The regulative and normative pillars can be mutually reinforcing; (Scott, 2008, p.53)
<ul style="list-style-type: none"> • Hierarchical dependent relationship with coercion the key method of control 	<ul style="list-style-type: none"> • Cultural cognitive systems involve a ‘taken-for grantedness’, the way things are done
<ul style="list-style-type: none"> • Well established application of agency theory in the franchising context beginning with Rubin (1978) 	Limited but growing understanding of the potential of institutional theory for understanding franchising (Shane and Foo, 1999; Combs et al., 2009; Barthelemy, 2011)

Note*: IA is not a problem in itself in the principal agent relationship. It becomes a problem when combined with moral hazard, that is the potential for the agent to act in his/her own interest against the interests of the principal

Table II: Franchise Regulation Development in China

Date	Law	Key Measures	Significance
November 1997	<i>Interim Measures on the Administration of Commercial Franchise Operations (Trial Implementation)</i>	Described how franchising worked as opposed to setting out specific rules and regulation	First official recognition of franchising as a distinct business model signalling official encouragement to engage in franchising in China Only applied to domestic franchisors
Adopted 30 December 2004, took effect 1 February 2005	<i>Measures for the Administration of Commercial Franchise Operations</i>	Requires all franchising activity to adhere to principles of 'voluntariness, fair dealing, honesty and credibility' Key tenets: Rights and obligations of both parties, prior disclosure and content of franchise agreement covered Permits a franchisor to grant either a master franchise or direct franchise which allows the franchisee to sub-franchise Franchise term must be at least 3 years Franchisors must have at least two directly owned stores operating in China for a period of at least one year in order to qualify as a franchisor (2+1 rule) International franchisors must apply to engage in franchising by submitting a series of documentation including business license, proof of qualification to be a franchisor, franchise agreement, franchise manual and prior disclosure information including audited financial statements, information about existing franchisees, information regarding all litigation during 5 years preceding a franchise agreement Franchisees are subject to confidentiality agreements for the duration, and following the potential termination of a franchise agreement	Replaced the 1997 measures and implements the <i>Regulations on Foreign Investments in Commercial Industry</i> which became effective on 1 June 2004 Necessary due to WTO accession in 2001 Covers both domestic and international franchisors Somewhat confusing, for example, the <i>Measures</i> fail to address cross-border franchising between foreign franchisors and domestic Chinese franchisees Confusing with regard to how the 2+1 rule affects international franchisors
Adopted 31 January 2007, took effect 1 May 2007	<i>Regulations on the Administration of Commercial Franchises</i>	Overrides any parts of the <i>Measures</i> that contradict the <i>Regulation</i> Filing Rules and Disclosure Rules issued to help enforce the <i>Regulation</i> Attempts to counteract domestic franchise fraud Only corporations, not individuals, can become franchisors Franchisors must have a mature business that can provide sufficient support to franchisees including a franchise manual, training and other services. However, the <i>Regulation</i> is not specific on exactly what support must be provided Franchisors must disclose all relevant information in order that franchisees make informed investment decisions when entering into a franchise agreement Registration must take place within 15 days of a franchisor entering into a franchise agreement. The franchise agreement must contain specific issues such as a 'cooling-off' period and franchisees are bound to confidentiality with regard to franchisors trade secrets	Attempts to address certain ambiguities, particularly with regard to international franchise arrangements Some elements of ambiguity still apply with regard to the 2+1 rule but the requirement that ownership must be in China has been removed As a result of ambiguity it remains to be seen how enforcement will operate

Source: Adapted from www.franchise-update.com/article/316, accessed 18/09/2009; www.franchisebusiness.com.au/c/DC-Strategy/China-The-New-Franchise-Frontier-n852223 accessed 18/11/2011; www.fargre.com/showarticle.aspx?Show=2981&PrintPage=True, accessed 19/09/2009; www.asiabizblog.com/archives/2007/03/guest_column_ch.htm accessed 18/11/2011

Table III: The Case Companies

Case	Franchisor Respondent	Length of Interview (approx)	Franchisee Respondent	Length of Interview (approx)	First Year Franchising in China	Retail Sector	Origin
A	Franchisor representative in China	60 minutes	Franchisee owner	45 minutes	2003	Shopping Goods - Kitchenware	US
B	Franchise manager	45 minutes	Franchisee owner	50 minutes	2000	Shopping Goods - Health Products	China
C	Franchise manager	90 minutes	Franchisee owner	45 minutes	2004	Shopping Goods - Health Products	China
D	CEO	60 minutes	Franchisee owner	50 minutes	2004	Convenience stores	China
E	Franchise manager	45 minutes	Franchisee owner	45 minutes	2004	Convenience stores	China
F	Franchise manager	60 minutes	Franchisee owner	45 minutes	2004	Convenience stores	China
G	CEO	50 minutes	Franchisee owner	45 minutes	2004	Convenience stores	China
H	Franchise manager	120 minutes	CEO (master franchisee)	75 minutes	2006	Convenience stores	China/Hong Kong
I	Franchise manager	75 minutes	Franchisee owner	60 minutes	1998	Convenience stores	China

Table IV: Interview Guide: Thematic Issues and Within Theme Issues Explored in Franchisor and Franchisee Interviews

Thematic Issues	Within theme issues to explore
<i>Company franchise history</i>	Year of start up, how many people are employed, company size
	Industry and competitive environment at the point of entry into franchising and how it has evolved
	Why and how the franchise business started
<i>Establishing franchise relationships</i>	How franchise partner(s) are selected and the criteria (if any) which are employed to choose partner(s)
	How the franchise relationship was established
<i>Day-to-day operation of the franchise business</i>	Structure of the franchise operation
	Rules, regulations and terms and conditions of the franchise contracts
	How the franchisee/franchisor operates the business
	How the franchisor/franchisee perceives the state of the franchise operations
<i>Support</i>	How support operates and the main methods of support
	The context for support implementation
	How the franchisor/franchisee perceives the support given by/received from the counterpart and why it is perceived this way
	The importance of support for the franchise relationship
<i>Control</i>	How control is maintained/exerted and the main methods of control in the relationship
	The context for control implementation
	How the franchisor/franchisee perceives control in the relationship and why it is perceived this way
	How control impacts on the franchise relationship
<i>Conflict</i>	Indicators of conflict
	Antecedents of conflict
	Resolutions to conflict
	How the franchisor/franchisee perceives conflict in the relationship and why it is perceived this way
	How conflict impacts on the franchise relationship
<i>Power</i>	Sources of franchisor/franchisee power
	How power is exercised
	How the franchisor/franchisee perceives power in the relationship and why it is perceived this way
	How power impacts on the franchise relationship

Table V: Sources of Power, Control, Support and Conflict in Retail Franchise Relationships in China

	Franchisor	Franchisee
Power and Control	<ul style="list-style-type: none"> • Contract • Brand • Market information • Support services • System infrastructure 	<ul style="list-style-type: none"> • Store location • Market information e.g. alternative sourcing channels • Information exchange between franchisees
Support Services	<ul style="list-style-type: none"> • Marketing support • Product quality and cost • Operational support <ul style="list-style-type: none"> ○ Training ○ Logistics ○ Monitoring (regional supervisor and IT equipment) • Initial estimation of return on investment • Secure opt-out • Periodic gatherings and team building 	
Sources of Conflict	<ul style="list-style-type: none"> • Lack of competitive pricing • Poor logistics and transportation infrastructure • Franchisee perceptions that franchisor not sufficiently effective against the presence of counterfeit goods in market 	<ul style="list-style-type: none"> • Purchasing products from unauthorised channels • Experienced franchisees with local market knowledge acting against franchisor recommendations • Lack of willingness to bear costs of improving systems