



## Opportunistic behaviour in hospitality franchise agreements



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### ABSTRACT

This paper combines agency and social exchange theoretic perspectives to examine opportunistic behaviour in hospitality franchise agreements. It identifies and analyses the opportunistic behaviour of both franchisors and franchisees through a qualitative study of Turkish hospitality franchisees. A model of opportunistic behaviour and social exchange is developed from the study for further empirical testing. The model depicts different categories of franchisee behaviour, how franchisee behaviour is influenced by the behaviour of franchisors, the relevant characteristics of social exchanges between franchisors and franchisees, and the outcomes of those exchanges. As such, the study provides a complementary perspective of franchise opportunism and exchange relationships. A number of implications for hospitality franchise stakeholders are identified as a result.

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### 1. Introduction

Business format franchising is a popular choice for many hospitality firms seeking domestic and international expansion. In business format franchising, franchisors develop a business concept which franchisees replicate and operate in their local community (Hoffman and Preble, 1993). 'The franchise is identified by its trademark, product or service, and method of operation that is monitored and controlled by the franchisor' (Weaven and Frazer, 2003, p. 56). Although extant research examines franchising from a range of theoretical perspectives, agency theory is one of the most popular (Perryman and Combs, 2012).

Agency theorists argue that the relationship between principals (franchisors who own the brand) and agents (franchisees who operate branded units) is economically efficient. Franchisees contribute to the cost of expansion through their unit-level investment and this vested interest reduces the risks of them acting opportunistically (Alon et al., 2012). Although Combs and Ketchen (2003) found strong support for agency theory, critics argue it sheds little insight into the dynamics and management of franchise relationships (Brookes and Roper, 2011; Grewel et al., 2011). Furthermore, franchisors' opportunistic behaviour and franchisees' perspectives are often overlooked (Barthelemy, 2011).

Nyadzayo et al. (2011) argue that social exchange theory (SET) can overcome agency limitations by shedding insight into the

behavioural dimensions of franchising (Harmon and Griffiths, 2008). SET focuses on social exchanges which are embedded in, and valuable to understand economic exchanges (Bignoux, 2006). While extant research uses SET to examine different franchise issues (Meek et al., 2011; Nyadzayo et al., 2011), few studies specifically examine franchise opportunistic behaviour. Nonetheless, this research demonstrates the value of using SET to examine franchise relationships, particularly if combined with other theoretical perspectives (Lambe et al., 2001).

This paper therefore draws on both agency and SET theories to examine opportunistic behaviour in franchising. It aims to identify the influence of social exchanges on franchisee and franchisor opportunism through a qualitative study of Turkish franchisees. The paper offers a complementary perspective on franchise relationships and contributes to the franchise literature through the development of a model of opportunistic behaviour and social exchange which depicts different categories of franchisee and franchisor behaviour, and the characteristics and outcomes of social exchange.

The paper begins by exploring agency and SET research to develop research questions. The study design and findings are then presented before a framework for further empirical testing is developed. The conclusions highlight the contributions of the research, its implications and limitations, and the directions for future study.

### 2. Agency theory and franchising

Agency theory is concerned with relationships between principals (franchisors) and agents (franchisees) who operate branded

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units on their behalf (Lafontaine, 1992). Agency research falls predominantly within five broad categories which examine the economic rationale for franchising in either domestic or international markets, for multi-unit franchising, franchise performance, and control mechanisms. Table 1 provides an overview of empirical research. Most studies in the first three categories support the rationale for franchising and multi-unit franchising as a way of efficiently combating agency problems (Norton, 1988; Weaven and Frazer, 2007a,b; Ni and Alon, 2010). Given franchisees vested interest and claim to residual profits, their goals are more aligned with the franchisor and monitoring costs are reduced (Watson, 2008). Research in Table 1 which examines franchise performance supports these arguments (Shane, 1998; Combs et al., 2004; Aliouche and Schlenrich, 2009).

However, agency problems of adverse selection, moral hazard and hold ups (Shane, 1998) are not fully eliminated due to goal divergence, monitoring problems (Garg et al., 2005) and information asymmetry (Doherty and Quinn, 1999). Watson and Johnson (2010) advise that perfect goal alignment is not realised as franchisors' generate earnings through franchisees' royalties and franchisees, through profits. Moral hazard problems occur when franchisees act in their own self-interest and free ride or shirk (Hussain et al., 2013). Franchisees free ride when they reap network benefits without bearing a proportional share of the costs (Carney and Gedajlovic, 1991) and shirk if they neglect their responsibilities and wilfully evade contractual obligations (Brown et al., 2014). Hold ups occur when one party acts opportunistically to renegotiate an agreement after relationship-specific investments have been made (Shane, 1996). These behaviours and inefficient investment (Garg et al., 2005) can exacerbate information symmetry (Doherty and Quinn, 1999).

Franchisees are more likely to free ride in units with high brand recognition that rely on transient customers (Brickley and Dark, 1987; Michael, 2000); when monitoring is difficult (Fladmoe-Lindquist and Jacque, 1995; Shane, 1996), when market conditions are less predictable and information asymmetry is high (Choo, 2005; Cochet et al., 2008). Agency theorists recognise the importance of contractual control as well as the limitations of contracts to control all future franchisee behaviour (Lafontaine and Oxley, 2004; Kashyap et al., 2012). Research in the fifth category therefore investigates the use of different formal and informal control mechanisms. While monitoring and enforcement, incentives and relational mechanisms are all used to control franchisee opportunism, empirical findings on their effectiveness are mixed (Paik and Choi, 2007; Cochet et al., 2008; Boulay, 2010; Chen, 2010). Additionally, franchisors' capabilities (Choo, 2005) and external competitive, cultural and regulatory environments (Contractor and Kundu, 1998; Antia et al., 2013) influence their effectiveness.

While these studies contribute to our understanding of opportunistic behaviour, current research focuses predominantly on franchisees' opportunism, overlooking franchisors' opportunistic behaviour (Combs et al., 2004; Dickey et al., 2007; Watson and Johnson, 2010). Researchers advise that agency problems, including more calculated harmful behaviour, should be examined more comprehensively (Kaufmann and Dant, 1996; Michael, 2000; Garg et al., 2005) by combining agency with other theoretical perspectives as Table 1 and Jell-Ojobor and Windsperger's (2014) literature review suggest. Section 3 therefore explores SET and its application to franchise research.

### 3. Social exchange theory (SET) and franchising

Social exchange comprises the voluntary actions of individuals that are motivated by the returns they are expected to bring (Bignoux, 2006). They can be purely social or combine economic

elements, but they cannot be contracted explicitly (Das and Teng, 2002). The focus therefore is on personal ties between exchange partners (Bignoux, 2006). Lambe et al. (2001) contend that initial transactions are crucial in determining whether relationships will expand, diminish, remain the same, or dissolve. Their evolution and growth is dependent on the evaluation of relational outcomes (Lee et al., 2010). Bignoux (2006) argues therefore that social exchanges are shaped by trust, reciprocity and reward, although researchers have also operationalised social exchange using dependence, norms, commitment, satisfaction, equity, cooperation and conflict (Lambe et al., 2001). More recently, researchers have added opportunism as an exchange variable arguing relationship quality and trust are critical to mitigate opportunistic behaviour (Lee et al., 2010).

There are relatively few franchise studies that have applied SET. Table 2 lists these studies according to whether they focus on control or relationships. Studies in the first category identify that greater formalisation and decentralised decision making (Kidwell et al., 2007), social interactions between franchisees (El-Akreimi et al., 2010) and franchisees' affective (emotional) commitment (Mignonac et al., 2013) all serve to decrease franchisees' opportunistic behaviour. Meek et al. (2011) identify that affective commitment is positively influenced by collaborative communication. While Nyadzayo et al. (2011) focussed on brand citizenship behaviour, their findings highlight the role of social bonds and conflict resolution to reduce opportunistic and non-compliant franchisee behaviour. These researchers report the value of SET, but recognise the need for further research to 'tease out' franchise relationship 'nuances' (Meek et al., 2011, p.575) which arguably involve the behaviour of franchisors and franchisees.

Franchise research underpinned by relationship marketing theory highlights the relevance of relational variables similar to SET research (Lim and Frazer, 2002; McIntyre et al., 2006; Dickey et al., 2007; Altinay et al., 2014). It identifies the positive influence of relational norms (Brown et al., 2000), perceptions of franchisor integrity and competence (Davies et al., 2011) and multi-unit franchising (Griessmair et al., 2014) on mitigating franchisee opportunism. While much research focuses on franchisee behaviour, an exploratory study by Frazer et al. (2012) identifies that conflict stems both franchisor and franchisee opportunistic behaviour.

While both research streams contribute to our understanding of franchise relationships, research which examines franchisee and franchisor opportunistic behaviour from the franchisee perspective is limited. This study therefore attempts to develop our understanding of franchise opportunism by combining agency theory and SET to answer the following research questions:

1. What different types of opportunistic behaviour do franchisees and franchisors engage in?
2. How are these behaviours influenced by the social exchanges between the franchisee and franchisor?

Section 4 explains how the study was designed to answer these questions.

### 4. Research design

A qualitative exploratory study was deemed appropriate to allow the researchers to get close to franchisees (Altinay et al., 2014) and better understand their actions and the reasons for, and outcomes of, their behaviour (Mason and Douquette, 2008). Qualitative studies capture the situation-specific nature of experiences considered necessary to explore the situational complexities of relationships and allow the generation of new insights and theories

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