

The Impacts of Relational Norms and Relationship Quality on Franchise Firm's Performance: The empirical of Malaysian Franchisee.

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Abstract—: Franchising is one of the best way for expanding a business in the competitive industry and global market. Franchising industries are growing rapidly in most countries and have contributed to the growth of gross domestic product. This study adopts a quantitative approach, applying a cross-sectional study. This study attempts to examine empirically relational mechanisms which may influence the relationship quality and business performance in franchising relationship from franchisee's perspective. The findings reveal that relational mechanisms are crucial in affecting franchisee relationship quality. The results provide strong evidence that franchisee relationship quality is found to significantly affect business performance in the franchise system.

Keywords— franchising, franchisee, relational norms, relationship quality, performance

1. Introduction

Franchising is the replication of success's business system in doing business especially for new entrepreneur. Indeed, franchising system also was considered as the fastest developing forms of business in most of countries in the world [1]. Franchising is the most successful business model between business-to-business (franchisor and franchisee). Franchise firms have options to develop new business models and work in diverse economic systems and different geographical areas. Franchising is found to be the best option to enter for a new market either local or international

markets [2].

From Malaysia perspective, numerous franchisees have encountered problems in running their business and they have left the franchise system due to poor performance or termination by the respective franchisor. For example, franchisee in the food and beverage sector claimed that many franchisees face difficulties in operating their franchise business and finally close their outlets after one or two years in operation [3]. Furthermore, they notify that they are in debt of between RM100,000 to RM450,000 as a result of unfair practices of franchisors. Since no other studies have been conducted to identify the franchisee issues in Malaysia, this research will explore the effect of social norms towards relationships quality and to examine the outcome of successful franchising relationships. Such studies could assist the government agencies such as Malaysia Franchise Association (MFA) and Perbadanan Nasional Berhad (PNS) to formulate new strategies to enhance existing franchising developmental programs for potential new entrepreneurs.

The survival prospects and the success of franchise business systems continue to be debated among academicians and practitioners. Stanworth, Purdy and Price [5] assert that despite the franchising industry claims of strong growth and low failure rates, the reality appears to have been of generally modest growth and high failure rates. Bates [6] and Shane [8] finds that 35% of franchise business systems fail compared to 28% of non-franchised businesses. The real growth of US franchising from 1975 to 1990 plunged drastically from 284.6% to 58.5% and the average annual growth rate declined

from 9.4% to 3.1% [4]. Shane [8] also highlights that approximately three-quarters of all new franchise systems fail within twelve years. The high failure rate of the new franchise systems indicates that franchise is not an easy business in which to succeed. Even though the franchise system is a tested and proven model, it does not guarantee an entrepreneur's success. Lafontaine and Kaufmann [10] highlight that the high rate of failure of the new franchise systems suggests that the survival of a new franchise system over time is an important measure of performance. Therefore, this study will look into franchise performance and franchise relationship quality as key factors which have contributed to the success of franchise systems especially from the franchisees' perspective

2.0 Theoretical Background and Hypotheses Development

Franchising can be defined as a legal agreement between the franchisor (the owner/creator of a system) and the franchisee (individual/company who is the recipient of right or privileges by the franchisor) to operate the business of offering, selling or distributing products or services by using the franchisor's logo, business name, trademark or brand name based on a specified location and over a specified period of time, and in return receives a payment of fees or royalties paid by the franchisee. The business-format franchise is identified as the most comprehensive franchise business in Malaysia [11]. Many businesses are reported to use this format of franchise model in Malaysia such as Smart Reader, Cambridge English For Life (CEFL), Genius Aulad, Focus Point, Nelson and Daily Fresh.

The development of the B2B relationship is crucial due to extensive customization and the long-term relationship with customers [12]. However, there is limited research on the application of RQ from a franchising context [13]–[16]. Therefore, this study focuses on the franchisor-franchisee relationship quality which is considered an important element in maintaining the franchising venture success over the long term. Additionally, Clarkin and Rosa [17] highlight that the relationship quality between inter-firm parties ultimately determines the success of a franchise business. Furthermore, Clarkin and Rosa [17] reveal, in their study, that a franchised firm will perform better in conditions where there is partnership, collaboration and cooperation between the franchisor and the franchisee.

2.1 Relationship quality

The concept of relationship quality (RQ) is embedded in the field of relational marketing (RM) [18]. RM is frequently referred to as a new paradigm in the marketing discipline, which had

previously focused on marketing mix variables [19]. There is no consensus in the literature on the set of dimensions that represents the construct of RQ [20], [21]. Many studies related to RQ employ different dimensions in various research contexts and business settings. For example, studies of RQ were found in the context of buyer-seller [37], supplier-manufacturer [24], manufacturer-distributor [25] and franchisor-franchisee [26]. Nevertheless, the researchers agreed that the concept of RQ is a higher order construct consisting of several distinct but related dimensions [21], [27].

Most studies found in the marketing channel identified the RQ as multi-dimensional which consists of trust, commitment, satisfaction, cooperation, communications and conflict [28]–[30]. Although, previous researches of RQ have used different dimensions, the variables of trust, commitment and satisfaction are the most frequently studied [20], [31]. Furthermore, Ishak and Jantan [29] find that most studies in RQ have identified trust, commitment and satisfaction as main dimensions of RQ. In line with this study's definition for franchisor-franchisee RQ, the researcher will include commitment and satisfaction as the main constructs in franchisor and franchisee RQ.

In franchising, commitment is shown as an essential variable for franchisor-franchisee relationship success [32]. Commitment is important in so far as it results in cooperation, reduces the potential of attractive short-term alternatives, and enhances profitability [33], [34]. Numerous studies find that commitment is related positively to a higher performance level and relational benefits [23], [30], [35], [36]. Apart of commitment, satisfaction indicates the importance of mutual agreement between the franchisor and the franchisee pertaining to their goal achievement, contractual obligation and the franchisor's fairness among franchisees [37]. The franchisee's satisfaction towards his/her franchisor will positively affect the franchise performance [38].

2.2 Franchise Performance

Business performance is the main objective of any organizational establishment. Furthermore, business performance is a major issue in marketing research [39], [40]. In the business-to-business context, most studies focus on performance such as export performance [41], supply chain performance [42], [43], sales effectiveness [18], [44], financial performance [45] and relational benefits such as relationship enhancement and continuity [46]; loyalty intention [47]; maintain the relationship and invest in the relationship [48], and behavioral

intention [49]. In franchising, more attention is focused towards attitudinal satisfaction compared with performance and relational benefits. Thus, this research will close the gap by considering performance as a main outcome of RQ from the franchising perspective.

From the relational perspective, only a few studies use relationship performance measurements as RQ outcomes in buyer-seller exchange [50], [51]. Selnes and Sallis define relationship performance as “the extent to which the partners consider their relationship worthwhile, equitable, productive and satisfying” [50]. O’Toole and Donaldson suggest that the buyer-supplier relationship performance can be seen from financial and relationship dimensions which include items measuring satisfaction, profitability, sales, dependence and quality [51].

The franchisor-franchisee RQ as an important factor in ensuring the success of the franchise business model. Previous research suggests that higher levels of RQ lead to greater levels of operational and business performance [43], [52], [53]. Based on the above discussion, our research model has led us to the following hypotheses:

H1: The franchise relationship governed by high levels of relationship quality is leads to higher in non-financial performance.

H2: The franchise relationship governed by high levels of relationship quality is leads to higher in financial performance.

2.3 Relational Norms

Relational mechanism is based on Macneil’s (1980) framework who developed a set of norms which determine “behavior that does occur in relations, must occur if relations are to continue, and hence ought to occur so long as their continuance is valued” (p.64). The relational contract theory argues that where an exchange occurs a contract exists and, therefore, a contract is present in all business-to-business exchanges. Macneil proposed nine norms “of the right action binding upon members of a group and serving to guide, control, or regulate proper and acceptable behavior” (Macneil, 1980, p.38). The dimension of relational norms is multidimensional and there is no general agreement in the literature on their number and content [55]. Heide and John use three dimensions that appear to have relevance in the buyer-seller setting; flexibility, information exchange and solidarity [56]. These dimensions are explained below:

Information exchange is defined as “a bilateral expectation that parties will proactively provide information useful to the partner” [56]. Communication builds stronger relationships in an

exchange relationship especially as it resolve disputes, aligns goals and uncovers new value-creating opportunities [33]. Information exchange is found to be the most important mechanism to manage the franchise relationship quality and increase partner satisfaction [57].

Flexibility is defined as the “bilateral expectation of a willingness to make adaptations as circumstances change” [56]. Flexibility is a coordination mechanism because the franchisor and franchisee must adapt their operation and react to unforeseen changes in the franchise network [58]. Due to competition factors, the franchisor will change the operating procedures or system for new products or services introduction. For instance: during promotional activities, the price of a product or service shall be revised (promotion discount) or introducing new products/services.

Solidarity is defined as “the extent to which an exchange relationship is seen as a long term venture rather than an “arm’s length” encounter” [59]. The focus of the relational norm of solidarity is on “the preservation of the unique and continuing relationship in which the various commercial transactions take place” [60]. Moreover, the franchise system can achieve a high level of solidarity by having interdependence to succeed between franchisee and franchisor. In view of this, this study proposed the following hypothesis:

H3: The more a franchisee perceives that franchise relationship is governed by high levels of information exchange, the higher he will have in relationship quality.

H4: The more a franchisee perceives that franchise relationship is governed by high levels of flexibility, the higher he will have in relationship quality.

H5: The more a franchisee perceives that franchise relationship is governed by high levels of solidarity, the higher he will have in relationship quality.

In conclusion, relational norms are important in governing the behavior of the exchange partner and this mechanism is applied in many firms in developing long term relationships [61]. For example, Toyota emphasizes their corporate value and continuous developing of social norms in managing their car dealers [61], [62].

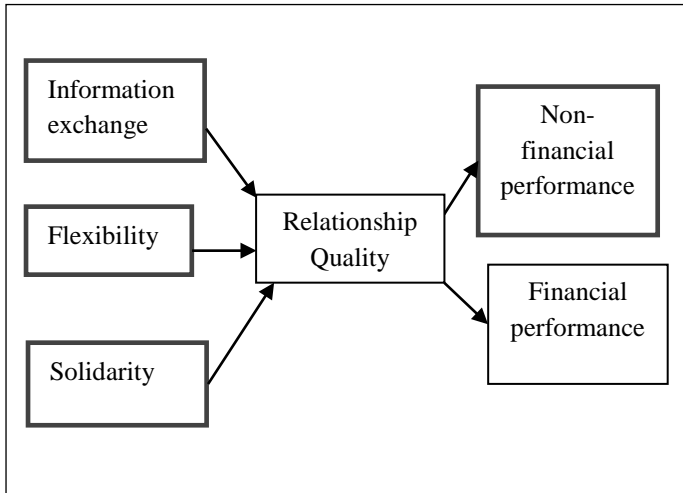


Figure 1: Research Framework

3.0 Methodology

3.1 Sample and data collection

This study focuses on the Malaysian franchise system for the research sampling. The respondents are franchisees who operated business-format franchise in Malaysia. This study is based on a quantitative approach and applying a cross-sectional study. A total of 400 questionnaires were distributed and 133 questionnaires were successfully returned. The usable response rate was 32 percent comprising 128 usable responses from a total of 400 questionnaires sent to franchisees.

3.2 Measurement

RQ is a meta-construct which consists of several key dimensions such as commitment and satisfaction etc. that reflect the overall nature of the relationship between exchange partners [63],[64]. The commitment was measured by seven items adapted from previous studies such as Cater & Cater and Gounaris [65], [66]. Relationship satisfaction was measured with three items adapted from Sanzo et al. and Geysken and Steenkamp [67], [68]

In line with Heide and John's work, the researcher used these dimension of norms (solidarity, information exchange and flexibility) in the franchising relationship [56]. Eleven item-scales were adapted from Antia & Frazier and Heide & John [69], [70]. Three items measure solidarity, five items measure information exchange and three items measure flexibility from the perception of the franchisee towards relational norms practiced in franchising relationships.

Relationship performance is a wider view that incorporates the perspective of the other partner and measures the performance of a wider variety of relationship activities [51]. This author (2002) suggest that relationship performance could be divided along non-financial and financial performance dimensions. Moreover, many studies today focus on both financial and non-financial performance measures [42], [51].

The financial performance dimensions were conceptualized by using four items; net margin, sales growth rate, returns on investment (ROI) and return on assets (ROA). The respondents were asked to rate the percentage of each indicator for net margin, sales growth, ROI and ROA.

3.3 Analytical procedures

The final measurements model and structural models were tested using Partial least squares (PLS). PLS regression analysis was developed in the late seventies by Herman Wold [71]. PLS is used when ordinary assumptions such as multivariate normality and large sample size are not met. PLS is a statistical tool specifically designed to cope with small datasets, missing values and the presence of multi-collinearity often exists in samples used in marketing research [71]. Various studies use PLS in relationship marketing particularly in relationship quality [32], [72].

In order to proceed with SEM-PLS, there are two stages for performing SEM which consist of a measurement model and structural model [73], [74]. Firstly, the measurement model is evaluated by checking the reliability and validity of each measure used in the framework model. The composite reliability and internal consistency reliability (Cronbach's alpha) are evaluated to ensure each value follows the recommended evaluations. The cut-off value for composite reliability and internal consistency reliability (Cronbach's alpha) is 0.7 [75]–[77]. After all measurement of all constructs have adequate reliability and validity assessment, all the measurement items are kept for testing the structure model. As tabulated in Table 1, the AVE of all latent constructs ranges from 0.650 to 0.795, which exceeds the recommended level of 0.50 [78].

Table 1: Measurement Model

Constructs	Items	Loadings	CR ^a	AVE ^b
Info Exchange	COM1	0.812	0.911	0.720
	COM2	0.854		
	COM3	0.866		
	COM4	0.861		
Flexibility	FLX1	0.926	0.956	0.878
	FLX2	0.950		
	FLX3	0.934		
Solidarity	SOL1	0.839	0.910	0.836
	SOL2	0.867		
	SOL3	0.862		
Relationship Quality (RQ)	RQ1	0.925	0.910	0.836
	RQ2	0.904		
Relational Performance	RP11	0.655	0.928	0.564
	RP12	0.706		
	RP13	0.739		
	RP14	0.702		
	RP15	0.793		
	RP16	0.760		
	RP17	0.730		
	RP18	0.796		
Financial Performance	FP1	0.869	0.938	0.792
	FP2	0.852		
	FP3	0.935		
	FP4	0.902		

^a Composite reliability (CR) = (square of the summation of the factor loadings) / {(square of the summation of the factor loadings) + (square of the summation of the error variances)}

^b Average variance extracted (AVE) = (summation of the square of the factor loadings) / {(summation of the square of the factor loadings) + (summation of the error variances)}

For discriminant validity, the square roots of AVE for each construct as presented in Table 2 are less than the AVE latent variables. In conclusion, the measurement model demonstrates adequate convergent validity and discriminant validity between the construct and the other constructs [79]. In statistically term, the squared root of each construct's AVE should be greater than its highest

correlation with any other construct in measurement model [80]. As shown in Table 2, the squared roots of the AVE latent variables are greater than the correlations for each construct.

Table 2: Discriminant validity of constructs

Variables	IE	FP	Flex	NFP	RQ	Sol
Info Exchange (IE)	0.848					
Financial Performance (FP)	0.294	0.890				
Flexibility (Flex)	0.658	0.251	0.937			
Non-Financial Performance (NFP)	0.583	0.207	0.458	0.751		
Relationship Quality (RQ)	0.808	0.353	0.694	0.649	0.914	
Solidarity (Sol)	0.704	0.283	0.595	0.511	0.703	0.856

Note: The square root of AVE values is shown on the diagonals and printed with bold; non-diagonal elements are the latent variable correlations

For hypothesis testing, the path analysis was used to verify all hypotheses generated in this study, the PLS software generates estimates of standardized regression coefficients which refer to beta values for model path [81]. PLS uses re-sampling procedures known as nonparametric bootstrapping to evaluate the significance of the parameter estimates [82]. In this study, the researcher uses 1000 resampling procedures for bootstrapping as aligned with previous studies in the business-to-business context [73]. The results of the model estimation including standardized path coefficient, one-tailed significance of the paths and the amount of variance captured are presented in Figure 2.

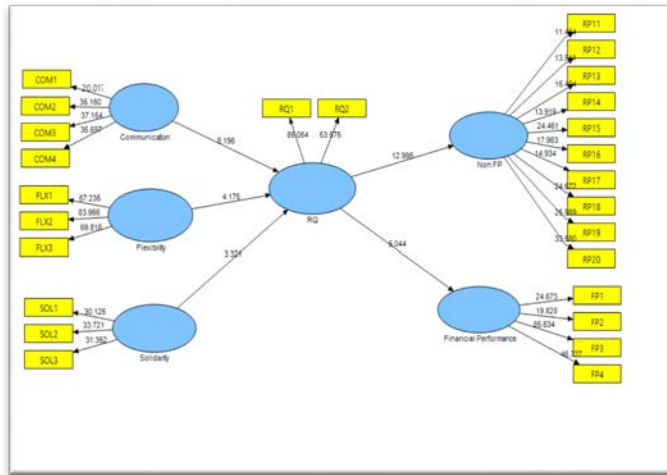


Figure 2: Results of the path analysis.

4.0 Results

Based on Table 3, the results of hypothesis testing show that all hypotheses are supported at a minimum of $p < .001$. Information exchange, flexibility and solidarity are positively related to RQ, whereas RQ is positively related to non-financial performance and financial performance. Therefore, all hypotheses in this study - H1, H2, H3 and H4 are accepted. Furthermore, the results show relational norms are predicting approximately 70 percent of the variance for RQ and 57 percent of franchisee’s loyalty variance. The higher variance explained by relational mechanisms indicates that relational norms which consists of information exchange, flexibility and solidarity are important in developing RQ in the franchising relationship in the Malaysian context. In other words, the result of this study suggests that the franchisee’s RQ is mainly explained by the development of relational norms in franchise relationship.

Table 3: Path Coefficient and hypotheses testing.

Relationship	Coefficient (B)	T-value	Result
H1. RQ -> Non-Financial Performance	0.649	12.995**	Supported
H2. RQ -> Financial Performance	0.353	5.044**	Supported
H3. Info Exchange -> RQ	0.506	8.196**	Supported
H4. Flexibility -> RQ	0.240	4.175**	Supported
H5. Solidarity -> RQ	0.204	3.321**	Supported

Note: **Significant at $p < 0.05$ based on one tail t-statistic table, as t-value greater than 1.65.

5.0 Discussion and Conclusion

The findings show that RQ is positively related to relational performance (non-financial performance) and financial performance. Based on path analysis, RQ has a strongest effect on non-financial performance compared with financial performance. In other words, RQ is an important variable in predicting the future of the relationship between franchisor and franchisee. This result also provides strong evidence that RQ has a large effect in franchisee performance. Therefore, the prior result in other business-to-business context (such as exporter-importer, supplier-manufacturer) is applicable for franchising relationships in which the good relationship between franchisee-franchisor has contributed to the success of the franchise business.

Communication shows the strongest effect in relational norms. This result revealed that communications (information exchange) is the most important role in developing effective relational norms and keeping a good channel relationship. This situation will provide effective relational norms to govern franchise relationship which can develop trust, commitment and satisfaction in long term. The solidarity of franchisor-franchisee in franchise relationship is demonstrated in the behavior of togetherness to preserve their relationship. Flexibility in relational norms also plays significantly roles in building a good relationship between franchisor and franchisee. In franchise business, there are challenges for franchisor to implement a standardization and uniformity of franchise operation throughout their franchise network in geographical dispersions.

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