

Developing a model of franchise business relationships

Rahatullah, M.K, Bang College of Business, KIMEP, Almaty

Email: mrahat@kimep.kz

Robert Raeside, Napier University Edinburgh

Abstract: *The business to business (b2b) relationship literature shows that the features of business relationship such as control, support, cooperation and power act a little differently in franchise business. Information on, and identification of the actions in the franchise business relationship, that can increase or diminish trust and commitment between both partners, is also scarce. Furthermore, how can these actions contribute to, solidify relationship; attaining over all business development, adding value, achieving synergy, and competitive advantage? This paper will briefly review literature on the relationship of the franchisor and franchisee, investigating its elements, actions that deteriorate it and providing a background that how and why the conflicts occur. From this it will be hypothesised that certain actions of the parties in relationship and suggest a generic conceptual model that be adopted and applied by both partners in order to increase cooperation and work together for over all business growth. This will help to add value, achieve competitive advantage and growth. This model could be applied in any environment. This paper will act as catalyst for development of a model for franchise business introduction and growth in CIS.*

Keywords: Franchise, Business, Relationships

1. Relationship of Franchiser and Franchisee

In any business technology, knowledge and relationship management are the building blocks and form foundations for its development (Walters et al., 2002). The relationship management provides assistance to identify, establish maintain and reinforce the economic relationships with customers, suppliers and partners who have capabilities and capacities. The objectives of organisation and their partners can be met by agreeing and implementing mutually acceptable strategies, Walters et al., (2002) and Perry et al. (2002). However, it requires management to adopt a cooperative and collaborative view and not the conflicting strategy, especially when dealing with the customers and the case is vice versa with suppliers and partners. This can influence positioning and overall franchise business strategy through identification, development and maintenance of partnerships by making certain of meeting the customer expectations by both the agreement parties by forming and implementing a synergetic business development effort (Perry et al., 2002; Walters et al., 2002 Geyskens et al., 1999).

The literature depicts significant differences in thoughts of the researchers on relationship features. This is often because research is done in specific industries in a certain country. It is studied either for the structured contractual arrangements or more flexible evergreen agreements or when specific relationships have been studied that are either for short or longer term (MacNeil, 1980). According to Hausman (2001) "It is not surprising that the 'relationships' produce conflicting results since little effort has gone into identifying the specific type of relationship under investigation". Dissimilarity also

appears in behavioural character of these relationships and that the behavioural processes like trust, commitment, dependence, relationalism, flexibility, communication, and power balance have potential to affect inter firm success (Achrol, 1997; Cravens and Piercy, 1995; Dwyer et al., 1987; Mohr and Nevin, 1990 and Morgan and Hunt, 1994). These constructs have been identified as key factors in long-term relational success. They may be useful in locating a specific relationship along the relational continuum and predicting its potential for success, possibly promoting that success through improved understanding of the relationship (Hausman, 2001).

The relational exchange theory, Macneil (1980) and Dwyer et al. (1987) consider exchange as an isolated transaction at one end and a full relational exchange at the other end (Bogazzi, 1975). Relational exchange relationships are durable, dynamic and adaptable to changing conditions. While the concept of mutual commitment and interdependence is central to the study of relational exchange, Boyle et al. (1992), trust and its manifestations (i.e. information sharing, co-operative synergy and low levels of perceived risk) constitute the most critical aspect of an exchange relationship (Achrol, 1991). This highlights the importance of relationship features, i.e. control, support, power and cooperation (Morgan and Hunt, 1994). In the relationship if the commitments meet or exceed expectations of either party, they make further investments, Aksel and Sven (2002) so the relational exchange develops overtime. This is because transactions are viewed in terms of history and anticipated future (Dwyer et al., 1987; and McIntyre et al., 2004; Hackansson and Snehota, 1995; cited by Aksel and Sven, 2002). These relationship features provide an opportunity to both franchisor and franchisee to lay the building blocks for an effective, efficient and long lasting dyadic relationship. It enables them to win each other's trust and commitment which has been achieved through consensus, increased confidence in each other, information power, effective positive control and the two way knowledge dissemination. In the relationship consensus, commitment, trust and cooperation are achieved through Control, Power and Support mechanisms. However, in franchising, because of its unique nature and interdependency of both parties, these constructs seem to play differently than in other disciplines, as evident from the figure 1. We will discuss and develop this paper on the basis of these relationship features and discuss in relation to franchising.

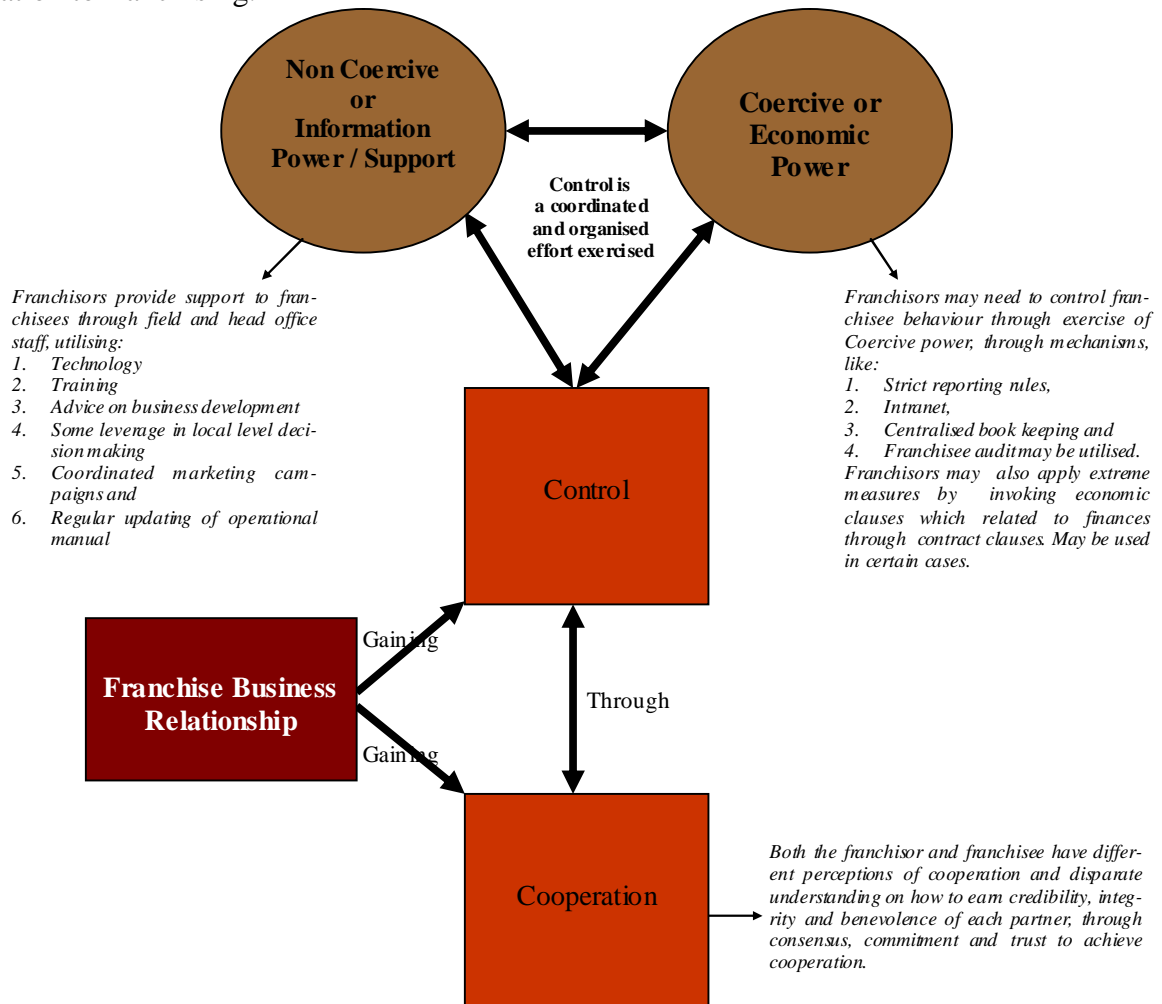


Figure 1 Franchise Business Relationship

The relationship in franchise business is more intricate than other business relationships. Its basis is acquiring cooperation between parties. Both the franchisor and franchisee communicate, interact and exchange information frequently between them in order to gain the cooperation. In this exchange the franchisee's effort is to secure maximum help and assistance required from the franchisor, for his business development, whereas; the franchisor targets to control the franchisee behaviour in order to minimise the shirking, opportunism and other behavioural uncertainties and secure the franchisee cooperation for its macro level targets and goals at the same time.

The franchisor may use coercive and non-coercive power through control mechanism in order to keep the franchisee motivated and at the same time acquire cooperation and support for business development.

2. Role of Cooperation in Franchise Business Relationship

There is substantial research material available on 'cooperation' as an important construct in relationship building and here we would try to apply the research of various scholars such as Ring and van de Ven (1992) Morgan and Hunt (1994) Anderson and Narus (1990) Heffernan (2004) Perry et al. (2002) Dwyer et al. (1987) Justis and Chan (1991) Norton (1988) Baucus et al. (1996) Quinn (1999) Doney and Cannon (1997) Wilson and Mummleni (1986) cited by Perry et al. (2002) and Ganesan (1994). From these works elements like commitment and trust and its components of Benevolence, Integrity and Credibility appear as important and these links are displayed in figure 2.

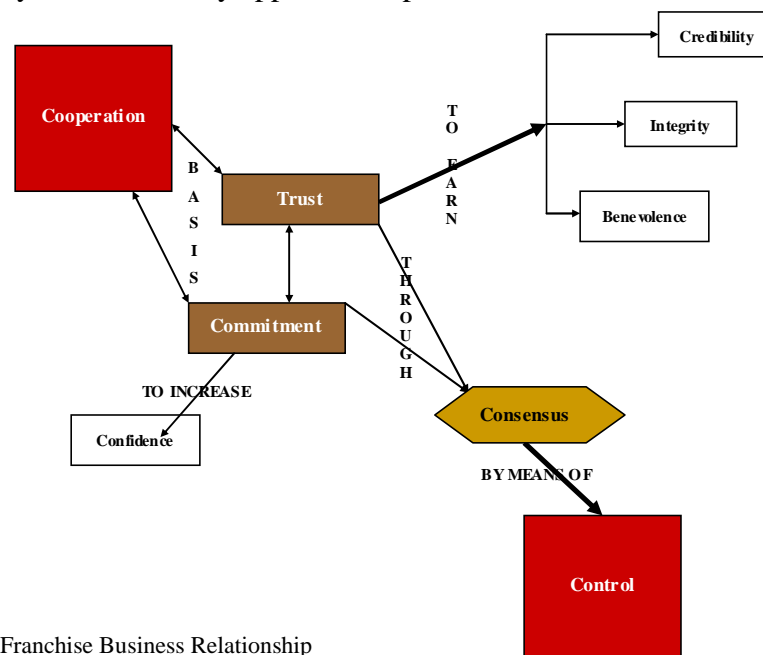


Figure 2 Cooperation in Franchise Business Relationship

The basis of cooperation is trust and commitment that can be achieved through consensus and to earn credibility, integrity and benevolence of each other. The consensus is arrived at, through exercise of various control mechanisms in place in which both exchange information and communicate with each other. The level of trust and commitment will increasingly depend upon the use of control measures as mentioned in previous paragraphs. The interaction among franchisor and franchisee is to earn benevolence, integrity and credibility; to ensure that the individual goals and joint business development effort embarked on has been successful as shown in figure 2.

In the literature Trust has been discussed and defined in different ways, however, it is agreed by all that Trust is developed over a period of time and cannot be achieved at once. Trust is developed over five stages in a franchise business life cycle. i) Pre-relationship stage. ii) Early interaction stage. iii) Relationship growth stage and iv) Partnership stage, where the relationship is at its most mature stage and the partners have developed a high level of experience in dealing with each other, learning, which was crucial in the relationship growth phase, has reached a stable level and both parties feel importance of each other. This leads to an implicit and explicit pledge to continue the relationship.

High levels of commitment are shown towards each and the relationship has established norms that guide conduct and the last stage is v) relationship end stage, where the relationship is terminated and both the parties no longer have a business association.

Commitment to the relationship is an enduring desire to maintain a valued relationship. Relationship commitment exists only when the relationship is considered important and a committed partner wants the relationship to continue indefinitely and is willing to work at maintaining it. Whereas, Trust is a willingness to rely on partner in whom one has confidence. The above implies that the parties are susceptible to breaking commitments that will lead to problems, so from very beginning the parties may endeavour to seek trustworthy partners in order to honour the relationship commitment they made.

Consensus on means and ends that the franchisers and franchisees desire for, warrants an important influence on the competitive advantage of the franchise firms, but their physical separation, disparate individualistic challenges, and incompatible goals lead to disputes. As the franchisers establish contracts specifying key decisions regarding how to run the franchise, and establish extensive training programs to transfer knowledge to franchisees about retail outlet operations. The franchisees are authorized to run the business to a certain standard as specified in the contracts. The franchise arrangement becomes mixture of motives and objectives of two different firms with contractual and also relational obligations. Partners comply with formal contracts but depend on cooperation to advance common methods and goals, and the trust they have built in each other as consensus leads to trust and cooperation.

The foundation of relationship commitment and trust lies in the fact that, a) the cost of relationship termination and its benefits influence commitment, b) the values shared by franchiser and franchisee can manipulate both commitment and trust, and c) The opportunistic behaviour of franchisee will directly impact the trust they enjoy, Morgan and Hunt (1994) and Justis and Chan (1991), d), Timely and relevant communication increases trust between franchiser and franchisee, Perry et al. (2002) and will directly impact the trust they enjoy, and e) Trust will influence commitment and confidence parties have on each other. The franchiser and franchisee can overcome certain problems within the relationship through information exchange (Wilson and Mummleni, 1986 cited by Perry et al., 2002). This is carried out through regular and frequent information exchange within a franchise system that may facilitate the business in many respects. The investment in time and energy to produce positive interpersonal relationships between franchisers and franchisees takes place on regular basis. It is with regard to latest procedures, pricing, product, Frazier (1983), Parsa (1996) and Wilson and Mummleni (1986) cited by Perry et al., (2002) current market scenario, marketing, training, budgeting, performance data, reporting, El-Ansary and Stern (1972), technical assistance and communications with external parties and stake holders and assists social bonds development (Perry et al., 2002).

3. Control

Several scholars (El-Ansary and Stern, 1972; Doney and Cannon, 1997; Quinn and Doherty, 2000; Quinn, 1999; Frazier, 1983 and Parsa, 1996) provide valuable insight into the control facet of the franchiser and franchisee relationship. In a franchise business Control mechanisms are implemented and managed through Head office and in some cases through the master franchisee or agent. Franchisers and franchisees operate in an interdependent environment in which the participants intentionally or unintentionally attempt to influence each other. The literature on b2b relationship suggests that the basis for one member's possession of power in a dyadic relationship lies in another party's dependence therein. However, in franchise business it seems that the franchisee also possesses a certain amount of power, i.e. the local business information and the increased capability he has brought to the overall business. This is central to any franchise business growth and franchisee may use it to control franchisor's behaviour, therefore concept of power is central to the issue of understanding the means adopted by one member to change or modify the behaviour of another in a franchise business.

As evident from figure 3, the control is exercised through Coercive or non coercive power by means of Technology, Field or Head office staff. Literature suggests that franchisers use two means to control

the behaviour of franchisees i.e. coercive and non-coercive. Coercive power is primarily exercised through the franchise contract, and is related to the finances of the franchisee. This is also called economic power, whereas non-coercive or information power is exercised through support activities of the franchiser and may be used to influence franchisee behaviour, enhance control and develop business. The expectation being that when franchisees receive adequate support from the franchiser they are easier to control and feel satisfied. It also assists the firms to grow and maintain the relationship.

As clear from figure 3 the non coercive power i.e. support mechanisms or the capacity building of the entrepreneur includes training, marketing, promotional, technical, operational assistance, business planning and updating of the operations manuals. It is primarily carried out through intranet, extranet or the internet and involves field and head office staff. It is obtained through the franchisor's support activities and is concerned with management by persuasion and example, rather than by threat. On the other hand the coercive power that also is exercised through same mediums is when the franchiser and franchisee relationship is strained with conflicts and or disputes. There is one exception of economic power i.e. franchisor's insistence on tying. The main reason could be that the franchiser desires to maintain quality and allows his own or his nominated suppliers raw material usage by franchisee. However, this also constitutes a source of potential conflict, especially when franchisee know that the same standard raw material is available else where or franchiser is charging higher than market price for it.

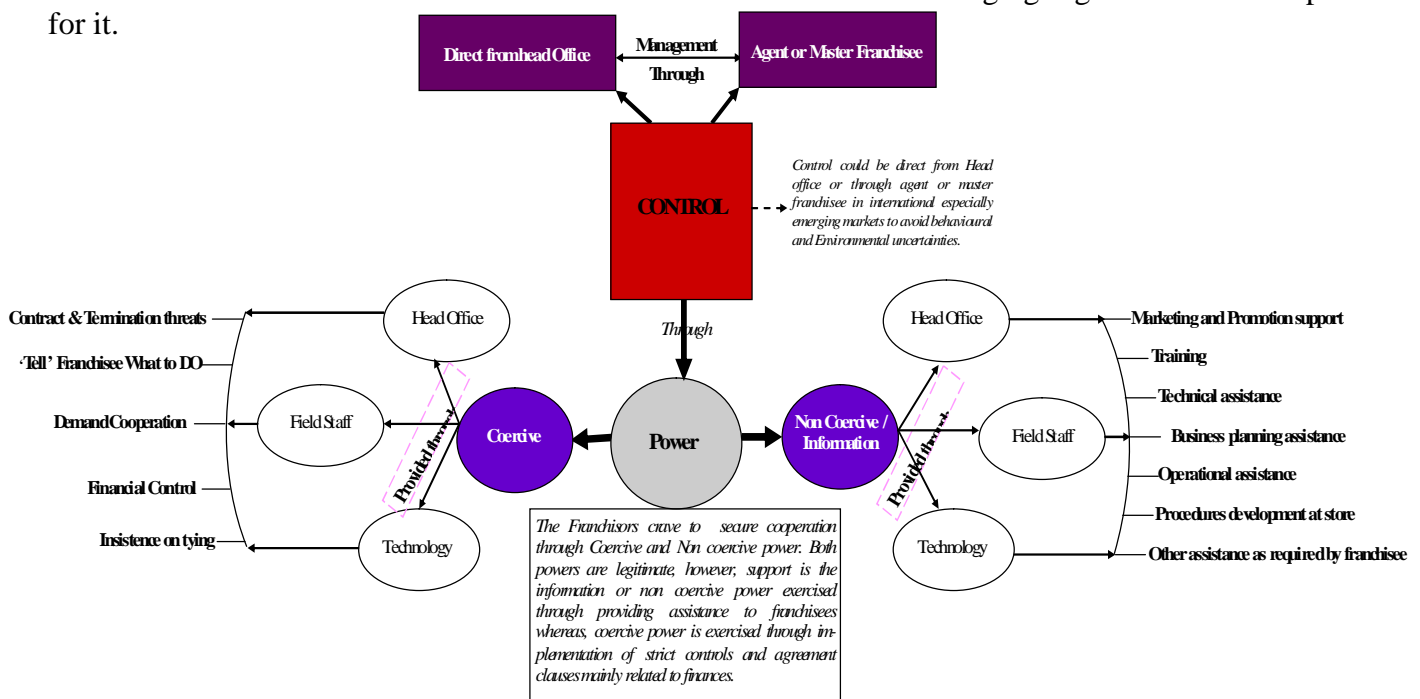


Figure 3 Control mechanisms in Franchise Business Relationship

Ideally the need for use of coercive power is minimal, except for tying for the sake of maintaining quality as mentioned above, because it is related directly to finances, and generally the franchiser does not ask for or demand cooperation invoking relevant agreement clauses. As the coercive power depends on fear or concern for the loss of a right or a possession, franchisee may expect threats or warnings from the franchiser regarding current franchise operations or future expansion opportunities (Parsa, 1996). A second type of economic power is legitimate power, which is associated with legal rights to a franchise concept controlled by a franchiser or master franchisee. The level of legitimate power in a franchise system is dictated by the nature and terms and conditions of the franchise contract (Quinn, 1999). Reward power is based on the franchisor's ability to distribute something of value to franchisees for meeting the franchisor's objectives.

Furthermore, "in an international franchise system, supporting and maintaining franchisees is considered particularly difficult and subsequently the cost of providing franchise support is higher. As soon as the franchiser expands to an international scale, because of the distance the behavioural and environmental problems start to show and a non-coercive approach becomes more difficult to implement and over time the economic-legal model of system management or coercive sources may

dominate. However, since it is easier to communicate and interact on a domestic level hence, the institutional or non-coercive systems are implemented on a national scale”. In certain situations the master franchisee or agent could be subjected to coercive sources of power or control in order to minimise the uncertainties, shirking and opportunism. In such scenarios the agent or master franchisee reports to and is in close contact with the head office. Whenever, there is a breach identified by the franchisee or an action of either party is perceived to be against norm or aimed at injustice the conflicts occur.

4. Conflicts and resolution

The above discussion exposed the importance of understanding the type, sources and resolution mechanisms of conflicts that may arise in a franchise business relationship. Literature such as, Baucus et al., (1996); Morgan and Hunt, (1994); Hing, (1995); Richardson and Rullo, (1992); Fock and Kwong, (2001); Justis et al., (1993); Kedia et al., (1995); Marks, (2004); Mathewson and Winter, (1985); Norton, (1988); Caves and Murphy, (1976); Shane, (1996); Frazier, (1983) and Quinn, (1999) provide insight into the subject that reveals behavioural, information, knowledge and finance related actions of both parties that ignite conflict, and these are summarised as below in table 1.

Actions that raise conflicts when Franchisers:	Actions that raise conflicts when franchisee’s fail to:
Modify strategies to offset the effects of rising competition	Demonstrate an expected level of managerial talent and energy
Encroach on franchisee’s market or allot it to another	Put in hard work
Unfairly terminate franchisee’s contracts	Provide sufficient capital needed and agreed previously
Fabricate successes	Complement the franchisers goals and objectives
Provide the support material that is not suitable for franchisee’s outlet	Demonstrate that they are not involved in opportunism and do not shirk
Charge high price for support and promotional and cheaper alternatives are available in the market	Keep to their allotted territory and in order to maximise profits and enters unauthorizedly in other territory
Ask and impress for tying	Adopt uniform quality standards
Tend to maximise benefit by having the maximum number of franchisees and thus minimising individual franchisee territory or distance between franchisees	Recognise the right of franchiser to police the franchisees under limits and perceives it threat
Do not fulfil on time the promises for services	Pay royalties on time
Does not listen to franchisee inputs	Disclose information
	Agree about adopting competitive strategies and methods as advised by franchisers and agreed to
	Fail to participate in innovative marketing strategies, or
	May identify and acknowledge but ignore franchisor’s goals in pursuit of their own entrepreneurial interests, possibly misrepresenting costs and revenues
	Deviate from the franchisor’s formula
	Resist changes needed to keep the system competitive

Table 1: Actions of franchiser and franchisee that raise conflicts

These sources of conflict lead to a power struggle in the relationship that tilts by design in the favour of franchiser depending upon the life cycle stage of the business system and the type of corporate structure. Balance may slant in case of existence of a master franchisee or area development franchisee, though numerous legislations have been passed to bring a balance between the powers of each party.

Conflict resolution has consistently occupied a central role in models of the inter-organizational exchange process and is viewed as the primary mechanism for reducing manifest conflict in distribution channels. Several processes, approaches and procedures have been put forth by the scholars for the conflict resolutions among the franchiser and franchisees that create dissension among them. It is be noted that the solutions are not generic and have been put forward for specific problems, certain countries and particular franchise business sectors.

As most of the problems arise out of the behaviour of the individuals and various groups of behavioural conflict resolution mechanisms have been proposed in the organizational behaviour literature (March and Simon, 1958; and Pruitt, 1981 cited by Dant and Schul, 1992). These literatures suggest that the reactions of firms to conflicts could form processes of a) problem solving, b) persuasion, c) bargaining and d) politics. Once the conflicts arise the partners may embark upon either institutionalised mechanism through negotiations process or institutionalised conflict resolution mechanisms i.e. legal remedies available under contract (Dant and Schul, 1992).

5. Unanswered questions

Though the literature on franchising is fairly comprehensive, however, the above review of literature reveals that relationship in the franchise business is not totally dependant upon the behaviour of each party, but is contingent upon the actions of both the parties that they may take as a result of a certain occurrence or incident in the business. After the discussion of relationship features, components and their role in the franchise business, next step is to identify the actions in each of the component and feature of relationship that can supplement this relation and help solidify the relationship. The gaps have been identified by the Scholars like, Heffernan (2004) Hausman (2001) Doney and Cannon (1997) and Morgan and Hunt, (1994) and there is little discussion about these factors in literature. To the best of our knowledge the above discussion reveals following gaps in the literature.

1. What actions in the dyadic relationship can improve it by enhancing, trust, commitment and cooperation, increase the confidence enabling credibility, integrity and benevolence for each other?
2. What can be done by both the parties to better the relationship?
3. To further the understanding of the capabilities of relationship strength.
4. Explain how relationships achieve positive joint outcomes.
5. Franchisee perceptions of “focusing trust in the franchiser, why and what are the factors of posing trust in a particular franchiser by the franchisee”?

As the relationship features have been thoroughly investigated for b2b relationships, but following general questions also arise from the review of literature for franchise businesses.

1. What are the principles on which the franchiser and franchisee maintain or break their relationships? Evaluating the relationships.
2. What are the perceptions of franchiser and franchisee, of the relationships and what do they expect from their partners in maintaining and strengthening this delicate foundation of their business?
3. What is the crux of franchise business relationship, what actions and deeds of both franchiser and franchisee in control and power mechanism of relationship will increase or decrease trust, commitment and cooperation with each other and consequently grow the business.
4. What will be the effect of franchisor’s insistence on tying, on relationship? In many cases franchisers insist franchisees to purchase the raw material either from them or from designated suppliers. In certain circumstances the franchisees can get the raw material of same standard from else where, either cheaper or on same prices of even better quality.

6. The Need

The above discussion shows that the development and evolution of trust requires certain behavioural, system and procedural adaptations from both the franchiser and franchisee. This will illustrate that they possess necessary capability, competence and expertise to undertake and retain the purpose of the relationship they have entered into and extend the partnership stage in the relationship. The reliability and confidence in each other will increase when both the parties adhere to written and verbal commitments. When parties have trust in each other, they become more accommodating, act with equity and if a certain situation arises and achieving consensus becomes easy. Consequently both partners will act with benevolence and integrity and the credibility of each other will develop. Prevalence of relationship commitment and trust is central to any successful relationship to encourage the franchiser and franchisee to i) work at preserving relationship investments by cooperating with each other, ii) resist attractive short-term alternatives for the expected long-term gains by staying together, and both can iii) view potentially or visibly high-risk actions of each other as prudent on the belief that their partners will not act opportunistically and will not shirk. Therefore, when both commitment and trust together prevail, outcomes are produced that promote efficiency, productivity, and effectiveness. Commitment and trust leads directly to cooperative behaviours that are conducive to relationship, otherwise, as commitment and trust decline disagreements start to surface.

The effective franchise business development requires exceptional communications, cooperation, thinking and acting together as a network. Therefore, there is a need to identify such actions and deeds of the franchisers and franchisees that can enhance relationship between the two parties and consequently over all business development and growth of the system where franchisers and franchisees work synergistically, add value and learn and achieve overall business development securing competitive advantage.

7. Hypothesis

From above we hypothesise that the following needs to be investigated.

1. If both the parties keep the communication effective and efficient, the relationship is more likely to be maintained.
2. The stronger the relationship of franchiser and franchisee, the increased growth and over all business development, companies secure, that will help build synergy and add value.
3. The more franchisor's effort to build the franchisee capacity building, the more confidence and commitment of the franchisee increases and will work with more commitment
4. The longer the dispute history between franchiser and franchisee, the more aggressive contending and yielding approach to negotiation and problem solving is applied by both the franchiser and franchisee.
5. The more franchisee recognises the franchisor's overall effort for the business development the commitment towards relationship maintaining and preserving will increase from franchisee

8. Relationship to achieve Synergy

Keeping in view the external influencers, asset specificity, uncertainties associated, constraints and other potential negative forces that may act against the firm, a franchise company must understand and prepare strategy for meeting the threats and develop synergetic activities and strategies for overall business development. This will allow the parties to understand their environment and act together. Accordingly each relationship component receives appropriate interest, concentration and attention according to its importance. Figure 4 shows that the franchiser and franchisee can develop a synergistic approach of working for business development by concentrating on their relationship. This shall allow them more time and combines energy and resources for the business growth activities. As mentioned earlier, most relationships fail to provide the benefits desired by the forming partners. The concept of relationship strength adds to the emerging understanding of what makes successful relationships, by demonstrating that success may result from a combination of

compensatory factors, rather than a single factor. As the parties start trusting each other based on their behaviour and fulfilment of the commitments made Morgan and Hunt, (1994) the over all business development activities gain momentum and both benefit.

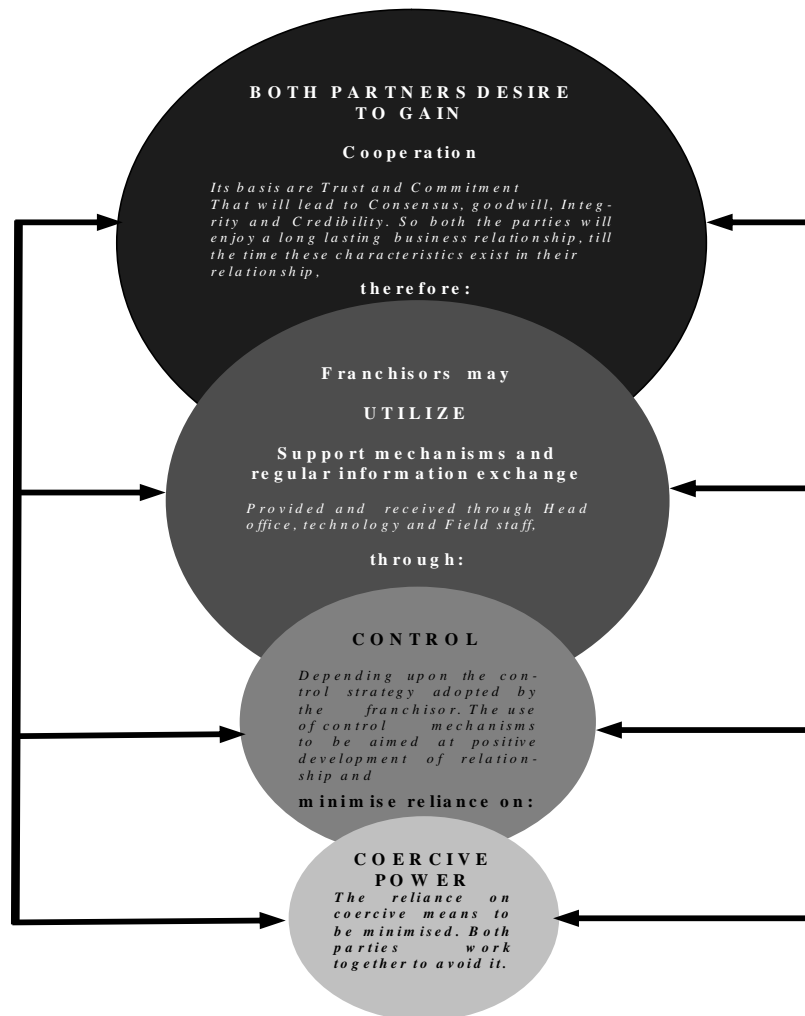


Figure 4 Franchiser and Franchisee to build and work together for synergistic business development impact

As both the partners desire to gain each other's Cooperation and is the highest priority, therefore franchisers may maximise the support mechanisms, decrease the use of Control instruments and minimise the use of coercive or economic power in order to secure franchisee's cooperation.

The consensus on resources, sources and objectives represent important considerations, but franchisers should examine their methods to identify dimensions on which franchisees must agree and those allowing room for dissension (Norton, 1988). Franchisees value discretion and may rebel if unduly controlled, especially if franchisers intrude and try to impact on decisions made by experienced franchisees about how to compete at the local level (Baucus et al., 1996). Franchise systems may operate more successfully and franchisers may experience fewer disputes when franchisees have latitude regarding competition.

9. Conceptual Model

We understand that once the franchiser and franchisee have initiated the process of rectification in their actions and deeds, they will be better able to work in a more coordinated manner and concentrate on business development of their respective businesses as team where people share common goals, is more flexible and produces better performance; based on the model shown in figure 5.

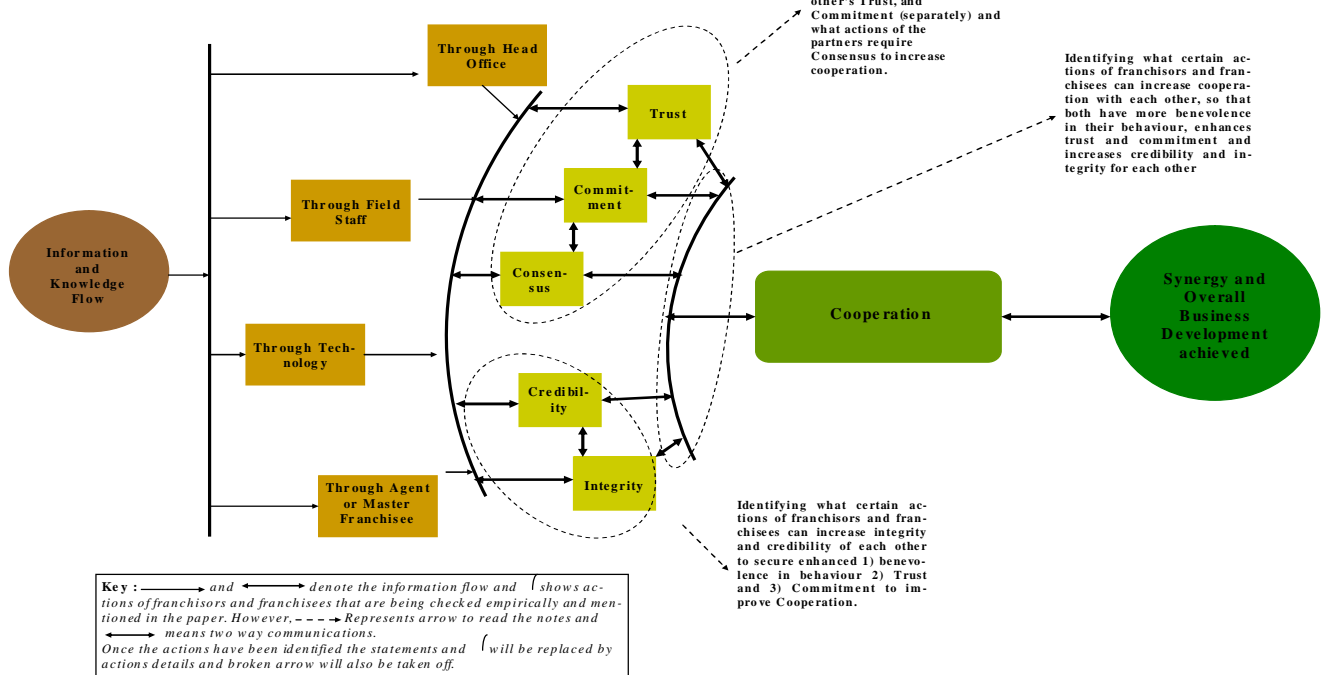


Figure 5 Franchise Business Relationship Rationale for overall Business Development

When the empirical work is completed the related actions identified by the franchisors and franchisees will be pointed out in the relationship features and its elements. Thus the model will highlight the actions and deeds of larger (franchiser) and smaller (franchisee) organisations in their routine business that can be implemented in the relationship through communication. This will allow both the partners work more for business development, enhance their productivity and streamline their functions in a similar way as total quality management Deming, (1986) and European foundation for quality management philosophy, as illustrated in figure 6.

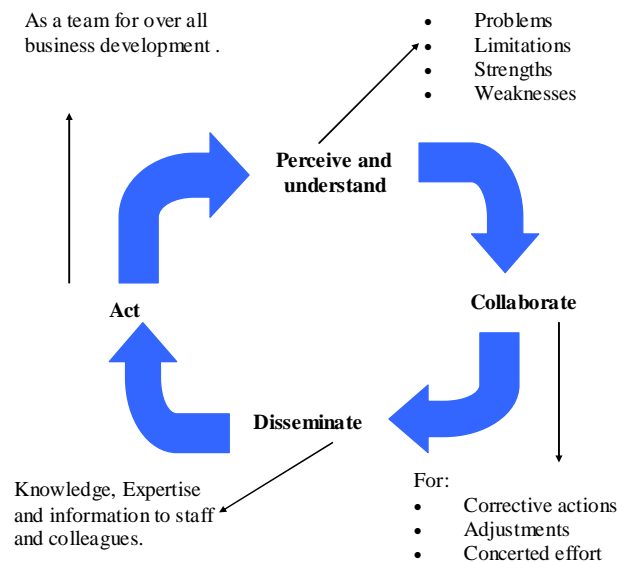


Figure 6 Franchiser and Franchisee functions in a franchise business relationship

One of the outcomes of the model will be that the franchiser and franchisee will be able to perceive and understand the problems, limitations and strengths and weaknesses of each other in a better way. This will allow collaboration and make adjustments in a coordinated manner. This will enable them to disseminate the knowledge in the organisation for over all business development, add value and achieve synergy.

10. Conclusion

Franchisers and franchisees have a joint goal of overall business development, as each other's

development or deterioration affects the other. Therefore, both require working for developing, maintaining and strengthening their relationship. This can be achieved through frequent information and knowledge exchange by adopting and adapting to, in their systems, procedures and behaviours and incorporated in their corporate strategy. This will provide them mutual competitive advantage and reduce imitability and substitutability of their products and services, increased durability, approachability and innovative capability in both the personal behaviours and organisation culture. The organisation will also develop skills to create, acquire and transfer knowledge and modify its behaviour to affect new knowledge and insights, hence overall business development achieved and value added.

The model will help the franchise business to fulfil the purpose of their existence based on their vision and mission. Hence, a value added organisation that has achieved the competitive advantage and overall business development, will be better able to compete and build itself on its core and distinctive competencies. Hopefully, by embarking upon these practices the franchise firm will emerge as an ethical entity meeting its social responsibility, and its culture and style will evolve with the growth as evident from figure 7.

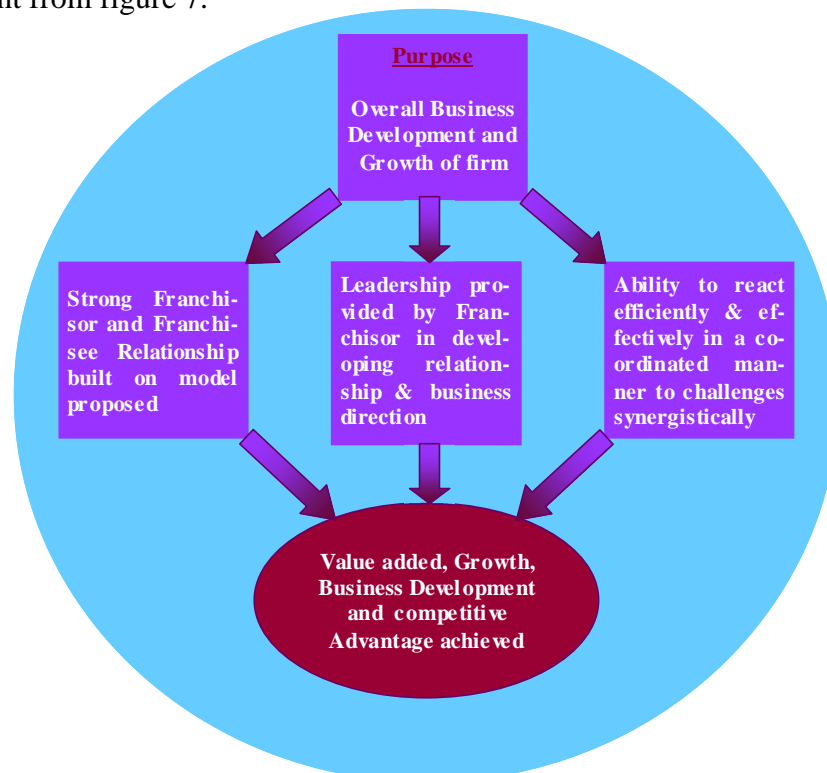


Figure 7 Achieving the Purpose of existence and overall business development

The next step in the research is to carry out comprehensive survey of franchise companies, including franchisors and franchisees. The aim is to test and verify the hypothesis and research questions. The findings will be reported

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