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Franchise relationships: tacit expectations, great expectations

Abstract

The franchise relationship is a contractual bond made between a franchisor (the owner of a brand and a distinctive concept) who wants a rapid duplication of stores, and of a franchisee, an independent trader joining a franchise network in order to have access to a successful business system. Franchisees expect franchisors to be loyal and to comply with the previously negotiated contractual provisions. They hope for a franchise relationship free from opportunism. In addition to the existence of a formal contract determining the major obligations negotiated between parties, the parties have tacit expectations of their partners, that they actually consider as obligations. Unwritten agreements are part of a psychological contract which, if not adhered to, may have a negative impact on the franchise relationship when interpreted – sometimes wrongly – as the manifestation of opportunistic behavior. This article is based on an exploratory investigation conducted in France to identify, from personal accounts, the types of betrayal of the psychological contract as perceived by the franchisees: betrayals that are often a sign of misunderstanding between franchisors and franchisees.

Keywords: France, franchise, method of life history, opportunism, psychological contract, unwritten agreements.

JEL Classification: K12, L14, L26, L81.

Introduction

When a company decides to sign a contract with another company, both obviously take care to formalize as minutely as possible what they expect from their partner operationally and strategically. They also take care to mention the penalties the partners expose themselves to in case of violation of the contractual obligations. Franchise contracts consequently have become more detailed over time, sometimes reaching 40 to 50 pages. As well as the formal contract listing each party's obligations, the parties also have specific and implicit expectations which will sometimes appear during the relation, the violation of which are considered as unacceptable (Robinson, 1996). Rousseau (1995), among others, underlined the critical significance of unwritten agreements in the governance of relations between employers and employees, and more widely, between organizations. These unwritten agreements are the basis of a psychological contract the betrayal of which may have destructive effects on the trust which was established between individuals or between firms. However, betraying a psychological contract does not necessarily mean displaying opportunism in Williamson's (1985) sense. It may simply be a lack of mutual understanding over what was expected of a relationship, but was not discussed at the time of the pre-contract exchanges. Opportunism is above all a matter of context and situation (Lecocq, 2004); the franchise relationship is an interesting field of investigation from this point of view.

The violation of the psychological contract between franchisors and franchisees is all the more likely when the relation sometimes extends over several decades. Players have difficulties in projecting themselves so far in the future at the time of the pre-

contractual negotiations: franchisees often think in terms of return on investment on the first contract, with eyes glued to the profit and loss form of the first two years. It is hard for them to imagine the many upheavals that will mark the life of their franchise network and modify their view of the franchisor-franchisee relationship (Chanut, 2007): such as changes in local competition when franchise networks become more concentrated, changes in franchisor firm owners, changes in concept or strategy, etc. It is hard to anticipate the consequences of so many events when the contract is signed, events with the power to disappoint the franchisees' tacit expectations. The difficulty of planning way ahead and of thinking of everything in advance in a formal contract justifies the psychological contract approach in order to avoid the increasing feelings of disappointment of franchisees, from minor frustration to betrayal, with the risk of breaking the relation.

This article is based on a qualitative exploratory survey conducted in France with 20 franchisees and 19 franchisors. The method used is the "*révélés de vie*" (life stories) in order to reveal and understand the contents of psychological contracts and particularly to list the franchisees' tacit expectations. At what time do they consider that their franchisor has betrayed the psychological contract? This question is significant from a managerial point of view as it directly conditions the perceived quality of the franchise relationship (and its potential lasting quality).

This article is organized as follows. Section 1 justifies the interest of using the concept of psychological contract to understand the franchise relationship. Section 2 presents the methodology. Section 3, exploiting the field survey, introduces what is perceived by the interviewed franchisees as a form of betrayal of the psychological contract; individual case studies provide examples of the two forms

identified, but which do not necessarily refer to opportunistic behaviours on the part of franchisors.

1. A psychological contract between franchisor and franchisees

The existence of opportunistic behaviors is nearly unavoidable in a franchise relationship as the parties cannot assess the actual value of the promises made when signing a contract; for example, on the franchisor's commitment to help franchisees during hard economic situations, or on the strict adherence by franchisees to promotional operations decided by the franchisor (Dnes, 2009). Hence, it is in the franchisors' interest to resort to informal rewards, rather than legal actions for violation of franchise agreements, to encourage their franchisees to comply with brand quality and/or uniformity standards (Badawi, 2010). Similarly, franchisees, before becoming members of a franchise network, should check its managers' values and mode of governance, by meeting franchisees already belonging to the franchise network. To cope with risks of manipulation, cheating or withholding of information by partners, contracts usually include a provision on the obligation of loyalty and each party anticipates a kind of "normal behavior". But loyalty or "normal behavior" is seldom explained. Although opportunism is often interpreted by transaction cost economy supporters as the violation of an explicit contract easily identifiable by outside observers, its socio-cognitive dimension is now recognized in inter-organizational relations: the way to approach opportunism varies depending on business contexts and players' interpretations (Lecocq, 2004), making the concept of the psychological contract particularly relevant.

The concept of the psychological contract was developed by **human resource management (HRM)** researchers concerning relationships between employer and employees. In a seminal work, Argyris (1960) refers to employer and employee expectations of the employment relationship, i.e., mutual obligations, values, expectations and aspirations that operate over and above the formal contract of employment. The idea is that in addition to the formal and written employment contract, that includes a number of provisions determining the major obligations negotiated between the parties, employees have expectations of their employer that they consider as obligations. Employees have their own representation of what the relationship with their employer should be, which is much more comprehensive than what is written in their employment contract. Non-written obligations are part of the psychological contract. They make up for the contract incompleteness, underlined by neo-institutional theory resulting from bounded rationality and environmen-

tal uncertainties, and as a source of opportunism from players who tend to privilege their own interest. As well as opportunism and the idea of deception (Williamson, 1985), the contract incompleteness may be a source of disappointment when parties do not have the same notion of a formal contract. Hence, perceived reciprocal obligations – not specified in the formal contract, but the basis for entering the relationship – should be defined.

Several elements characterize a psychological contract, including the fact that it will change with time. On the one hand, it is a perception depending on the mental representation of the rights and obligations stemming from the exchange relationship: it is subjective and specific to each partner. On the other hand, perceived obligations are tacit to the extent that players are not necessarily aware of them and do not state them explicitly; they are not reviewed by the parties during the pre-contract negotiations, but appear during the course of the exchange relationship, often in real-life experience. The betrayal of tacit expectations, for instance in terms of "good faith" (Terry and DiLernia, 2011), does not necessarily stem from an opportunistic behavior. It may also be a matter of mutual lack of understanding between partners that the psychological contract reveals outside the original formal contract. The concept of the psychological contract is relevant for analyzing all contract-based relations between firms, and Rousseau (1995) aptly suggested using it in the framework of a *general contract theory*.

To our knowledge, the concept of the psychological contract has not yet been used to understand the dynamics of the franchise relationship. Of course, it is not based on the same subordination link that characterizes the employment contract. Franchisees are legally and financially independent traders; they invest in a store and bear the operating risks in order to make a profit. But franchising is perceived by franchisors as an alternative form of governance to store management in their own name, with employed managers. As DiMatteo (2010) noted, "the franchise model is an example of the use of strategic contracting to create a private governance structure needed to sustain a long-term relationship". In addition, for would-be franchisees, entering a franchise network is an alternative to salaried employment or store operation outside a franchise network. Franchisees obviously expect of franchisors a high involvement in sharing know-how and operational supports, in exchange for the paid royalties and efforts to reinforce the global brand image at store level (Leslie and McNeill, 2010).

The franchise relationship is better understood with the notion of psychological contract when we con-

sider potential opportunistic behaviors from franchisors. The business world is no calm sea and the ability to quickly grasp opportunities – buying out concurrent franchise networks for instance – is a factor forcing players to accept sometimes major and not altogether anticipated changes. Franchisors are responsible for their franchise network strategies and their objectives may evolve with time, particularly on the occasion of the upheavals experienced by all franchise networks (Chanut, 2007); this will lead to changes in decisions and behaviors which may be perceived as opportunistic by franchisees and a breach of the original psychological contract. This is all the more true as franchisees, when becoming members of a franchise network, sometimes have difficulties in projecting themselves into the far future. Their temporal horizon is short, extending to the early years of operation at best, whereas the relationship may last for several decades.

Franchisors have to think about the “guarantees” that they should offer franchisees faced with the perceived risk of violation of the psychological contract during the relation. The conventional system of royalties partially protects franchisees from the franchisors’ opportunistic behaviors as their income relies on the activities of each store. From her field survey, Croonen (2010) listed the mechanisms promoting the spreading of a climate of trust inside a franchise network, and focused on transparency in calculating royalties, and also on the management of unsold articles or the resort to a third party in case of franchisor-franchisee disagreement. But other arrangements will have to be imagined to reassure franchisees when the franchise network reaches maturity. Franchisors should state what is implicit, to defuse any future conflict. This is what the psychological contract is for: supply a grid to reveal implicit obligations to prevent franchisors’ strategic decisions being interpreted as opportunistic by their franchisees.

2. Exploration of the French context

A field study was conducted in France to examine how franchisees perceive some of the franchisors’ behaviors as opportunistic (without such behaviors appearing as such to franchisors or outside observers), and when the psychological contract seems betrayed. The purpose is to present the franchisors’ obligations implicitly perceived by the franchisees, without detailing the psychological contract seen from the franchisors’ side as the perceived (non explicit) obligations are fewer from the franchisors’ side. The franchise contract is a support contract, generally written by a franchisor and his advisors and proposed to would-be franchisees (DiMatteo, 2010). Consequently, the formal contract includes the major obligations perceived by the franchisor

who is at liberty to make them explicit, written and contractual... in an increasingly voluminous contract, whereas the obligations perceived by franchisees remain highly implicit.

We adopted a qualitative approach, in harmony with the recommendations of researchers working on psychological contracts when their contents are to be defined (Campoy et al., 2005). Information was collected using the life history method consisting of inviting respondents to tell their story, a part of life in relation with the research purpose. The method is based on the recollection of major events as they were lived and memorized and on trying to identify their sequence (Bertaux, 1997). The method is relevant for revealing the obligations perceived from events experienced by players as positive or negative “critical incidents” and told in their own words. Sufficient information was obtained after 39 semi-directive interviews conducted with 20 franchisees and 19 franchisors (owners or managers) to collect both parties’ point of views. Respondents were selected as per a diversity criterion (sectors, seniority of franchise network or franchisee, gender, number of stores, etc.). Interviews were completed with additional sources of information (contracts and pre-contractual information documents, Internet sites).

Data were coded and examined according to two directions: description and analysis. The obligations perceived by both parties’ players were exhaustively listed, then coded and grouped by categories of a similar nature. Whenever it made sense, classification was done from concepts of exchange relationship as determined by the literature (mutual interest, profit sharing, power, franchisor contribution and assistance, relation aspects), which were illustrated and operationalized by precise perceived obligations. Several new subjects emerged: franchisees’ income level, sales conditions of franchised firms, and the respect of franchisees’ independence. The field study revealed a number of facts on the forms of betrayal of the psychological contract, which are illustrated by concrete examples from the stories told (anonymously, at the interviewees’ request).

3. Two forms of betrayal of the psychological contract

It is a common occurrence to read that conflicts are inherent to franchise networks because of the irreducible antagonism between franchisors’ and franchisees’ interests; the level of conflict could even tend to become higher with the increase in the number of stores and also over time (Hoy, 1994). It is however possible to complete the approach of the franchise relationship by referring to works on social exchanges, particularly those dedicated to the

psychological contract. A franchise network is like an exchange system where the parties' expectations are expressed more or less explicitly, without being necessarily written in formal contracts. The violation by franchisors of the franchisees' tacit expectations may degrade the relation, when franchisees think – wrongly sometimes – that franchisors are betraying the psychological contract. The field study conducted in France points revealed two forms of perceived betrayal.

3.1. Each franchisee's individual interests are not sufficiently taken into account. Macneil's (1980) work on the difference in nature between a transactional exchange and a relational exchange underlines the importance of taking into account mutual interests and a fair sharing of incomes between partners. A partnership must be a "win-win" one to last. The analysis of the personal stories shows that franchisees expect franchisors to consider the franchisees' interests as much as their own or the interests of the franchise network (of which they are guarantors) when making strategic decisions such as local micro-decisions associated with each store. This perceived obligation may be expressed in several very concrete elements.

3.1.1. Individualized income and assistance. French franchisees are aware of being residual claimants and of being the only ones to bear the operating risks of their stores. But they expect franchisors to create the conditions to allow them to earn an income reflecting the efforts they put in. Some franchisees, those who joined the franchise to become self-employed, often by benefiting from government aid, expect a fair compensation for work. Other franchisees, with a more entrepreneurial profile, expect an income higher than a salary, in view of the risks taken. These conditions expected from franchisors are represented by a reliable, complete and objective help in the preliminary assessment of the potential store profitability. This includes the foreseeable developments in a town's trading environment, a comprehensive business plan, the description of the financial results and problems met with by the possible previous franchisees, in addition to the legal information included in the *Document d'informations pré-contractuelles* made compulsory in France by the Doubin Law (1989) to reduce the information dissymmetry between franchisors and franchisees (see Box 1). In the course of the contract, franchisees expect of franchisors a transferred know-how and significant, innovating and personalized actual assistance in case of difficulties, for example during an economic crisis (teams dedicated to the audit of affected stores, search for suitable personalized solutions).

When strategic decisions are taken for the franchise network, such as a change of concept to adjust to market developments, the franchisors' time-frame may not be in harmony with the franchisees' time-frame. Franchisees consider that their franchisor should adapt the schedule to each store, unlike what occurs in an integrated network. New investments should not be imposed unless stores have made a reasonable profit, or if the franchisee's financial situation is still fragile. Finally, when franchisees sell their business, they expect a fair assessment of the selling price. When selling the store is not free, due to a provision requiring the franchisor's approval of the potential buyer, the selling franchisee expects the franchisor to offer a price taking the value of the business by the former franchisee into account, without favoring the buyer. In fact, franchisees prefer a contractualization of the selling price to make up for this restriction to the freedom to sell.

Box 1. Franchisors put the interest of the franchise network before the interests of the franchisees.

Mr and Mrs A have been franchisees for six years. Their store is in a medium-size town characterized by the inhabitants' high purchasing power and a small town center where business rents are particularly expensive. At the end of six years, they do not make a living from their store, in spite of a significant increase in their sales turnover and numerous prospecting actions. Mr A had to take seasonal work to add to their income while still working in their store. The business conditions in this town obviously do not allow a franchisee to earn enough to live on. Mr and Mrs A learned, well after signing their contract, that two franchisees had failed in the town before them; however, the franchisor had reinstalled franchisees so as to maintain the brand in the town. On top of that, a mall was built in the town center three years after Mr and Mrs A's installation, a few streets away from their store. The franchisor put pressure on them to move their store to the new mall, although the rent there was even higher. At the time of the interview, the franchisee was no longer in contract with the franchisor (it was not renewed), but the franchisor kept delivering goods as if nothing had happened. The franchise network manager calls him regularly to know whether he is thinking about the situation. The franchisee cannot stand this psychological pressure and talks of harassment. He is considering leaving the franchise network.

3.1.2. Duration of contract and territories. Franchisees consider it an obligation to be able to extend the partnership beyond the contractual period, except in cases of serious breach of contractual obligations. This should allow franchisees to go on operating their business, harvest the fruit of their labor,

and to see much further than the duration of a contract (generally six years and a half in France). The French courts have always refused the principle of an automatic extension of contracts or franchisee indemnity when contracts are not renewed, favoring the principle of contractual freedom. But franchisees consider that it is a violation of the psychological contract if a franchisee is ousted at the end of his contract and a store manager employed by the parent company is installed instead, even if geo-strategic reasons are put forward (control of the franchise network or of a geographical area). Such a decision increases franchisee precariousness. Similarly, franchisees feel that the frequent restrictions of the territorial area when their contract is renewed are a violation of the psychological contract, as Cox and Mason (2009) noted.

Moreover, franchisees expect franchisors to have a long-term vision of store development, to discuss development projects with them, and to include the franchisees' projects in the franchise network growth strategy. They also expect a transparent position on the multi-franchise issue. Some consider that existing franchisees should be granted priority for any available store near their customer areas. For example, in case of creation of a new business area in a medium-size town adjoining the exclusivity area defined in the franchisee's contract, to respect the spirit of the contract means extending the geographical area given to the franchisee to take the new situation into account. *A fortiori*, when a fusion results in the presence of "replicate" stores in an exclusive territorial granted to a franchisee, the situation must be solved intelligently taking into account the mutual interests and priority to franchisees (see Box 2).

Box 2. Franchisors ignore the franchisees' need for independence.

Mr B is the franchisee of a car accessory and repair firm. In fact, he is a multi-franchisee and owns six stores in several small towns inside a 150 km perimeter. His business is prosperous and he considers his relationship with his franchisor as well-balanced. This was not always the case, as he recalls a difficult episode following the takeover of his franchisor by a rival franchise network with two stores in his exclusive territorial area. The new franchisor proposed to the franchisees a redistribution of the bought stores, provided the franchisees agreed to sell him 34% of their firms. Mr B refused, as it was out of question for him to lose his independence. Then came a period of three years when the situation deteriorated. The franchisor went as far as opening a branch store in a new mall created on the outskirts of a town 200 m away from the limit of Mr B's exclusive territorial area to "push him a little". For the franchisee, while the formal contract did

not include the new mall, the spirit of the contract was to consider this mall as part of the exclusive area: "they operated this branch in my customer area". The situation was resolved after a few years and the franchisee was able to keep his independence.

3.2. Franchisees are not acknowledged and listened to as adult partners. Franchisors play a central, hub part conferring them the authority of defining the strategy of their franchise networks and of seeing that their franchise system specifications are complied with. Behaviors observed in franchisors are strongly criticized. Franchisees complain that they are not heard as partners and that they lack independence. These complaints come into two categories:

- ◆ *Franchisees' independence not respected and pressure put on them.* Such behaviors correspond to psychological or material pressure to get franchisees to act or decide in a given way. Several stories give striking examples: pressurise a franchisee at the end of his contract to force him to change location; not renew a contract while continuing deliveries causing psychological pressure through uncertainty (moral harassment); letting a conflict drag on for four years to weaken a franchisee and obtain a decision (see Boxes 1 and 2). Practices aiming at jeopardizing the franchisees' independence are condemned: attempting to obtain a majority holding in the store franchisees' capital, so as to better control the franchise network and selling prices, or imposing retail prices in breach of the law by issuing price lists on the Internet available to final customers. Such practices, qualified as *abuse of power*, are considered as against the psychological contract.
- ◆ *Attention and respect.* Franchisees expect franchisors to implement structures for a constructive dialog, such as general or specific commissions, to exchange views on strategy and consult franchisees on the key decisions about the franchise network's long-term commitments. Some franchisees have high expectations in terms of professional development and wish to invest actively in the franchise network: dialogue makes this possible. But this means that the franchise network managers have to respect the dialogue system where it exists. An example of violation of the psychological contract was mentioned: a franchisor did not respect the unfavorable advice given by the recruiting committee composed of the franchisor and of franchisees, that he had set up personally.

Franchisees also expect franchisors to be attentive, to listen to them, with each individual in mind, and to manage relationships and contracts intelligently. This implies the following obligations: to treat the "small" and the "big" franchisees with the same respect;

supply individualized information to installed franchisees whenever a new one arrives in their customer area; avoid any humiliating attitude; be honest in all circumstances, i.e., be transparent, acknowledge one's mistakes and consider franchisees as adults (see Box 3); authorize an early end of the contract in case of change of life circumstances having nothing to do with franchise (a divorce for instance), without penalties or any other form of barrier for getting out; finally provide a direct and quick way of contacting the franchise creator or manager who must remain accessible and available, even when the franchise network grows. Franchisees express a strong need for recognition as full, responsible and autonomous partners. They wish to be guided and considered at the same time. They feel franchisors should be polite and "correct".

Box 3. Franchisors ignore the franchisees' expertise.

Mrs F has been for one year the franchisee of a health care firm (slimming care and follow-up) whose owner changed 18 months ago following internal conflicts and the leaving of a large number of franchisees. She is pleased with her first year of activity but is very critical towards her franchisor who replaced a range of food supplements and meal substitutes by a new one. She has three criticisms to make: first, the franchisee's margin on the new range decreased, while consumers paid a higher price, making the products more difficult to sell; second, the products are less efficient (Mrs F noted customers were putting on weight, which is the limit!); and third, her regional contact asserted she was the only one not to sell the new range correctly, probably because "her selling technique needed reviewing", while she sounded out the other franchisees and found out they had reached the same conclusions: the new range was not very efficient and its sales turnover was decreasing. Mrs F is considering buying these products from another source.

Conclusion

This article examined a subject rarely studied in franchise network management: the psychological contract. The field survey in the French context revealed, from the franchisees' personal experience, two forms of betrayal of the tacit expectations franchisees have of franchisors. These two forms do not automatically mean that franchisors have proved to be opportunistic, but this is what franchisees do feel. While only in an exploratory stage, our approach helps our understanding of exchange relationships and the major importance of avoiding misunderstandings when recruiting new franchisees, so as to prevent mistakes and resulting feelings of disappointment. Implicit aspects are essential in our approach, aspects that the literature on franchise relationships have tended to ignore for a long time (Hendrikse and Windsperger, 2011).

Franchisors must try to explain the potential contents of psychological contracts in their franchise networks, each being different from other franchise networks. While contracts are active, franchisors must also finely tune relationship monitoring and the messages sent to franchisees. Franchisees should no longer be managed as a homogenous set with uniform expectations, but as "strategic groups" depending on their degree of awareness of the respect of tacit expectations. Research could extend in two directions. First, it would be relevant to conceptualize a model of the factors in the franchise psychological contract from works in HRM, while highlighting the specificities of the franchise relationships. The exploratory survey conducted in France could then be duplicated in other countries to identify possible differences in the nature of psychological contracts depending on specific cultures and institutional environments.

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