ENTREPRENEURIAL FAILURE: THE CASE OF FRANCHISEES (SUMMARY)

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SUMMARY

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Principal Topic

Understanding the causes of business owners’ success and failure is a cornerstone of entrepreneurship research. In this study, we extend agency theory and resource-based theory to explain franchisee failure.

Method

Agency theory applies to any joint effort in which one party delegates authority to a second. First, prior experience will yield survival enhancing human capital among franchisees, so franchisee failure is negatively related to requiring industry experience (Hypotheses 1, or H1). Second, agency theory predicts that active owner managers exert optimum effort, so franchisee failure is negatively related to requiring active ownership (H2). Third, the royalty rate is the percentage of franchisees’ sales paid to the franchisor; a higher royalty rate negatively affects franchisees’ motivation and therefore increases the probability of failure (H3). Fourth, when franchisees control a geographic monopoly, they will capture the fruits of any effort to improve their outlet’s reputation. Therefore franchisee failure is negatively related to the franchisor’s use of exclusive territories (H4).

Franchisors provide at least two important resources: brand names and operational routines. Better resources should reduce failure. Specifically, franchisors that invest heavily in brand names should experience less failure among franchisees, (H5). Teaching organizational routines to franchisees via comprehensive training programs should also benefit the franchisees by increasing their firm-specific human capital. Franchisee failure is negatively related to the length of training (H6).

Results and Implications

Data were drawn from a single industry (restaurants) to control for factors that affect competition. The dependent variable is the rate of failure, defined as the number of franchised outlets that failed in the prior three years divided by the number of franchised units that started the period. Independent variables were drawn from franchise contracts, thus facilitating coding. We controlled for the franchisor’s franchising experience, franchisor performance, and outlet size. Results support all hypotheses.

The study renders three important contributions. First, we explain franchisee failure by extending agency and resource-based theories. Extending agency and resource-based theories to the context of franchisee failure offers theoretical insights that are fruitful in other contexts. Finally, this research addresses an intensely practical question; can entrepreneurship be taught? Our results show that training can reduce the probability of failure. This result supports the notion that increasing business skills generally may reduce failure among other classes of aspiring entrepreneurs. Both practitioners and professors should be heartened by this result.

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