

FRANCHISOR-FRANCHISEE RELATIONSHIP
AND FRANCHISEE COMPETENCIES AS THE
PREDICTORS OF FRANCHISEES' BUSINESS
PERFORMANCE IN MALAYSIA RETAIL
SECTORS

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UNIVERSITI SAINS MALAYSIA
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**GRADUATE SCHOOL OF BUSINESS (GSB)
UNIVERSITI SAINS MALAYSIA**

DECLARATION

I hereby declare that the project is based on my original work except for quotations and citations which have been duly acknowledged. I also declare that it has not been previously or concurrently submitted for any other degree at USM or any other institutions.

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CHEE HUI CHONG

**Research report in partial fulfillment of the requirements for degree of
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ABSTRAK

Industri francais dilihat semakin penting di Malaysia dan ia menyumbang sebanyak sepuluh bilion jualan tahunan runcit di Malaysia(Ismail, 2004). Amalan biasa kontrak francais akan mengikat bersama pemberi francais dan pemegang francais untuk sekurang-kurangnya 5 hingga 10 tahun. Sepanjang tempoh kontrak, pemberi francais dan pemegang francais perlu bekerjasama untuk mengembangkan dan memajukan sistem francais. Prestasi sistem francais bukan sekadar bergantung kepada keupayaan individu, pemberi francais dan pemegang francais, tetapi juga hubungan kerja antara mereka. Kajian ini bertujuan menyelidik faktor-faktor yang mempengaruhi prestasi perniagaan sistem francais dari perspektif pemegang francais. Tumpuan khusus akan diberikan kepada kesan persepsi pemegang francais tentang kualiti hubungan francais dan kecekapan pemegang francais pada prestasi perniagaan pemegang francais. Kajian ini juga meramalkan bahawa perniagaan francais akan dipengaruhi oleh situasi dinamik alam perniagaan.

Seratus tiga puluh tiga soal selidik yang berguna telah diterima melalui pos daripada pemegang francais dalam sektor runcit di Malaysia. Kajian ini mendapati bahawa persepsi pemegang francais tentang kualiti hubungan francais mempunyai hubungan yang kukuh dengan ketara dengan prestasi perniagaan francais. Hubungan tersebut tidak dipengaruhi oleh mana-mana situasi dinamik alam sekitar. Prestasi perniagaan pemegang francais juga dipengaruhi secara ketara oleh kecekapan pemegang francais.

Kecekapan mengurus dan memimpin, konseptual, pembelajaran dan etika didapati mempunyai hubungan yang ketara dengan prestasi perniagaan pemegang francais. Berdasarkan hasil kajian ini, pemberi francais boleh meningkatkan prestasi perniagaan francais dengan meningkatkan hubungan pemberi francais dengan pemegang francais; menyediakan latihan berkaitan dan sesuai dengan keupayaan pembelajaran pemegang francais; dan melibatkan pemegang francais dalam aktiviti-aktiviti tanggungjawab sosial

korporat. Kajian ini adalah terhadap kepada sektor runcit francais di Malaysia. Penyelidikan masa akan datang boleh mengembangkan rangka kerja untuk memeriksa industri perkhidmatan francais atau meliputi faktor-faktor tambahan yang menjejaskan prestasi pemegang francais.

ABSTRACT

The franchising industry has increased in importance and accounted for more than 10 billion annual sales in Malaysia (Ismail, 2004). The normal practice of franchising contract would bind the franchisor and franchisee together for at least 5 to 10 years. During the binding term, franchisor and franchisee have to work together to grow the franchise system. The performance of the franchise system not only depends on the individual capabilities of franchisor and franchisee, but also the working relationships between franchisor and franchisee. This study aims at delving into the factors that influence the business performance of the franchise system from the franchisee's perspective. Specifically, this study focuses on the effects of franchisee perceived relationship quality and franchisees' competencies on franchisees' business performance. In this study, it is also conjectured that franchisee businesses, would be affected by the dynamic business environment.

One hundred and thirty-three usable questionnaires were received from mail survey of franchisees in retail sectors in Malaysia. The findings revealed that franchisee perceived relationship quality has strong significant relationship with franchisees' business performance; however, the relationship is not affected by any environmental dynamism. Franchisees' business performance is also found to be significantly affected by the franchisees' competencies. Organizing and leading, conceptual, learning and ethical competencies are significantly related to the franchisees' business performance.

In a practical sense, franchisor can improve the franchisees' business performance by enhancing the franchisor-franchisee relationships; providing relevant training that suits the learning ability of franchisees; and engaging franchisees in corporate social responsibility activities. This study is limited to Malaysia retail franchising sector. Future research can expand the framework to examine the services franchising industry or to include additional factors that affect franchisees' performance.

Keywords: Franchising, Franchisor-franchisee Relationship, Relationship Quality, Franchisee Competencies, Retail Sector.

CHAPTER 1

1.0 INTRODUCTION

1.1 Background of the Study

Franchising is a business form consisting of a franchisor with a market-tested products or services, entering into a long term contractual relationship with franchisees. Franchisees will operate under the franchisor's trade name to produce, or to market goods or services according to a format specified by the franchisor (Curran & Stanworth, 1983, p. 11).

Franchising has been extensively researched for more than 40 years. It started in the United States and spread to other parts of the world (Alon & McKee, 1999; Alon, Ni & Wang, 2011). Franchising in the United States has been growing rapidly. International Franchise Association (cited in Combs, Michael & Castrogiovanni, 2004) stated that in the United States franchising represents over 40% of retail sales. The PriceWaterHouseCoopers (2009) Franchise Report stated that franchise chains account for more than 5% of the United States private-sector output and more than 8% of the United States employment in 2008. The numbers of jobs created by franchising are more than the numbers of jobs created from durable goods manufacturers (PriceWaterHouseCoopers, 2009). In the 2011 Franchise Business Outlook Report (PriceWaterHouseCoopers, 2011), the franchise business is estimated to add 42,000 jobs in 2010 and would grow at a 2.5% rate in 2011.

Evidently, franchise is an important organizational format that could contribute to the nation's economy. Miller and Gossman (1990), cited in (Spinelli & Birley, 1996), described franchising as an organizational form structured by a long-term contract whereby the owner, producer, or distributor of a service or trademarked product (Andrea, 1999) grants the non-exclusive rights to a distributor for the local distribution of the product or service "franchisee". In return, the franchisee pays an up-front fee and ongoing royalties, and agrees

to conform to quality standards (Justis & Judd, 1986). The franchise business concept started in 1900s in the United States (Alon & McKee, 1999; Alon, Ni, & Wang, 2011) and spread rapidly throughout the world.

In Malaysia, the size of franchise industry has already surpassed RM 10.7 billion revenue in 2003 (Ismail, 2004) with a total of 3,781 franchise outlets in Malaysia, contributing to 80,000 jobs to the country. Franchising consistently achieves revenue more than RM 10 billion for the past few years. In 2009, franchising contributed 6% of retail sales in Malaysia (Damodaran, 2009).

In the speech of the then Minister of Defence, Dato' Seri Mohd Najib bin Tun Haji Abdul Razak during the official launching of Franchise International Malaysia 2005, franchising was mentioned and recognized as one of the fastest growing sectors in Malaysia. "... franchising is one of the fastest growing sectors in Malaysia." (Tun Hj Abdul Razak, 2005, para. 5) The franchise business rose rapidly since year 2000 because of Malaysia's strong economic climate and also because of the Malaysian government has adopted pro-franchise policy and welcomed franchisors from within and outside the country to invest in Malaysia (Tun Hj Abdul Razak, 2005).

A survey done by the Malaysia Franchise Association (MFA) recorded growth of 815% within 10 years, in franchise outlets from 413 in 1993 to 3,781 in 2003 (The Star, 2003). The growth of franchising in Malaysia is because of four main factors: consumer Acceptance (Faiz, 2006); advantages to Franchisor (Faiz, 2006); advantages to Franchisee (Faiz, 2006); and 100% backing by the Malaysian government (Hamid, 2007).

Table 1.1***Number of Registered and Active Franchising in Malaysia in 2010***

Sectors	Registered Franchising	Active Franchising	Percentage (Active Franchising)
Retail and Stores			
Food retail	143	110	
Convenient store and supermarkets	13	9	
Apparels and fashion stores	68	59	
Book store	6	4	
Jewelry store	5	5	
Time and watch store	2	2	
Souvenir store	6	6	
Furniture store	3	3	
Electrical and computer store	6	6	
Spectacle store	10	8	
Other stores (carpet, cloth, lamp, hardware, car accessories, electrical etc.)	7	6	
Sub total	269	218	61.6%
Business Services			
Children and preschool	54	39	
Business Service and maintenance	48	39	
Healthcare/Beauty	46	30	
IT & Telecommunication	18	9	
Others (farm, catering, water park, trading etc.)	31	19	
Sub total	197	136	38.9%
Total	466	354	100

Source: PNS website. www.pns.com.my

In Malaysia, franchising is a growing importance to the economy especially in the retail sectors. As shown in Table 1.1, the retail and store sectors which include food and beverages stores; apparels and fashion stores; convenient stores and supermarket; and other specialized stores consist of 61.6% of all franchise systems in Malaysia. 38.9% of Malaysian franchising is involved in business services such as preschool child care, information technology services, healthcare and beauty treatment services, as well as farming, Water Park, trading and catering. The popularity of these types of franchise systems is because of the significant increase of shopping malls in Malaysia. The retail franchise is a type of business

format franchising. Franchisor would need to transfer the whole know how of the business to franchisee, this includes food outlets, apparels, and retailing and supermarket. Services franchise such as maintenance, preschool, Information Technology (IT) and healthcare do not fall in the scope of this study. The three main reasons this study chooses to only study retail franchise in Malaysia are 1) There are brand names in the retail businesses; 2) The retail industry is the fastest growing industry for franchising; and 3) Retail franchisors have achieved significant success in this area of franchising (Harif, Hoe, Hussin, Isa, Othman & Din, 2011).

Table 1.2

Number of Franchise Registration and Growth Rate in Malaysia from 2000 to 2010

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Register	115	27	34	25	21	22	27	44	51	30	77
Growth %	-	-77	26	-26	-16	5	23	63	16	-41	157

Source: PNS Website. www.pns.com.my

Franchise registration in Malaysia is shown in Table 1.2. In year 2000, when Malaysia had just started to implement the Franchise Act 1998, where all previous franchise operations in Malaysia had to be registered with the Malaysian government, the total number was 115. The lowest number of registration for franchising was 21 in 2004 when Malaysia was facing slow economic growth. Similarly in 2009, there was a dip in the number of registration of franchising. In year 2009, the Franchise Industry was hit by the world economic recession (Hamid, 2009). Starting from 2005 to 2008 and 2010, as shown in Table 1.2, new franchising in Malaysia grew by 5%, 23%, 63%, 16% and 157% respectively. Strong growth rates indicate that the franchising is increasingly acceptable as a viable business venture in Malaysia.

Franchise is primarily linked to the development of the small and medium enterprises (SME) where SME is considered the main economic driver for a country. A few countries have adopted franchising as a means to promote entrepreneurship and SME in the country namely, the United States (Alon & McKee, 1999), Malaysia (Hamid, Mohd, Selamat, & Mastor, 2003; Ibrahim, 2000), Singapore (Foo, Peng, Lee, & Tang-Ng, 1998), Indonesia (Ibrahim, 2000), Brazil (Alvaro & Fabio, 1999), Austria (Glatz & Chan, 1999), European Community (Chan & Justis, 1992), Ukraine (Peretiatko, et al., 2009), Spain (Chan & Justis, 1993), and Russia (Alon & Banai, 2000; Anttonen, Tuunanen, & Alon, 2005).

The franchisees' entrepreneurship success would help the franchise system to grow by expanding their own businesses. Notably, the success or performance of entrepreneurship is associated with specific knowledge and skills that are equipped by individuals to perform a job role successfully which result in venture birth, survival and growth (Ahmad, 2007; Ahmad, Ramayah, Wilson, & Kummerow, 2010; Bird, 1995; Man, Lau, & Chan, 2002). Specific skills and knowledge which contribute to the success of a venture is identified as entrepreneurial competencies (Mitchelmore & Rowley, 2010). Entrepreneurial competencies are found in a number of studies contributed significantly towards the venture performance for small and medium enterprises in Hong Kong (Man & Lau, 2000), Malaysia (Ahmad, Ramayah, et al., 2010), Australia (Ahmad, 2007), China (Man, Lau, & Chan, 2008), and the United States (Chandler & Hanks, 1994).

In the context of franchising, franchisee is considered as an independent, small business operator whose entrepreneurial decision-making is independent; however the extent of the independence will vary according to the constraints imposed by each franchise agreement (Withane, 1991). In the competitive environment, franchisees have consistently involved in entrepreneurial activities such as product development, market research, and risk taking as shown in various recent studies (Baucus, Baucus, & Human, 1996; Christensen,

Parsons, & Fairbourne, 2009; Combs, Michael, & Castrogiovanni, 2004; Michael & Combs, 2008; Shane & Hoy, 1996; Torikka & Tuunanen, 2009; Tuunanen, 2007). Phan, Butler and Lee (1996, p380) strongly argued and explained that “Franchisees are in fact potentially entrepreneurial because franchisor’s ability to impose a strategic direction on any franchisee is limited, ...” based on the argument that franchisors have incomplete information, unable to anticipate value beyond the contract and do not have the flexibility to alter the strategic orientation of the contractual relationship with franchisees (Phan, Butler, & Lee, 1996).

Franchisor sets performance and management standards as well as manages the brand image of the franchise network. Franchisees manage the local environment and daily operations to gain profits from the activities to meet the contractual requirements of franchisor (Combs, Ketchen, & Hoover, 2004). In this respect, the profitability of franchisor comes from the effectiveness and performance of franchisees in distributing products and services to customers. The franchisee entrepreneurial performance is important because the success of franchising will depend on the business performance of the franchisee (Harmon & Griffiths, 2008).

Gauzente (2003) stated that the performance and satisfaction of franchisee are considered the central of the franchise network’s long-term survival. Therefore, the effectiveness of franchisee in managing the franchise business will contribute to the profitability of the franchisor (Gauzente, 2003).

In this regards, franchisee performance is important to understand the survival of franchise network. There are only a few limited streams of research on franchisee performance (Fenwick & Strombom, 1998; Hing, 1995; Withane, 1991). Morrison (1997) revealed that franchisee performance is affected by the satisfaction and personality of franchisee. It is found that higher franchisee satisfaction would lead to better performance from franchisee (Morrison, 1997). Morrison (1997) also suggested that franchisors with

management system that cultivates work-related attitudes and a stronger attachment to the network would promote high franchisee performance. When franchisees are satisfied with franchisor, franchisees are more cooperative and will contribute more towards the success of the overall franchise system (Roh & Yoon, 2009).

The nature of interdependence of franchisor and franchisee has made the relationship of franchisor-franchisee a key to franchise performance (Brown & Dev, 1997). In order to obtain better performance, managing relationship and providing constant support to franchisee is one of the most important functions for franchisor (Doherty, 2007; Foo, et al., 1998). The constant support from franchisor would help develop skills and competencies for franchisees. A higher level of competencies would contribute towards the performance of the firm for franchisee, as franchisee is considered as small and medium enterprises (Ahmad, 2007; Man, et al., 2002; Rahatullah & Raeside, 2008).

The franchisor supports, job satisfaction of franchisees, trust and commitment of franchisees will create a value beneficial to the franchise system. This intrinsic beneficial value, conceptualized by Harmon and Griffiths (2008) as Franchisee Perceived Relationship Value, would contribute towards the performance of the franchise system (Harmon & Griffiths, 2008). Harmon and Griffiths (2008) also stressed on the importance of franchisor-franchisee relationship towards the performance of both franchisee and franchisor.

Franchisees' business performance is affected by franchisees' competencies and the franchisor-franchisee relationships. Improving the franchisees' competencies and relationships would improve franchisees' performance and eventually would also improve franchisor's profitability. Franchisees' competencies and franchisor-franchisee relationships can be built through utilizing internal and relational resources obtained by franchisees. Internal resources as stated in the resource-based view refer to all assets, capabilities, organizational processes etc. which are controlled by SMEs that enable the firm to build

competitive advantages (Barney, 1991). The relational resources are the resources franchisees obtained from external parties, who are referred as franchisor, by paying franchising fees, licensing fees, royalties etc. A combination of two theories will be used in this study to explain the internal and relational factors that contribute to the business success of franchisee. Combined theories in franchise research is gaining popularity (Lafontaine & Kaufmann, 1994). Lafontaine and Kaufmann (1994) had encouraged the study of franchise phenomenon by using combination of various theories. It has been a fact that a single theory is not able to explain the franchise industry. This study will investigate the two main factors that influence the franchisees' performance based on two underlying theories namely 1) Resource-based view; and 2) Relational-based view. A model of franchisees' entrepreneurial competencies and performance will be introduced and competencies that are required by franchisees will be identified.

Similar to all businesses, franchising is also subjected to the influence of environmental factors. There are a lot of environmental factors being studied by the academic. In the context of entrepreneurship literature, two of the environmental dimensions, Benign versus Hostile and Stable versus Dynamic, were used to describe business environment (Ahmad, 2007; Zahra, 1993). As this study postulates that franchising is a form of entrepreneurship, the environmental dimensions of Stable/Dynamic were adopted.

As seen in the Table 1.2 the number of franchising registration in Malaysia was affected by the business cycle in Malaysia. In year 2009, during the recession and slow growth of the economy, the number of registration reduced significantly to 30 from 51 in 2008. In 2009, according to the Central Bank of Malaysia (*Bank Negara Malaysia*) GDP growth rate for Malaysia was -1.7, reduced significantly from 4.7 in 2008, which indicated that Malaysia was in recession.

Table 1.3***Malaysia Gross Domestic Product (GDP) from Year 2004 – 2010***

Year	2004	2005	2006	2007	2008	2009	2010
Gross Domestic Product (GDP)	6.8	5.3	5.8	6.5	4.7	-1.7	7.2

Source: *Bank Negara Malaysia*

The above phenomenon observed in the franchising industry is clearly explained by Oxenfeldt and Kelly (1968). During recession, demand will reduce and franchisors will face increasing competition that puts pressure on profits. Franchisors will tend to alleviate pressure by buying back franchises and managing them as outlets of “wholly-owned chains” (Oxenfeldt & Kelly, 1968). Increased competition will also reduce the willingness of entrepreneurs to franchise their business. This explains the effects and importance of environmental uncertainty or dynamism towards franchising industry. This is also consistent with Boyle’s (1999) investigation of the effects of environmental uncertainty or dynamism on franchise system by examining the oil companies’ petrol retailing franchise over the past 20 years. Increasing environmental uncertainty or dynamism encourages franchisors to adopt business format franchise characteristics in order to tighten franchisee control (Boyle, 1999). Therefore the environmental dynamism would affect indirectly the franchisee performance.

1.2 Problem Statements

The Malaysian government has identified franchising as one of the key measures to encourage entrepreneurship in the country. In the Eighth Malaysia Plan (*Rancangan Malaysia Ke-8*), from 1995 to 2000, the government had allocated a big budget amounting to RM 100 million via the franchise development programme to develop 60 new franchisors (Mohd & Mahad, 2005). Subsequently, the budget for franchise development in the Ninth

and Tenth Malaysia Plans were amounting to RM 20million and RM 50 million respectively (Yaakob, 2010).

Although tremendous effort has been put in by the Malaysian government to encourage franchising, the results were not obvious. The size of the franchise market in Malaysia has grown from USD 154 million in 1986 to a significant value of USD 214 million (RM 532.86 million) in 1990 and subsequently to RM 10.7 billion in 2009. According to the Malaysia Franchise Association, in November 2008, there are 360 franchise systems registered in Malaysia where 235 are home-grown franchise brands and 125 are foreign franchises. Out of the 235 home-grown franchises, 15% or 35 franchisors have expanded into international markets and penetrated into more than 20 countries (Malaysia Franchise Association, 2009). The Malaysian franchise industry has an average growth rate of 9 per cent per annum (Ibrahim, 2000). However, in numbers of franchise establishments, Malaysia is still in an infancy stage for franchising as compared to Singapore or Australia. As in 2008, Malaysia has about 360 franchisors and 8300 franchisees (Malaysia Franchise Association, 2009). Comparing to Australia, a country where the population is similar with Malaysia, there is 747 franchise systems in Australia which is double the franchise systems in Malaysia. As we compare to Singapore, the number of franchise system stands at 354 which is similar to Malaysia but with a quarter of Malaysian population (Malaysia Franchise Association, 2009). The above statistics shows a significant variation in the participation in franchising industry among Malaysians as compared to the neighbouring and other countries.

Mohd and Mahad (2005) also stated that the contribution from franchising in Malaysia is still unsatisfactory. It only covers around 5% of the total domestic retail sales (Mohd & Mahad, 2005). This shows that despite the enormous effort to develop franchising industry, the Malaysian franchise is still lagging behind and there are plenty of rooms for growth.

The growth of franchisors will depend on the growth of franchisees. Franchisees' failure is considered as sub-optimal performance of the franchise system where franchise contract is terminated before it expires (Holmberg & Morgan, 2007; Stanworth & Curran, 1999). The lack of performance either in the part of franchisor or franchisee will lead to franchisee failure. Sub-optimal performance can be directly related to failure because it is antecedents of franchisee failure. Success or failure dimensions are the end results of business venture which the business performance will be the measurement (Murphy, Trailer, & Hill, 1996).

A study conducted by Mohd and Mahad (2005) identified the cause of franchisee failure in Malaysia. Mohd et al (2005) stated that 8 major factors caused franchisee business failure, namely; 1) greed of franchisee, 2) franchisee attitude, 3) poor service of franchisee, 4) conflict with franchisor, 5) bad location selected by franchisee, 6) weak financial standing of franchisee, 7) cash flow mismanagement by franchisee, and 8) bad payer franchisee. It was found that franchisees failed due to mismanagement and lack of entrepreneurial skills. This statement triggers the debate whether franchising failure is mainly caused by the lack of entrepreneurial competencies among franchisees in Malaysia. Against this backdrop, the present study seeks to investigate the effect of franchisee competencies on franchisee business performance.

Franchisor and franchisee are business partners who are mutually dependent on each other's objectives and performance to achieve their goals and interest. This is because both parties are bind together by a long term legal contract. The co-dependency nature of the franchisor – franchisee relationships entails a sharing of benefits and burdens (Grunhagen & Dorsch, 2003). The quality of benefits and burdens shared between franchisor and franchisee would lead to conflict or cooperation and further determined the perceived value or quality of the relationship. The differences in perceived quality and value of the relationship would

affect the efficiency of the system performance (Maritz & Nieman, 2008). Empirical research has indicated that the perception of franchisee would affect the franchise performance (Falbe & Welsh, 1998; Kaufmann & Stanworth, 1995; Morrison, 1997; Spinelli & Birley, 1998). Another study that investigated the franchisee failure rate in the United States and Europe found that the reasons for franchisee failure were mismatch of expectations during early stage of relationship or before signing franchise contract and shift of franchisee perceived value of the relationship (Holmberg & Morgan, 2007; Holmberg & Morgan, 2003). Having noted that, most of the franchising studies are done in a Western cultural context (Huang & Phau, 2009) whereas there are not much studies considering Asian context (Chiou, Hsieh, & Yang, 2004). It is more compelling for studies related to alliance relationships such as franchisor – franchisee relationship, and performance because it is found that cultural differences have significant impact on the alliance relationship performance (David & Peter, 2004; Dong & Glaister, 2009; Suku & Emilija, 2009). This study attempted to contribute to the gap of literature to investigate franchise relationship in the Malaysian context.

In the franchising literature, there is an emerging interest and debate whether the franchisee should be regarded as an entrepreneur (Fenwick & Strombom, 1998). As summarized by Fenwick and Strombom (1998), there are three views in the literature namely 1) franchisee as an employee because of the constraints imposed by the franchise contract (Anderson, Condon, & Dunkelberg, 1992; Baucus, et al., 1996); 2) franchisee as an independent entrepreneur whose decision making can influence the performance of the outlet (Hoy & Shane, 1998; Kaufmann & Dant, 1999; Merrilees & Frazer, 2006; Williams, 1999); and 3) franchisee as intermediate between employee and independent entrepreneur, and the independence will vary between franchise system according to the constraints imposed by the franchise agreement (Grunhagen & Mittelstaedt, 2005; Knight, 1984; Withane, 1991). There are times when franchisee entrepreneurship and creativity has helped to develop the

competitive advantage of the franchise system (Combs, Ketchen, Shook, & Short, 2011).

Quote from Ray Kroc,

“The success of additions such as the Filet-o-Fish, the Big Mac, Hot Apple Pie and Egg McMuffin ... each evolved from an idea of one of our operators. So the company has benefited from the ingenuity of its small businessmen.”

More often franchisors will also have to face with franchisee who acts in a more entrepreneurial manner. Franchisee often breaks the rules set by franchisor, in believing that they have found a better way to enhance their individual performance. These actions will frequently challenge the integrity of the franchise system and threaten the franchisor's earnings (Fenwick & Strombom, 1998). This triggers a fundamental question whether franchisees' entrepreneurial characteristics and competencies would affect the performance of the outlet. This study would attempt to clarify the relation between franchisees' entrepreneurship and the franchisees' venture performance.

Despite the importance of franchisee and worldwide growth in franchising (Stanworth & Dandridge, 1994), franchising and specifically franchisees' performance are still regarded as the most understudied area of entrepreneurship (Bates, 1995; Fenwick & Strombom, 1998; Withane, 1991). There are very limited streams of franchising research on franchisee, and most of the study focuses only on the role of the franchisee within the franchising network (Anderson, et al., 1992; Hing, 1995; Knight, 1984; Stanworth & Dandridge, 1994; Withane, 1991).

Franchising in today's economy is very important but the scholar has almost no effort to understand what factors contribute to the franchisees' performance (Michael & Combs, 2008). Knowledge on the factors affecting franchisees' performance could help franchisors to adopt better relationship improvement strategies in managing franchisees. In a more recent

review of franchising literature, it was observed that most of the literature in franchisee consequences is lacking in theoretical explanation of relationships and in the guide of selection of variables (Combs, et al., 2011). Combs et al. (2011) commented that most studies are based on three areas namely 1) by “common wisdom” (Grunhagen, DiPietro, Stassen, & Frazer, 2008); 2) by prior findings in other contexts (Chiou, et al., 2004); or 3) by interviews (Frazer & Winzar, 2005).

As stated by Combs, Ketchen, Shook and Short (2011, pp 112):

“A next logical step is for researchers to build a theoretical foundation of explaining franchisee consequences... theories such as resource dependence (Pfeffer & Salancik, 1978) and the relational view (Dyer & Singh, 1998) ... would be good candidates to provide such a foundation”.

According to the review done by Combs et. al. (2011), there is no research done using resource dependence and relational view to explain the franchisee consequences such as franchisee performance. Combs et. al. (2011) has clearly identified the research gap for this study theoretically.

Answering the call from Combs et. al. (2011), this study utilizes the relational-based view and resource-based view theories in explaining the framework. The relational-based view involves mutual relationship between franchisee and franchisor; whereas the resource-based view explains the franchisee’s entrepreneurial competencies and skills in enhancing franchisee business performance.

Following the preceding discussion, there are four main research gaps in the franchise industry and specifically in the Malaysian context. The first research gap is to provide an argument whether franchisee is fully responsible for the franchise failure in Malaysia. By investigating the relationship between franchisee competencies and performance would help

to determine the effect of franchisees and their capabilities on the franchise failure in Malaysia. Second is to fill the literature gap of franchise relationship and performance in Malaysia, which is an Asian country. Third is to clarify the relationship between franchisee competencies and venture performance, and last is to fill the research gap using resource and relational view to explain the franchisee performance.

1.3 Purpose of the Study

The purpose of this study is to investigate the significance of the relationship of franchisee competencies and franchisee perceived relationship qualities on franchisee business performance. This would enable franchisors to better manage franchise relationship and eventually enhance the performance of the franchise industry.

1.4 Research Objectives

Based on the preceding discussion, the main objective of this study is primarily to understand factors leading to franchisee business performance. Specifically, this study intends to:

- (1) Investigate the relationships between franchisee perceived relationship qualities (i.e., in terms of trust, commitment, and satisfaction) and business performance.
- (2) Investigate the effects of franchisee competencies (i.e., Relationship, Commitment, Conceptual, Organising and Leading, Learning, Personal, and Social Responsibility and Ethics) and franchisee business performance.
- (3) Investigate the moderating effect of business environment on the relationship between franchisee perceived relationship qualities and franchisee business performance.

- (4) Investigate the moderating effect of business environment on the relationship between franchisee competencies and franchisee business performance.

1.5 Research Questions

Based on the above-mentioned, the present study seeks to find answers to the following questions:

- (1) To what extent does franchisee perceived relationship quality affect franchisee business performance?
- (2) To what extent do franchisee competencies affect franchisee business performance?
- (3) To what extent does business environment moderate the relationship between franchisee perceived relationship qualities and franchisee business performance?
- (4) To what extent does business environment moderate the relationship between franchisee competencies and franchisee business performance?

1.6 Significance of the Study

This study hopes to make six contributions to the development of franchise industry in Malaysia.

First, from the theoretical perspective, this study would contribute towards using relational-based view and resource-based view to develop the proposed framework of this study. This study will provide answers to the current call for such research to be done by Combs et. al. (2011). Although multiple theories are used in franchising research, the combination of resource-based view and relational-based view is pioneered by this study.

Therefore, building from these theories, the franchisee performance construction and the consequences of franchising can be developed further.

Second, there are many franchising research done in the world but they mainly focus on the western culture. According to Chiou et. al. (2008) there is limited literature on Asian context. This study would provide insights into the franchising industry in an Asian culture. Franchising in Asia currently has been growing very fast. It is very crucial to have more studies using Asia as the main focus because this would provide guidance to the franchise industry in Asian countries. As the franchise industry in Asian countries blossom, this study is timely to investigate the perspective of Asian franchisees towards relationship and performance.

Third, practically, this study would provide a framework for franchisor to better manage the franchise relationships. The perspective of franchisee regarding the value of the franchise relationship is very important because this will determine whether the franchisee would remain or leave. The turnover of franchisee would affect the performance of the franchise system. Therefore, it is very important for franchisor to understand what would encourage franchisee to stay with the franchise system. This study would provide a guide to franchisor in franchisee relationship management and further assist the franchise industry to grow in Malaysia.

Fourth, the debate whether franchisee is an entrepreneur has been on-going and the dominant view has not emerged. This study would contribute and add into the pool of literature debating the statement. However, the significance of this study is that it is the first in Malaysia to shift the debate from a western country to an Asian country. The findings on how entrepreneurial franchisees are in Malaysia would assist franchisor to strategize and match such entrepreneurship towards the performance and success of the franchise system.

Fifth, the customer perceived relationship quality is fully explored by the relationship marketing scholar. However, there is still under-study for the perceived relationship quality in the context of strategic alliance generally and franchising specifically. Franchising is a unique case of strategic alliance where a long-term agreement governs the relationship between franchisor and franchisee. Franchisee perceived relationship quality is important. It would affect the performance of the franchise system and would threaten the integrity of the franchise network. This study emphasizes on the importance of the franchisee perceived relationship quality and, urges and persuades franchisor to put more focus in managing the perception of franchisee to strengthen and to grow the franchise industry in Malaysia.

Last, the Malaysian government has been putting a lot of effort to develop entrepreneurship through franchising especially in the survival of franchisees. Plenty of soft loans and grants are given to franchisee to enhance their survival in a competitive environment in Malaysia. This study attempts to find out from the franchisees' perspective, the factors contributing to the franchisees' business performance. Mainly, the study would provide an overview on the competencies of franchisee that would significantly increase the performance and survival of franchisee. At the same time this study would be a guide for self-improvements for franchisee.

Similar study was done by Ahmad (2007) who applied entrepreneurial competencies framework to study Malaysian SMEs but excluding the franchise industry. With the focus only on franchise industry, this study would complement towards the entrepreneurial competencies study on Malaysian SMEs.

1.7 Scope of the Study

This study is done in Malaysia which is an Asian country. The respondents are from Malaysian franchise industry. This is a country wide research to better understand the franchisee perspective in Malaysia. Franchising in different countries has different franchise act governing the franchise relationships. Conducting survey in only one country could help to control the differences caused by the franchise act.

1.8 Definitions of Key Terms

Franchise is a business form consisting of franchisor, with a business package of products or services, entering into a continuing contractual relationship with franchisees, who are self-financed and independently owner-managed small firms, operating under the franchisor's trade name to produce and/or market goods or services according to a format specified by the franchisor (Curran & Stanworth, 1983).

Franchisor is a company who owns the rights to sells products and services and the rights to grants a franchise to a franchisee.

Franchisee is a person to whom a franchise is granted by franchisor.

Entrepreneurial Competencies is the underlying characteristics such as generic and specific knowledge, motives, traits, self-images, social roles, and skills which result in venture birth, survival, and growth.

Perceived Relationship Quality is the overall assessment of the strength of the relationship. Prior models of relationship quality have identified three dimensions namely, satisfaction with exchange partners, trust with exchange partners, and commitment to an ongoing relationship.

Environmental Dynamism is characterized by unpredictable and rapid change, which increases uncertainty for individuals and firms operating within them.

1.9 Organization of the Dissertation

This chapter has outlined the practical problems faced by the franchising industry in Malaysia as well as some shortcomings in the franchising literature specifically in the Malaysian context. This chapter also introduces some possible contributions to the franchising literature as well as the practical solution for the franchising industry in Malaysia. Hopefully a combination of the resource-based view and the relational-based view model, which is used in this study, could help to explain the franchisee performance in Malaysia. The remainder of the chapters will outline how these contributions are achieved.

Chapter 2 will address the literature review which forms the proposed model for this study. Two theories, resource and relational, that form the framework of this study will be reviewed along with the elements of entrepreneurships, entrepreneurial competencies, franchisee performance, gaps and contradictions that form the model of this study. The development of the model and hypothesis will be addressed in Chapter 3. The model will relates the franchisee – franchisor relationship variables and the franchisee entrepreneurial competencies with the franchisee firm performance. Sample and sampling techniques, data sources, statistical analysis and data presentation will be covered in Chapter 4. The results will be discussed in Chapter 5. The discussion, major findings, conclusion and future research suggestion will be stated in the final chapter.

Chapter 2

2.0 LITERATURE REVIEW

2.1 Introduction

As stated at the outset, the primary aim of this study is to identify the covariates that could explain franchisee performance in the context of retail sector in Malaysia. In today's competitive commercial landscape where businesses are seen struggling to remain afloat and surviving in the industry, business practitioners have no choice but to source for ways that could keep their business going. Similar to other form of businesses, franchising is also subjected to the influence of various factors that could increase or decrease the likelihood of success. As stated earlier, the central thesis of this study is that franchisor-franchisee relationship and franchisee entrepreneurial competencies are both important covariates that could affect the franchisee performance. Also, with the realization that businesses do not operate in vacuum and that external forces would affect the way business operates, business environment as proxies by environmental "dynamism" is conjectured as a moderating variable.

This chapter provides a summary of the literature review that is relevant to the current study of franchisee performance, competencies and franchise relationship quality dimensions. Each of the key dimensions is discussed in detail, relating to their previous studies, definitions, theoretical construct, and the relationship between the dimensions of interest.

2.2 Franchise Definition

The definition of franchising has evolved throughout the years as the business environment changes (Stanworth & Curran, 1999). The term “franchising” has been used to describe many different forms of business relationships, including licensing, distributor and agency arrangements. Franchising can be classified into three main development phases (Hoffman & Preble, 1993). The first phase of franchise known as tied-house systems where majority were consist of German brewers, who contracted with taverns exclusively, to sell their brand of beer. The second phase of franchise known as product-trade name franchising appeared in the nineteenth century, pioneered by Singer Sewing Machine Company to sell its products to its sales force, which in turn had to find markets for Singer. Currently franchising is at its third phase of development known as the business format franchising. It was developed by A&W Restaurants in the twentieth century (Boyle, 2002; Hoffman & Preble, 1993, 2003, 2004; Preble & Hoffman, 1994).

In the early literature, franchising was commonly defined as a distribution channel (Hunt, 1972; Stanworth & Curran, 1999). During 1960s, Hunt (1972) who studied the consequences of the franchise system of distribution had adopted definition of Ozanne and Hunt (1971) which defined franchising as:

- 1) A contract exists which delineates the responsibilities and obligations of both parties.
- 2) A strong continuing cooperative relationship exists between them.
- 3) The franchisee operates the business substantially under the trade name and marketing plan of the franchisor.

The first two characteristics defined the collaboration between two firms. Only the third characteristic stated by Ozanne and Hunt (1971) classified the relationships as franchise

relationships. Stanworth and Curren (1999) were of the opinion that the definition by Ozanne and Hunt (1971) was incomplete and understated the fact that franchisee is a legally separated business with its own capital base, employees, organizational structure, and specific customer relations which are independent of the franchisor.

In 1978, Rubin defined franchising from the legal point of view which was widely accepted by the researchers. Robin (1978) defined franchising as follows:

“A franchise agreement is a contract between two (legal) firms, the franchisor and the franchisee. The franchisor is a parent company that has developed some product or service for sale; the franchisee is a firm that is set up to market this product or service in a particular location. The franchisee pays a certain sum of money for the right to market this product.”

Robin (1978) further defined franchisee as “franchisee is a separate firm, rather than as part of the franchisor, is a legal and not an economic distinction.” According to Robin, a franchise organization is the network composed of a franchisor (the parent company, including company-owned units) and its franchisees. Franchising is the contractual process used to develop and maintain such a network (Castrogiovanni & Justis, 1998). From the contractual perspective, Klein (1995) also defined franchising as a form of transaction where the choice of contract terms would clearly differentiate the franchising from other forms of product distributions. Franchising would permit the transactors to achieve the benefits of large scale which is available in brand name development and organizational design (Klein, 1995).

In a more competitive environment as compared to the eighteenth and nineteenth century, licence owner would choose to tighten the control over their distribution agents (Boyle, 1999). Petrol retailing and other similar product-trade name franchising have

evolved their business model and ventured into business format franchising, diversifying into petrol cum convenient store retailing.

In 1983, Curran and Stanworth (1983) had proposed a new definition which covers the most modern varieties of franchising such as quasi-forms, multi-unit and master form of franchising which focus on product franchises such as automobile and petroleum distribution franchises. The definition is as follows:

“A business form essentially consisting of an organization (the franchisor) with a market-tested business package centred on a product or service, entering into a continuing contractual relationship with franchisees, typically self-financed and independently owner-managed small firms, operating under the franchisor’s trade name to produce and/or market goods or services according to a format specified by the franchisor” (Curran & Stanworth, 1983, p. 11).

The main difference between product-trade name franchising and business format franchising is the level of control by the franchisor. Franchisor offers a business package to franchisee which covers from site selection to point-of-sales of franchisee. The definition proposed by Curran and Stanworth (1983) was more complete than the previous definitions which only focus on product-trade name franchising.

The official definition of franchising adopted by the U.S. Department of Commerce stated franchising as “a method of doing business by which a franchisee is granted the right to engage in offering, selling, or distributing goods or services under a marketing format which is designed by the franchiser”. According to the U.S Department of Commerce, franchising can be categorized into two types namely product distribution and business format franchising. Product distribution franchises are relationships between a supplier and dealer designed to sell the franchisor’s products. The franchisee re-sells the franchisor’s branded