Finnish Franchisee Discontinuance and Failure: An Empirical Study

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Abstract
The present study focuses on franchisee discontinuances and failures during the three years 1999-2001. The study was the first of its kind in Finland while internationally the topic has been studied for instance in the USA, the UK and Australia. As a matter of fact, few franchise topics have generated more interest over the years than franchise failure rates. Past franchising literature on the topic has largely been based on franchisor surveys, used very divergent concepts and definitions and indicated widely ranging failure estimates. Furthermore, many of the studies are based on secondary data. Thus, comparison of the past results is difficult. The current study was based on primary data.

In this paper franchising is approached from entrepreneurship viewpoint and taken as a form of starting and conducting entrepreneurship and business. Entrepreneurship literature has perceived survival as a key performance measure. Further, significant new venture failure rates have been noted for long. In franchising context, performance i.e. success and survival or failure is always a wider question covering franchisor, franchisee and their collaborative, long-term contractual relationship. A broader stakeholder view goes even beyond that. Suppliers, financial institutions, customers, investors, and others all suffer as the circle of real and/or opportunity cost/loss widens because of franchisee discontinuance. The great pledge of franchising is that it is, or should be, less risky for a franchisee than the option of starting and running a stand-alone business.

In addition to reporting the empirical results of the examination, the paper deals with notions relating to discontinuance and failure. Here the definition of failure means an occasion where a franchisee ceases operation and the cause for exit is franchisee's bankruptcy, liquidation or financial reasons. Other occasions are referred as turnover. In case of a turnover, another franchisee or franchisor will continue operating the outlet. Franchisee discontinuance and turnover are

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considered as close synonyms and used rather interchangeably. However, turnover refers to franchisor’s point of view whereas discontinuance relates to franchisee’s perspective and is seen as a more general notion on the same matter.

The data for the current study was gathered in spring 2002 with a postal survey. The questionnaire was mailed to all 46 member franchisors of the *Finnish Franchising Association*. The survey was targeted to CEOs or franchising managers. Altogether 33 responses were received of which 32 were usable, adding up to a response rate of 70%. Those 32 franchisors that responded represented 19.5% of all the 164 franchises operating in Finland in 2002. Hence, the obtained results cannot be generalized nationally. Nevertheless, the findings can be considered as indicative. Moreover, it is worth noting that the investigated franchisors were organized in the national franchisor association, which might have an effect on the results.

The results indicate that the average annual franchisee turnover rate was 11% which is in line with the results of the earlier international studies. Worth remembering is that turnover figures include failures. The respondent firms reported in total eight bankruptcies occurring during the investigated years. Moreover, in nine occasions the reason for franchisee exit was avoidance of further losses or discontinuance of unprofitable operations. Consequently, in proportion to the average number of franchisee owned outlets (1027) per year in 1999-2001 the figures gave an average annual franchisee failure rate of 1.6%. The risk of bankruptcy for franchised businesses (0.78) seemed to be around half of the risk for stand-alone businesses (1.32). Noteworthy is though, that the risk, discontinuance and failure figures of stand-alone businesses and franchisees are not always fully comparable.

Every fourth (24%) franchisor reported facing unexpected franchisee turnover where franchisee ceased operations before his/her franchise contract expired. Furthermore, every third (32%) franchisor saw unexpected franchisee turnover as detrimental to the franchise. It is worth mentioning that only part of the failure and turnover related disadvantages and problems cause evident and easily measurable expenses. If the whole extent of direct and indirect expenses and financial losses resulting from franchisee turnover and failures were known, franchisors might pay more attention to the issue and try to prevent and control it vigorously.

As the findings of this and previous studies indicate, franchisee discontinuance and failure is a topic worth of more and well established scholarly examination. Furthermore, franchisors should investigate and analyze the reasons for franchisee turnover and failures consistently and annually. The outcomes of the analyses should be reflected to recruitment practices, franchisee profiles and site selection practices. Franchising is a growth strategy, but trying to accelerate growth by compromising and bargaining over criteria and standards in franchisee recruitment and site selection is likely to increase franchisee turnover and failures in a long-term. Franchisee discontinuances and failures can be and should be prevented, since they erode the earnings of both franchisees and franchisors.

Keywords
franchisee, discontinuance, turnover, failure, Finland

1 Introduction and Background

The present study focuses on franchisee turnover and failure. Franchising is approached from entrepreneurship viewpoint and taken as a form of starting and conducting entrepreneurship and business (see e.g. Shane & Hoy 1996, Hoy & Shane 1998, Kaufmann & Dant 1999, Stanworth & Curran 1999, Hoy & Stanworth 2003, Tuunanen 2005). Shane (2003, 5) perceived survival as a key performance measure in entrepreneurship among growth, profitability and experiencing initial public offering. He defined survival as continuation of entrepreneurial effort. In his view, the importance of survival as a measure stems from the fact that few firms survive.

According to Burns (1989, 32) “most businesses are born to die or stagnate”, and ”there is substantial turnover in numbers and types of businesses in all Western countries”. This holds true e.g. in Finland where 50% up to 55% of all start-up firms will survive through the first five years of operation (Hyrsky 2006). The higher probability of ceasing to trade seems to be a fundamental characteristic, other than size per se, that distinguishes small and large businesses (see Storey 1994, 78). The very small, mainly young firms are responsible for most of the discontinuances (Bates & Nucci 1989, 6-7), and this fact has an effect on the general failure statistics of SMEs. In Finland (99.8%) as well as in other Western European countries majority of the enterprises are small and medium sized.[3] Stanworth, Purdy, English and Willems (2001) brought out that new franchisors and franchisees that both are many times small businesses face the risk of failure in their early years and that their survival patters largely mirror those of conventional small businesses.

Vesper (1990, 63) saw that both success and failure can take different forms. Success can mean survival, growth, profitability or satisfaction for the business owner. Failure can mean less of such things than one might prefer, which can be different than what another might prefer. According to Vesper (1990), performance depends upon complex factors. In the franchising context, performance, i.e. failure or success and survival, is always a wider question covering franchisor, franchisee and their collaborative, long-term contractual relationship. A broader stakeholder view of franchisee failure goes beyond the franchisor and franchisee. Suppliers, financial institutions, customers, investors, and others all suffer as the circle of real and/or opportunity cost/loss widens

[3] According to the EU Commission enterprises with less than 250 employees are classified as small- and medium sized companies. Further, companies that employ less than 50 persons are classified as small enterprises. Companies with less than 10 employees are called microenterprises. (Hyrsky 2006, 18-21)

because of franchisee turnover. (Holmberg & Morgan 2003). The great pledge of franchising is that it is, or should be, less risky for a franchisee than the option of starting and running a stand-alone business. (cf. e.g. Stern & Stanworth 1994, 21; Hoy 1994) These specific features make the topic worth of closer scrutiny.

Franchisee turnover and failure have been studied to some extent for instance in the USA, the UK and Australia. In Finland this was the first study of its kind. Franchise contract is in the heart of franchise relationship and issues related to franchisee turnover and failure are determined in contracts (Tuunanen 2004). However, legal systems, regulations and ethical codes concerning franchising differ for instance, between the EU-countries and the USA. Therefore, a short description of these is given in the following. To further set the scene for the study, Finnish franchising statistics from year 2002 are presented.

1.1 Franchising and Legislation

Franchising specific legislation is virtually non-existent in Finland and in other EU countries[4]. The civil law system prevails in all EU countries with the exception of Great Britain and Ireland. To compare, in the USA the common law system and the federal and state constitutions plus a mix of federal and state legislation have shaped a complex and unique juridical entity that influences how franchise contracts are drafted. The respective systems are in fact significantly different. (Tuunanen 2004)

In Finland information on the stipulations, franchisee obligations and characteristics of the franchise contracts and pre-sale disclosures for nascent franchisees is scarce and typically not available for the public. Franchise contracts are strictly confidential and no information on the contract may be given to a third party. A very different system is applied in the USA where franchisors are by the federal law forced to publicly disclose key information relating to their franchise systems. A standard form of disclosure, accepted in every state, is called the *Uniform Franchise Offering Circular* (UFOC). The UFOC document serves two primary functions: to prevent fraud or misrepresentations of material facts and to present relevant facts to prospective franchisees. (Justis, Chan & Haynes 1991; Justis & Judd 1998; Justis & Vincent 2001). Moreover, the uniform standard of disclosure enables comparisons between various franchise offerings. (Tuunanen 2004)

As a member of the *European Franchise Federation* (EFF) the FFA applies the *European Code of Ethics for Franchising* (EFF 2002). The Code of Ethics prohibits member franchisors from giving misleading or subjective information to franchisees. Moreover, franchisors should give franchisees all possible written material concerning the franchise relationship well before signing the franchise

[4] Belgium, France, Italy, Spain and Sweden are exceptions from this. In these countries some aspects of franchising are regulated. In many cases the regulation concerns franchise disclosure.

contract. Franchisors should also choose and accept as franchisees only persons who have the skills, education, personal traits and financial qualifications required in running a franchise outlet in the particular franchise. However, it is important to take into account that the law does not enforce the Code. Instead, it is meant to promote good franchising practice. In addition, in Finland it binds only the member franchises of the FFA. This implies that a prospective franchisee might be in a weaker position regarding the quantity and quality of information accessible for his or her disposal. As a result, franchisee dissatisfaction may later arise and lead to friction between the parties.

For comparison, the IFA's *Code of Ethics* (IFA 2002) intends to establish a framework for the implementation of the best practices for the franchisor and franchisee co-operation. It also represents the ideals for the franchise relationships and core values that are the basis for the resolution of the challenges that may arise between the parties. Differences between the Code of Ethics of the EFF's and the IFA's Code of Ethics are evident. While the European Code offers straightforward and detailed instructions and guidelines concerning mainly franchisors' actions, such as presale disclosure, franchisee recruitment and the minimum contents of the franchise contract, the American Code deals with the moral nature of the interdependent relationship between the parties. In general, the differences between the respective codes may reflect the dissimilarities of the franchise specific regulations.

1.2 Franchising in Finland in 2002

A breakthrough in business format franchising appeared in the late 1980s when a stream of franchises was founded and the national franchise association established. The first known business format franchise in Finland started its franchise operations in the late 1970s (Tuunanen & Hyrsky 2001). Yet today, franchising is a rather novel and under-recognized form of entrepreneurship in Finland.

Since the mid-1990s, the number of franchises operating in Finland has grown nearly 15% annually. According to the statistics there were 164 franchises in the Finnish markets in 2002. Of those 69 were Retail franchises and 67 Service franchises. The rest, 28 franchises were in Restaurant sector (including café and fast food franchises). This rather rough statistical classification of franchised businesses comes from the *Finnish Franchising Association* (FFA). Majority of the franchises were home-grown and had purely domestic origin while slightly more than a quarter of the franchises had foreign ancestry. More than a quarter (28% or 46 franchises) of the total amount of franchises was members of the FFA. The 164 franchises had together 5,750 outlets. Two out of three outlets (68% or 3,900) were owned and managed by a franchisee. The rest (32% or 1,850) were company owned. There were some 3,400 franchisees, which tells that nearly 500 stores were governed by a multiple-owner. (Tuunanen 2003)

Franchising employed 38,000 people directly. The total amount included part and full time employees working in franchisors' headquarters, company owned and franchisee owned stores. Retail sector employed a half (50%) and Restaurant sector one third (33%) of the employees. The gross annual sales of franchising in 2002 were 3.54 billion euros (equaled some 3.25 billion US dollars). Franchising accounted for around 2.5% of the gross domestic product (GDP). Less than two percent of all active and registered companies in Finland were franchised. The annual sales in franchised Retail channels accounted for more than ten percent of all retail sales in Finland. Likewise, more than ten percent of the total annual sales of restaurant sector were generated by Restaurant franchise chains. Notably, franchised Services created only one percent of the total annual sales of services. (Tuunanen 2003)

The paper began with an introductory section starting off with a presentation of the subject, followed by summary of franchising related legislation issues and a brief overview of franchising in Finland in year 2002, when the data for the current study was gathered. Next, literature review is presented with discussion of the definitional issues. Subsequently, research design is depicted and the key findings introduced. The paper ends with discussion and implications section.

2 Literature Review

Entrepreneurship literature has long noted significant new venture failure rates. Furthermore, few franchise topics have generated more interest over the years than franchise failure rates. (Holmberg & Morgan 2003) In their extensive sociological model of franchising, Stanworth and Curran (1999) positioned franchise failure as one factor (at the organizational level of franchising) having an influence in the development of franchising. Hoy, Stanworth and Purdy (2000) identified "degrees of survival and failure" as an issue dominating previous franchising studies. Their view was in line with Kaufmann (1996) who brought forward franchisee failure as an interesting franchising-specific field of study. Additionally, Young, McIntyre and Green (2000) published a content analysis of 285 research papers presented in International Society of Franchising conferences in 1986 and 1988-1999. Among the four most popular subjects of the studies were "franchise management", "franchise relationship issues", and "performance and growth".

Elango and Fried (1997) called attention for better performance measures for franchise systems and instead of *descriptive* studies that have dominated the scene they craved more *prescriptive* studies covering the franchisee side of the business. Elango and Fried (1997) named one stream of the past franchising studies as "creation of franchising relationships". These studies have managerial orientation, and the perspective of the studies is performance and profit maximization. The present paper falls in this category.

Nye (1988), Williams (1996) and Frazer and Terry (2000) studied franchise terminations and contract non-renewals in the USA and Australia. Empirical findings of these studies have not supported claims (cf. franchisor opportunism) that franchisors systematically abuse their right to terminate. To the contrary, terminations have been mainly motivated by the poor outlet performance.

Holmberg and Morgan have done a long-term work in studying franchise turnover and failure (Holmberg & Morgan 1996, 2000, 2001, 2003, 2005a, 2005b). According to them past franchisee failure literature has largely been based on franchisor surveys, used very divergent concepts and definitions and indicated widely ranging failure estimates. Thus, comparison of the results of previous examinations is difficult. Holmberg and Morgan (2003) pointed to the need for more reliable franchise failure studies (see also Cross 1994, 1998; Castrogiovanni, Justis & Julian 1993). Franchise failure research is strongly influenced by the failure concept underlying the study's research perspectives, data collection, analysis and resulting research conclusions (Bates 1995; Stanworth & Dandridge 1994). Diverse franchisee "success" and "failure" realities and perceptions exist among researchers and franchise system stakeholders (Falbe & Welsh 1998; Hoy 1994).

Consequently, Holmberg and Morgan (1996, 2000, and 2003) suggested that the need is not to define failure definitely, but rather to view the process comprehensively (see also Cross 1994, 1998). They proposed an eight step franchisee failure model, suggesting that the first indicators of failure can often be seen very clearly: 1) franchisee core competent misfit, 2) franchisee-franchisor dissatisfaction, 3) franchisee discontent, 4) royalty delinquency, etc., 5) complaints to FTC, 6) turnover/termination, 7) defaults/other losses to creditors, 8) closure.

Holmberg and Morgan (2003) also put forward a broader stakeholder view of franchisee failure going beyond the franchisor and franchisee. According to them suppliers, financial institutions, customers, investors, and others all suffer as the circle of real and/or opportunity cost/loss widens because of franchisee turnover. If recognized and managed at earlier steps on the continuum, systematic risk mitigation strategies might be developed, losses minimized and turnover possibly avoided. These strategies may avoid real and/or opportunity costs if franchisor-franchisee relationships, business issues, and failure risk are managed appropriately. Selected studies on franchisee failure and discontinuance are summarized in Table 1.

Table 1: Past studies on franchisee failure and turnover

Scholars (Year)	Nature of the study and the sample	Research interest	Key findings
Padmanabhan (1986)	empirical, secondary data (U.S. Dep. of Commerce	comparison of riskiness figures of franchisee-owned establishments to corresponding figures	generally franchising had lower failure rates and risk compared to wholesale trade and stand-alone businesses

	1971-1981)	of wholesale trade and Dun & Bradstreet annual Business failure data	
Walker & Cross (1988)	conceptual	examination on franchise failure and turnover definitions and related issues, comparison of franchise and small business failure data	a serious lack of appropriate data on franchising failures exists, definitional problems plague the area; due to a lack of suitable data it is impossible to conclusively compare failure rates among franchisees and independent businesses causes of franchisee and franchisor failure are very similar; while many causes of franchise failure relate to small business in general, some are specifically related to the distinctive nature of franchising
Castrogiovanni, Justis & Julian (1993)	empirical, secondary data (UFOCs), N=140, n=103, response rate 74%	failure rate (of franchised and company-owned units)	failure rate 4.17%; failure rate ascends as franchisors get older; neither size nor capital intensity had effect on failure
Cross (1994)	conceptual	failure: definitional and measurement issues	many franchise failure causes are generic but some are related to the distinctive nature of franchising; definitional problems plague; better methods are needed to be able to compare failure rates between franchisees and independent businesses
Cross (1998)	conceptual	failure: definitional and measurement issues, failure typologies and potential policy initiatives	general failure categories: discontinuance of franchisee owned-units, termination of the franchisee for financial reasons, failure of franchisor

			turnover include items that are not part of failure (conversions of the outlets, outlets sold between franchisees, other termination reasons than financial) lack of reliable data on franchising failure; its unsure whether franchised businesses have lower risk than independent; definitional and methodological problems plague
Stanworth, Purdy, English & Willems (2000, 2001)	empirical, secondary data	failure of franchisors /franchise systems	young, less than 4 years old, and small franchise systems pose a risk that is of rather similar magnitude than in conventional businesses the sector has had a tendency for overpromise by e.g. using terms “proven” and “tired-and-tested”
Holmberg & Morgan (2003)	empirical, secondary data, N= 472 – 1226, n= 447 - 834 UFOCs from 1994 to 1997	franchise failure and turnover	overall franchisee turnover rates increased noticeably over the 4-year study 8.86% - 10.49%

3 Definitional Issues

Franchisee turnover and failure have different meanings. Franchisee turnover will take place when a fixed-term franchise contract expires and is not renewed. However, a franchisee may exit the franchise system before the end of franchise contract period or as the contract expires. When expiration date of a fixed-term franchise contract is at hand, the parties will face a situation where franchisee either continues operating the business or gives up the franchise. At that point the franchisor-franchisee relationship and the quality of co-operation are weighted.

Frequently franchisee decides to continue and the parties will renew the contract. At times franchisee wants to renew the contract but the franchisor refuses and the other way around. The end result may be mutual agreement or disagreement of one or both parties.

Franchisee termination or withdrawal before the expiration of franchise contract period is many times difficult to anticipate and causes a problematic state of affairs. Depending on contract provisions either franchisor, franchisee or both may initiate termination. Contract violations can often be found when termination occurs before the end of contract period. Franchisor has to find another franchisee to continue outlet operation or take over the outlet. The worst option is permanent closure of the outlet. In that case the possible franchisee failure has lead to outlet closure.

Usually the term failure refers to termination due to financial reasons. Nevertheless, there are other causes and failure does not automatically lead to bankruptcy. Reason for termination may also be avoidance of further losses. It should be considered that many problems whether related to business environment, franchisee's company or franchisee will finally result in financial difficulties of the franchisee’s business. Reliable and accurate analysis of the causes and consequences of termination is hard. The problems are often versatile and long-term and the parties may have opposite and subjective interpretations of the state of matters. The essential definitions related to the research subject are depicted in Table 2.

Table 2: Key definitions related to the research subject

Notion	Definition	Notes
Exit	Any situation where a franchisee leaves the franchise system.	Does not refer to success, failure or reasons for leaving the franchise system.
Termination	Franchisee exits before expiration of the franchise contract. Either franchisee or franchisor initiates the termination.	Franchise contract provisions concerning termination are franchise system specific.
Turnover	Fixed-term franchise contract expires and is not renewed or franchisee exits before the expiration of the franchise contract for some other reason than franchisee's bankruptcy, liquidation or financial reasons.	Either franchisor takes over the outlet(s) or another franchisee continues operation(s).
Discontinuance	Discontinuance can be considered as close synonym to turnover and may be used rather interchangeably.	Turnover refers to franchisor’s point of view whereas discontinuance relates to franchisee’s perspective. Discontinuance is a more general notion on the same matter as turnover.

Failure	Occasions where franchisee ceases operation and the reason for exit is franchisee's bankruptcy, liquidation or financial reasons. Franchisor may also face failure and a franchisor-owned outlet may have to be closed down. Causes relate to financial reasons, i.e. unprofitable operations, which may stem from e.g. poor site location and/or tense competition.	The outlet(s) may not have to be closed down; franchisor may take them over or find another franchisee to continue operation(s).
Closure	Permanent closure of a franchisee or franchisor-owned outlet.	Closure does not necessarily refer to failure.

The previous studies have taken up some essential points related to the key definitions portrayed above and those are presented in the following. Turnover is a broader concept than closure and “a more encompassing term than failure” (Walker & Cross 1988). Turnover is the term used to denote a change in ownership of a franchise outlet. The change could occur because the unit was cancelled or terminated by the franchisor, reacquired by the franchisor, not renewed by the franchisor, transferred to another entity, or not doing business for other reasons. The turnover rate more appropriately “indicates the overall likelihood of remaining in business” (Cross 1998). Turnover includes the category of transfers, a category particularly susceptible to double counting. Without investigating circumstances behind each outlet’s transfer, there is no way of knowing the extent of the double counting problem.

The UFOC Item #20 shows prior three years data for five separate turnover event categories that might also refer to business failures: 1) transfers – a franchisee unit is transferred from the existing owner to a new franchisee owner, 2) cancellations - the franchisee unit is cancelled for failure to comply with quality control reasons or other reasons, 3) non-renewals – the franchisee unit contract is not renewed and the unit may be closed, sold to a new franchisee, or converted to a company-owned unit, 4) reacquisition – the franchisee unit is purchased by the franchisor and becomes a company-owned unit, and 5) other – units which are no longer doing business for other reasons.

There are several problems with the categorization since e.g. the categories are not necessarily mutually exclusive. This may cause double counting. Obviously, the categories do not reveal the reasons behind turnover. Turnover does not always mean failure, thus the reason for it may be positive or negative. Moreover, this information is not obtained if the whole franchise system ceases. What should be remembered though is that franchisor failure – the closing down of the franchisor does not necessarily mean the closure of the individual franchisee units. (Stanworth et al. 2001, Holmberg & Morgan 2003, Buchan 2005, cf. Frazer 2004)

4 Research Design

4.1 Scope of the Study

In the current study the definition of failure means an occasion where a franchisee ceases operation and the cause for exit is franchisee's bankruptcy, liquidation or financial reasons. Other occasions are referred as turnover. When turnover happens, another franchisee or franchisor will continue operating the outlet. Franchisee discontinuance and turnover are considered as close synonyms. However, turnover refers to franchisor's point of view whereas discontinuance relates to franchisee's perspective and is seen as a more general notion on the same matter. Franchisor may also face failure and a franchisor-owned outlet may have to be closed down. Causes frequently relate to unprofitable operations, site location and competition. Evidently contradictions can be found in concept classifications but they have been used in several previous international studies.

4.2 Data Collection

The data for the present study was gathered in spring 2002 with a postal survey. The questionnaire was mailed to all 46 member franchisors of the *Finnish Franchising Association*. The survey was targeted to CEOs or franchising managers. Altogether 33 responses were received of which 32 were usable, amounting to a response rate of 70%. When reminder calls were made it was found that many franchisors were reluctant to provide this type of information on their businesses. Those 32 franchisors that responded represented 19.5% of all the 164 franchises operating in Finland in 2002. Hence, the obtained results cannot be generalized nationally. Nevertheless, the results can be considered as indicative. Moreover, it is worth noting that the investigated franchisors were organized in the national franchisor association which might have an effect on the results. A more detailed description of the respondent franchises is given in Table 3.

Table 3: Sample description (n=32)

Item		**n (%)**
Origin of the franchise	Finland	27 (84%)
	USA	3 (9%)
	Sweden	1 (3%)
	Denmark	1 (3%)
Business sector	Services	14 (44%)
	Retail	12 (37%)
	Restaurant (including café and fast food)	6 (19%)

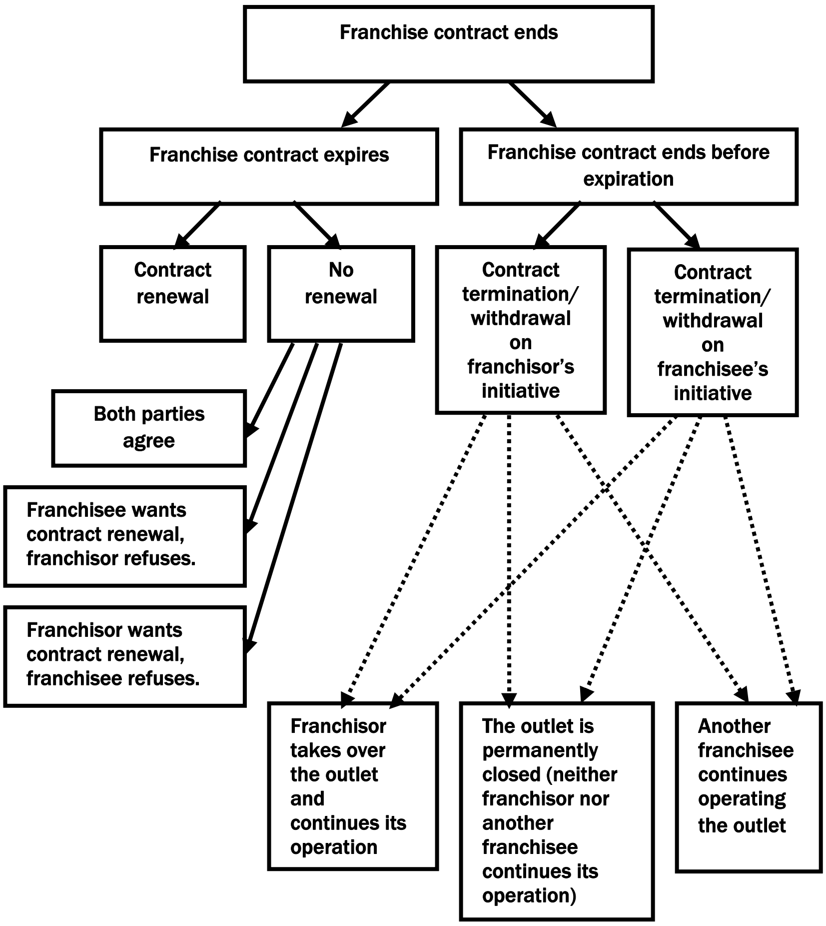
Year of business start-up	1940 or before	5 (16%)
	1941 - 1960	1 (3%)
	1961 - 1980	8 (25%)
	1981 - 2000	17 (53%)
	2001	1 (3%)
	Mean	1974 and 10 months
	Median	1985 and 6 months
Year of starting franchise operations	1987 - 1990	9 (29%)
	1991 - 1994	7 (22%)
	1995 - 1998	8 (25%)
	1999 - 2001	7 (22%)
	Not applicable	1 (3%)
	Mean	1994 and 2 months
	Median	1993
Size of franchise systems		
Franchisee owned outlets	Less than 20	19 (65%)
	20-39	4 (13%)
	40-59	3 (10%)
	60-79	2 (6%)
	80 or more	2 (7%)
	Mean	33.9
	Median	8
Company owned outlets	Less than 20	23 (74%)
	20-39	4 (10%)
	40-59	2 (6%)
	60-79	1 (3%)
	80 or more	1 (3%)
	Mean	28.4
	Median	7
Total number of outlets	Less than 20	12 (39%)
	20-39	7 (23%)
	40-59	6 (19%)
	60-79	3 (10%)
	80 or more	3 (10%)
	Mean	62.0
	Median	28

Note: percentages may not add to 100% due to rounding

Regarding origin of the franchise and business sector the sample description figures reflect the franchising statistics discussed before in the paper. The youngest of the sampled franchisor companies started business in 2001 and the oldest in 1885. The company that launched franchise operations first did so in 1987 while four companies initiated franchising as late as in 2001. One of the respondent firms had not started franchise operations at the time of the study. The fastest ones launched franchise operations one year after business start-up whereas it took 112 years for the "slowest" company. On average it took some 20 years (median 8 years) for the studied companies to start franchise operations. The size of sample franchises also reflected the size distribution of all franchises operating in Finland in 2002. Typically franchise chains are rather small. The questionnaire included mainly structured questions but some open-ended questions were also incorporated. The questionnaire was based on a model (see Figure 1) created after in-depth interviews of the six leading Finnish franchise attorneys. Fixed-term franchise contracts were applied in all examined franchises.

The respondent firms were asked on possible franchisee terminations in years 1999-2001, causes for terminations, the party (i.e. franchisor or franchisee) initiating termination, the year of termination, and the status of the franchisee outlet subsequent to termination. Furthermore, information on possible closures of the franchisor owned outlets during the three years in question was inquired.

Figure 1. Generic Model on the End of Fixed-term Franchise Contract



5 Results

Table 4 presents franchisee terminations in 1999-2001 and the relative turnover rates in the studied franchises. Franchisee turnover shows franchisor's ability to hold on and engage franchisees into the franchise system. Further, turnover points out the average time a franchisee operates in a franchise system. The outcome should be compared to the franchise contract term in the particular franchise. For example, if franchisee turnover is 10% per year, on the average franchisees will change once in ten years in a franchise system. If turnover rate is high, most likely the franchisor is facing a serious problem lowering the productivity. Franchise contracts that are "too short" will feed franchisee turnover. In Finland franchise contracts are typically significantly shorter than for instance in the USA (Tuunanen 2004). The appropriate length of a franchise contract is based on franchisee's financial facts.

Table 4: Franchisee terminations and turnover in 1999 - 2001 (n=32)

Year	No. of franchisee terminations	Total No. of franchisee owned outlets	Relative turnover rate
1999	89	979	9.00 %
2000	114	1051	10.85 %
2001	129	1051	12.27 %
Total	332	3081	10.78 %

In 1999 almost half (47%) of the ceased franchisees were terminated. In 2000 and 2001 the corresponding figures were 54% and 64% respectively. Moreover, in more than half (53%) of the cases in 1999 the termination was initiated by a franchisee. In the following two years the equivalent figures were 41% and 42%. Nevertheless, in 1999 there were 14 (64%) franchises with no franchisee terminations and in 2000 and 2001 the corresponding numbers were 13 (57%) and 12 (44%).

Table 4 indicates that on the average the turnover rate was 11% per year which is in line with the results of the earlier international studies. For instance, in 1997 in the UK the amount of franchisee turnover was found to be 10% per year and the US statistics from year 1997 presented a franchisee turnover figure of 10.5%. It should be remembered that turnover figures include failures.

The respondents were inquired on the causes for franchisee exits and the party that took the initiative (see Table 5).

Table 5: Causes for franchisee exits in 1999-2001

		Franchisor initiative	Franchisee initiative	Total
Franchisee related causes	- bankruptcy	7	1	8
	- liquidation	0	0	0

for exits	- retirement	0	7	7
	- illness	26	8	34
	- death	0	0	0
	- personal reasons (e.g. family situation)	25	17	42
	- tiredness	6	40	46
	- franchise contract violations or another dishonest behavior in part of the franchisee	14	2	16
	- something else, what?	71	35	106
Franchisor related causes for franchisee exits	- franchise contract violations or another dishonest behavior in part of the franchisor	0	0	0
	- something else, what?	1	15	16
Causes for franchisee exits related to the business environment	- termination of the outlet tenancy agreement by landlord	3	0	3
	- accident / damage / loss (e.g. fire, water leakage)	1	0	1
	- something else, what?	0	0	0
Business related causes for franchisee exits	- avoidance of further losses or discontinuance of unprofitable operations	4	5	9
	- tense and unbearable competition	21	0	21
	- something else, what?	0	0	0
Other causes for franchisee exits	- non-renewal of the franchise contract	22	1	23
	- long-term, unsolvable conflict between the franchise contract parties	1	1	2
	- something else, what?	0	6	6

Regarding franchisee related causes for exits the respondents marked most often “something else” and wrote down causes such as “misrecruitment”, “misfit between the franchisee and the business category”, “franchisee did not comply with contract provisions”, “franchisee made a career shift”, “lack of energy on franchisee’s side and franchisee’s carelessness on financial matters”. Some respondents did not identify any particular cause. The large number of answers in this category might indicate that respondents could not classify the causes for exits under any of the given options or on the other hand, took the easy way out if they did not want to identify the cause. Causes that relate to franchisees personally such as tiredness, illness and family situation were behind many exits. Noteworthy, there were also several franchisor related causes for exits. The respondents gave causes such as “management decision”, "operational difficulties" and “inappropriate site selection”.

Business related causes for franchisee exits such as tense competition and unprofitable operations were also found. Franchisee exits due to avoidance of further losses or discontinuance of unprofitable operations were considered as failures. What was interesting though was that only in three cases the cause for exit was termination of outlet tenancy agreement by landlord. Moreover, in more than twenty cases the cause for discontinuance was franchise contract expiration and non-renewal.

The questionnaire included an open ended question asking the two most important reasons that led to closure of franchisee owned outlets in 1999-2001. This referred to situations where neither franchisor nor another franchisee continued operating outlets. Fourteen franchisors answered and gave in total 25 reasons for closures. Nine (36%) answers indicated financial reasons, six (24%) were franchisees' personal reasons, four (16%) answers related to poor choice of outlet location. Six (24%) reasons could not be classified in any other category.

Worth recognizing is that the number of franchisees and franchisee owned outlets is not necessarily the same since some of the franchisees might be multi-unit owners. However, previous studies have shown that circa 85% of the Finnish franchisees are single-unit owners (Tuunanen 2003). Eight franchisee bankruptcies were recorded during the investigated years 1999-2001. Therefore, the average franchisee bankruptcy rate was 0.78%[5]. Only one bankruptcy, where no-one, neither franchisor nor another franchisee continued operating outlet, took place. The average annual failure rate was found to be 1.66% since franchisee exits due to avoidance of further losses or discontinuance of unprofitable operations and bankruptcies were considered as failures.

Also franchisor-owned outlet closures took place during the studied three years (see Table 6). In total the relative share of closed franchisor-owned outlets of the total amount of franchisor owned outlets was 1.69% in 1999-2001. The figure could be considered as franchisor failure rate. To examine the total failure rate of a franchise, franchisee and franchisor failure rates can be combined. Here the figure was 3.35%.

Table 6: Closures of the franchisor-owned outlets in 1999 - 2001 (n=32)

Year	No. of closures	Total No. of franchisor - owned outlets	Relative closure rate (%)
1999	5	758	0.66%
2000	14	841	1.66%
2001	23	879	2.62%
Total	42	2478	1.69%

For the sake of comparison, figures describing the stock of enterprises in Finland are presented in Table 7. Especially the relative shares of ceased enterprises and bankruptcies are of interest. The number of ceased enterprises includes bankruptcies. Ceased enterprises are neither liable to pay value added tax nor do they act as employers. Nonetheless, not all companies are permanently

[5] 8 bankruptcies/1027 franchisee owned outlets x 100 = annual franchisee bankruptcy rate 0.78%

ceased, instead they might be in a so called “resting state”. According to the figures in Table 7 the average risk of bankruptcy for franchised businesses (0.78%) seemed to be around half of the risk for stand-alone businesses (1.32%) during the studied years. Further, the number of ceased enterprises appears significantly higher compared to franchising. The current study measured outlet closures which differ from enterprise closures. Therefore, the figures might not be fully comparable, for instance, there is no equivalent figure for franchisee discontinuance.

Table 7: Key figures of the Finnish enterprise stock in 1999 – 2001

Year	No. of start-ups (%)	No. of ceased enterprises (%)	Net increase (%)	No. of bankruptcies (%)	Total No. of enterprises
1999	21 557 (9.82 %)	19 626 (8.94 %)	1 931 (0.88 %)	3 080 (1.40 %)	219 516
2000	22 446 (10.07 %)	20 091 (9.01 %)	2 355 (1.06 %)	2 908 (1.31 %)	222 817
2001	21 998 (9.78 %)	20 308 (9.03 %)	1 690 (0.75%)	2 793 (1.24 %)	224 847

Source: Hyrsky 2006, Ministry of Trade and Industry

<u>Notes</u>:
Start-ups = number of enterprise openings and their relative share of the stock of enterprises
Ceased enterprises = number of enterprise closures and their relative share of the stock of enterprises
Net increase = Enterprise openings minus enterprise closures and the relative share of the stock of enterprises
Bankruptcies = number of bankruptcies and their relative share of the stock of enterprises
Stock of enterprises = total number of enterprises in Finland

The respondents were asked on the status of the outlet subsequent to franchisee exit. According to Table 8, more outlets were transferred to other franchisees than converted to franchisor-owned. On the other hand, there were only three contract transfers relating to generation successions in 1999-2001. Furthermore, more franchisee than franchisor owned outlets were opened in the respondent 32 franchises.

Table 8: Outlet conversions, contract transfers and new outlet openings in 1999-2001 (n=32)

	1999	2000	2001
No. of outlets converted to franchisor-owned	8	8	17
No. of outlets transferred to another franchisee	32	20	32
No. of new franchisor-owned outlets opened	20	19	24
No. of new franchisee owned outlets opened	76	57	42

Every fourth (24%) franchisor reported facing unexpected franchisee turnover where franchisee ceased operations before his/her franchise contract expired. Furthermore, every third (32%) franchisor saw unexpected franchisee turnover as detrimental to the franchise. There were several disadvantages and problems mentioned: increased monitoring costs, rise in training, advice and field-support costs, lost revenues, costs from outlet closures, strangled growth of the franchise system, badwill and negative publicity, heightened recruitment costs, know-how leakages and franchisor operational and time management problems.

It is worth mentioning that only part of the failure and turnover related disadvantages and problems cause evident and easily measurable expenses to franchisors. Previous international studies have indicated that franchisors tend to underestimate the costs of franchisee recruitment (Macmillan, 1996). The results of the present examination lend support for this. The franchisors were asked as how severe they saw the disadvantages caused by unexpected franchisee turnover. A five-point Likert-type scale ranging from 1, i.e. no disadvantages, to 5, i.e. severe disadvantages, was used to measure the severity of disadvantages. The mean score was 2.74 (median 3) indicating that franchisee turnovers were seen as somewhat disadvantageous. Interestingly, no answers with value 5 were given.

6 Discussion and Implications

6.1 Managerial Implications

Based on the results of the study the following recommendations could be given to franchisors. Franchisee recruitment and outlet site selection are vital issues for the success and growth of the franchise. Hence, close attention should be paid to constant development and improvement of analyses and decision making practices related to them. Franchisees are the collaborative partners of the franchisor and franchisor’s success depends inevitably on the success of franchisees. The study showed that part of the exits relate to franchisee’s personal matters which can be anticipated and controlled at least to a certain extent. Many failures and outlet closures had to do with inferior outlet location choices. Outlet location decisions require expertise and have a straightforward effect on the success of the forthcoming business. In the light of the results, it is very likely that many franchisors could improve on these areas.

An interesting finding was that the franchisors did not seem to consider the effects of unexpected franchisee turnover as detrimental or problematic. This is especially surprising since the most severe barrier for faster growth of franchisors in the Finnish market is dearth of future franchisees. If a franchisee decides to exit the franchise franchisor has to either find a successor to the outlet(s) or to close it(/them) down. There are costs related to both options: recruitment costs due to finding another franchisee to continue operations or if franchisor decides to take over the outlet, costs from staff recruitment, training and orientation. The possible sale of the outlet(s) or closing it(/them) down will also demand various resources. Moreover, all the options are likely to require franchisor's attention and move the focus away from the core business. Franchisee turnover and especially failures will cause badwill and negative publicity to the whole franchise system. Additionally, the existing franchisees as well as future franchisees will notice discontinuances and failures and the way franchisor reacts on and manages the situations. In the worst case, more exits, recruitment difficulties and stagnation of growth will follow. Further, franchisors should consider, what is the real growth of the franchise system or is there any, if franchisee exits happen on a regular basis. If the whole extent of direct and indirect expenses and financial losses resulting from franchisee turnover and failures were known, franchisors might pay more attention to the issue and try to prevent and control it vigorously. Yet, not all expenses due to the failure and turnover related disadvantages and problems are evident or easily measurable.

A closer examination of the causes generating franchisee exits gave support for dividing turnover cases into two categories "natural turnover" and "unnatural turnover". "Natural turnover" refers to occasions where franchisee turnover is difficult to anticipate and thus, challenging for franchisor to prevent. Examples are franchisee's sudden personal and health problems or even death. "Unnatural turnover" means occasions where signs and causes for possible turnover can be registered and influenced if proper and timely managerial actions are taken by franchisor. Outlet location, competition, financial reasons, constant under-performance, franchisee's dissatisfaction and frustration, opportunistic behavior, friction and conflicts in the relationship with franchisor are some examples. Franchisors should have regular and versatile measures for monitoring and securing the well-being of the franchised businesses. Moreover, reasons for franchisee turnover and failures should be examined consistently and annually. Every case should be analyzed individually even though there might be several exits in the franchise. What is more, the outcomes of the analyses should be reflected to recruitment practices and franchisee profiles. Franchising is a growth strategy, but trying to accelerate growth by compromising and bargaining over criteria and standards in franchisee recruitment and site selection is likely to increase franchisee turnover and failures in a long-term.

6.2 Research Implications

Franchisee turnover and failure have been studied to some extent internationally. The earliest studies of the topic date back to late 1980's and interest on this pertinent and complex issue has continued over the past years. However, several disputes relate to previous studies starting from discrepancies related to definitional issues. On the other hand, the topic is very delicate and challenging to study. Contrary to the previous U.S. studies, the present study was based on the primary data gathered with a mailed questionnaire. This can be regarded as a merit, since the method applied provided much richer data on the phenomenon under investigation.

Some limitations relate to implications of the study. First, it should be considered that the study was based on the franchisors' perceptions on franchisee failure and turnover. Second, franchisee turnover and failures is a negative matter and some of the respondents had reserved or even critical opinions on this type of studies. Negative attitudes towards inquiries on the matter may have caused refusals to respond, leaving some of the questions unanswered or wittingly giving false information. Third, the sample of 32 respondents was small compared to the total number of franchisors (N=164) operating in Finland in 2002 and therefore, the obtained results cannot be generalized nationally. Nevertheless, the results can be considered as indicative. Moreover, it is worth noting that the investigated franchisors were organized which might have an effect on the results (cf. Code of Ethics). Fourth, the data was gathered with a postal survey and the questions were mainly structured. Qualitative research methods could be more useful with this type of delicate subject. Fifth, the results do not indicate what happened to franchisees after discontinuances of franchise relationship. How many continued their business as stand-alone business owner and how many ceased their entrepreneurial career. Therefore, it would be fruitful to collect data from ex-franchisees in order to explore their career paths.

The authors have a follow-up investigation on franchisees who have given up the franchise. The results of the forthcoming study will partly expand on the results presented here. Likewise, research on success and survival of franchisees' businesses compared to stand-alone businesses operating on the same business category is planned. Franchisee turnover and failures are important issues for follow-up, learning and development for the franchisors. The success of a franchise depends on the success of the interdependent parties, franchisor and franchisees.

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