CONFLICT INITIATION, RESOLUTION, AND OUTCOMES
IN FRANCHISE CHANNEL RELATIONSHIPS: THE ROLE OF REGULATION

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ABSTRACT

Franchise relationships are prone to conflict. So as to safeguard the rights of individual franchisees, several states have legislated greater franchisor disclosure (registration law) and/or franchisor “termination for good cause” (relationship law). The impact of regulatory oversight on franchisor-franchisee conflict, however, remains unclear. Relying on agency theory arguments, we first assess the impact of the regulatory context by itself and in combination with franchisors’ dual distribution structure on the incidence of litigated conflict. Conditional on litigation, we also predict the impact of franchise regulation on the incidence, nature, and outcomes of franchisor-franchisee conflict. We test our hypotheses using a unique multi-source, archival database of 411 instances of litigation for 75 franchise systems observed over 17 years. Parties’ litigation initiation and resolution choices are seen to be driven by regulatory constraints and their interaction with the dual distribution structure of the franchise system, and to result in a trade-off between prevailing in the particular conflict and achieving franchise system growth objectives.

Key Words: Franchise registration law, relationship law; conflict; dual distribution.
Franchising is a mainstay of the US economy, with more than 800,000 franchised outlets accounting for $1.2 trillion of US GDP (International Franchising Association, 2011). The typical “business format” franchise relationship calls for the franchisee to make a lump sum and ongoing payments to the franchisor, and to abide by the latter’s operational stipulations. In return, the franchisor provides ongoing support to all its franchisees, and monitors and enforces quality standards across members of the franchise system on a continuing basis (Shane 2005). Despite binding contracts, trademark infringement, termination of the relationship, or a myriad of other missteps by either party could cause conflict, “…a situation in which one channel member perceives another channel member to be engaged in behavior that is preventing or impeding him from achieving his goals” (Gaski 1984, p.11). In response, the aggrieved party may undertake behaviors designed to frustrate the goals of its channel partner (Pondy 1967). Left unresolved, such serious manifest conflict may lead to litigation.¹

In an attempt to reduce such costly dysfunctional conflict as well as safeguard the interests of individual franchisees, fifteen states now require franchisors to register with state regulators prior to offering franchise opportunities. The additional disclosure pursuant to such registration laws is designed to provide potential franchisees with detailed information on the franchisor’s background and operations (Shane 2005), as well as to provide an additional layer of regulatory oversight. Furthermore, twenty two states have enacted relationship laws that require franchisors to provide “good cause for termination” of their franchisees. Although long standing (both laws were first enacted in 1974), such regulation of franchising has always been

¹ Prior research on channel conflict recognizes the possibility of seeking the involvement of third parties, even while acknowledging that such a reliance “…signals the failure of parties’ ability to reach an acceptable solution by interpersonal means” (Dant and Schul 1992, p. 40). Consistent with this, we regard the incidence of litigation as indicative of serious manifest conflict between franchisor and franchisee.
controversial. Whereas supporters of regulation laud the transparency brought about by registration law and the “franchisee day in court” elicited by relationship law (Benoliel 2009), its detractors steadfastly oppose regulation, citing the high cost of compliance and the additional burden it imposes on the franchisor’s task of quality assurance (Brickley, Dark, and Weisbach 1991; Klein 1980).

The marketing discipline has remained for the most part on the sidelines of this ongoing debate, despite a rich tradition of scholarship on channel partner conflict spanning multiple decades (see, for example, Brown and Day 1981, Ganesan 1993, Hibbard, Kumar, and Stern 2001). Such reticence may be attributed to a number of causes. First, notwithstanding the acknowledgment that conflict is “…a dynamic process composed of a series of conflict episodes” (Brown and Day 1981, p. 263), prior empirical assessments – whether considering the drivers and relationship outcomes of conflict, dealers’ use of punitive actions against their suppliers, or the efficacy of market-oriented behaviors in deterring conflict – have relied overwhelmingly on participants’ self-reports of conflict with their channel partners. Although providing useful insights, such cross-sectional assessments cannot inform our understanding of unfolding conflict dynamics. As well, such “after the fact” reporting falls prey to several potential memory and self-serving biases.

Second, despite widespread agreement that either channel partner may fail to perform as agreed (Hibbard, Kumar, and Stern 2001), we are not aware of any prior marketing channels-related study of conflict that allows for such a possibility. Instead, prior research has exclusively adopted the perspective of a single party, usually the one with the greater power in the channel relationship. The question as to when either party may undertake further escalation of serious manifest conflict so as to safeguard its interests therefore remains unanswered.
A third significant gap in our understanding pertains to the outcomes associated with either party’s conflict management efforts – what Pondy (1967) refers to as the “conflict aftermath.” Most prior research in marketing has been undertaken with a view to understanding the drivers of conflict (Dant and Schul 1992; Lusch 1976). The few attempts to assess conflict management consequences have tended to focus on immediate and dyad-specific outcomes – satisfaction with the outcome (Ganesan 1993), or dealer performance and relationship quality assessments (Hibbard, Kumar, and Stern 2001). Such an emphasis on immediate, dyad-specific outcomes ignores the critical notion that “…[a]n organization’s success hinges to a great extent on its ability to set up and operate appropriate mechanisms for dealing with a variety of conflict phenomena” (Pondy 1967, pp.299, 300).

The central issue of whether the franchise regulatory context serves to reduce or increase the incidence of serious conflict between franchisors and their franchisee partners, and the implications of both parties’ conflict management efforts for dyadic and franchise system-wide outcomes remains unaddressed. What is needed is a rigorous longitudinal study of actual conflict episodes that is based on relatively objective accounts of their initiation, resolution, and corresponding outcomes.

The present study addresses just such a need. We regard litigation between franchise partners as representative of serious manifest conflict – behavior that frustrates the goals of the other partner (Pondy 1967). We examine both parties’ litigation initiation and resolution choices and the dyadic and systemic consequences attributable to these choices. Relying on agency theory (AT) information asymmetry arguments, we assess the impact of regulation – registration law and relation law – on the incidence of litigated conflict between franchisors and their franchisees. We hypothesize the impact of such regulation to vary significantly by (a) the level of
analysis – across the franchise system (regulated and non-regulated markets alike) or within the particular market where the conflict occurs, (b) the specific regulation considered – registration law or relationship law, and (c) the dual distribution structure of the channel system – the extent to which the franchisor relays simultaneously on company owned and franchised outlets. We collect multi-sourced archival data with respect to 411 instances of litigation for 75 franchise systems over a 17-year observation window. Conditional on litigation occurrence, we identify whether the franchisor or the franchisee would be more likely to initiate the litigation, predict the likelihood of the litigation being settled by alternate dispute resolution (ADR) rather than adjudication, and assess the dyadic and systemic outcomes attributable to the prior litigation initiation and resolution choices. In doing so, we make several important contributions to the marketing literature on conflict management and its associated outcomes.

First, findings from this study speak directly to the health of franchise relationships, and by extension, of franchising in general. No doubt, the regulatory environment shapes most if not all businesses (Grewal and Dharwadkar 2002). As is evident from “dealer day in court” and the ever-increasing scrutiny of franchisors’ operating procedures (Brickley, Dark, and Weisbach 1991), this is particularly true in the case of franchising. In assessing how variations in regulatory practice shape franchisors’ and franchisees’ litigation-related decisions and their attendant outcomes, the present study speaks to the efficacy of franchise regulation. We are thus able to provide insights as to the interplay between environmental and structural determinants of serious manifest conflict incidence and its management (Dant and Schul 1992).

Second, we assess not only the dyadic, more immediate consequences pursuant to channel partners’ conflict management choices but also the systemic, longer term outcomes attendant to such choices. No doubt, firms’ litigation initiation and resolution choices are at least
partially informed by their expectations of prevailing in the conflict at hand. When considering the appropriate response to perceived goal impediment, channel members must undoubtedly appreciate the consequences of such a response with regard to the focal issue. A single minded focus on prevailing in the immediate issue at hand, however, could prove counter-productive to longer term aspirations involving the wider channel system. The present study underscores the latter trade-off and promotes a nuanced understanding of the intricacies of conflict management.

Third, analyses based on “snapshots” of the phenomenon are unable to speak to the evolving dynamics inherent in each party’s response and counter-response during the course of a conflict. Our examination of actual litigation choices and outcomes gleaned from franchise disclosure documents, public court records, and multiple franchise industry-specific trade publications minimizes the well-known survey data-related concerns and provides rich insights into the evolving dynamics of serious conflict and its attendant outcomes.

In the sections that follow, we first provide an overview of franchising as an agency relationship and how serious conflict might arise and be resolved. The anticipated role of registration law and relationship law in mitigating agency problems is then discussed. We then propose hypotheses linking each law, in isolation as well as in combination with the dual distribution structure of the franchise system, to the (dis)incentives they elicit with respect to conflict and its resolution, and the outcomes attributable. This is followed by a description of our empirical context, data collection and analysis methods. We conclude with the managerial and theoretical implications of our study.

**FRANCHISING AS AN AGENCY RELATIONSHIP**

The franchise system comprises the franchisor (principal) and the franchisees (agents) it selects, trains, and supports to represent the franchise brand across different, often far-flung
In making franchisees residual claimants of profits, the franchise arrangement is meant to ensure their best efforts on behalf of the franchisor’s brand. However, the potential for *two-sided moral hazard* (Lafontaine 1992), whereby incentives exist for both the agent as well as the principal to renege on their performance obligations before and/or during the course of the relationship, has been long acknowledged (Rubin 1978). This two-sided moral hazard is a direct result of information asymmetry between the franchisor and its franchisees (Bergen, Dutta, and Walker 1992). Franchisors are unable to fully verify whether their franchisees are undertaking their best efforts on behalf of the brand (Brickley and Dark 1987), thereby resulting in a higher potential for *franchisee moral hazard*. In turn, *franchisor moral hazard* is also a very real possibility, as franchisors may misrepresent themselves (their abilities, resources, and prior success) to potential franchisees, and/or their intentions to continue the relationship (Hunt 1973; Rubin 1978). Whereas the former results in franchisees being misled or lacking critical information with respect to their franchisors’ ability and motivation to perform, the latter leaves the franchisee vulnerable to an unanticipated dissolution of the franchise relationship at the franchisor’s whim.

The lack of complete information on both sides of the dyad results in a significantly higher likelihood of conflict. Figure 1 presents a stylized example of a serious conflict episode. Within the present context, conflict is said to occur when the franchisor or the franchisee perceives its partner to indulge in acts impeding the achievement of its own goals (Etgar 1979). In response, the aggrieved party is likely to bring its grievance to the attention of the offending party, the start of manifest conflict (Felstiner, Abel, and Sarat 1980). Such a claim seeking redress, if denied or contested in whole or part by the offending party, is said to constitute a dispute (Galanter 1983). In the face of the offending party’s intransigence, the aggrieved party
must now decide whether to further press its claims or withdraw (Etgar 1979). Once the decision to undertake legal proceedings against the offending party is initiated, the litigating parties must also decide whether to seek resolution by adjudication (ie, a court order by a judge) or by agreeing to alternative dispute resolution (ADR) methods - arbitration, mediation, and/or negotiation (Goldberg, Sander, and Rogers 1999). The common thread underlying the latter dispute resolution alternatives is compromise, rather than the single-minded pursuit of “victory”.

So as to minimize franchisee moral hazard, franchisors design and offer fairly complete and one-sided contracts (Kashyap, Antia, and Frazier 2012), specifying their franchisees’ obligations prior to, during, and after the relationship. While safeguarding the franchisor’s interests well, such contracts remain fairly vague about the latter’s performance obligations. Moreover, there is little room for negotiating the terms of such contracts (Shane 2005). Franchisees may “take it or leave it”, and must rely only on the franchisor’s concern for its reputation to serve as its bond (Klein 1980).

*Franchise Registration Law and Relationship Law*

As a response to the potential for franchisor moral hazard, the Federal Trade Commission (FTC) requires all franchisors to provide prospective franchisees with information about themselves at least ten days before any franchise agreement is signed (Shane 2005). In addition, individual states have adopted statutes regulating the franchise relationship to varying degree, resulting in a patchwork of regulatory constraints that vary significantly by state. Two legal statutes of importance to franchising are registration law and relationship law requirements.

*Registration law* comprises the body of regulations specifying the information franchisors must disclose to potential franchisees prior to the induction of the latter into the franchise system. Such information includes, but is not limited to, prior bankruptcies and litigation (if any),
stipulations with respect to initiation, maintenance, and termination of the franchise relationship, post-termination non-compete clauses, exclusive territories, as well as the number of franchisees assigned, transferred, and terminated over the prior three years. Currently, fifteen states have a registration law requirement: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin.

Franchisors in registration law states are required to file franchise disclosure documents (FDD, formerly known as uniform franchise offering circulars or UFOC) with the state’s regulatory authorities before they may begin to sell franchises in the state. Any “material changes” to the contract terms require the franchisor to file an updated FDD. In imposing full disclosure requirements on franchisors, registration law is designed to nullify or at least reduce the information asymmetry-related advantage franchisors might have relative to their franchisees. Also known as disclosure statutes, registration law is primarily concerned with making as much information about franchisors’ operations available to prospective franchisees prior to the latter’s induction into the franchise system (Murphy 2006). Franchisor moral hazard is sought to be minimized by reducing the information asymmetry favoring the franchisor.

Relationship law comprises the body of regulations requiring franchisors to provide “good cause for termination” of their franchisees. A second relevant regulatory constraint pertains to the existence of relationship law statutes – laws passed to restrict the power of franchisors over franchise terminations, renewals, transfers, and certain other aspects of the franchise relationship (Grueneberg 2008). Also known as “termination law”, relationship law represents a bid to preclude the capricious termination of franchisees by their more powerful franchisor partners by requiring the latter to have “good cause” – usually interpreted as the
franchisee’s failure to comply with the franchise agreement – for termination (Shane 2005).

Twenty two states have promulgated relationship law requirements: Arkansas, California, Connecticut, Delaware, Florida, Hawaii, Illinois, Indiana, Iowa, Kentucky, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, North Dakota, South Dakota, Virginia, Washington, and Wisconsin. The rationale underlying relationship law is franchisee empowerment via relationship continuity. Franchisor moral hazard is sought to be minimized by raising the cost of relationship termination.

The requirements of full disclosure and “good cause” termination are designed, of course, to safeguard the interests of franchisees within the state where the particular regulation is in effect. It is worth noting, however, that such regulation has the potential to significantly impact system-wide franchise operations, including those in states not subject to franchise regulation. Consider, for example, registration law requirements. So as to comply with each registration state’s disclosure requirements in as cost-efficient a manner as possible, as well as limit their liability against allegations of discriminatory treatment of franchisee partners across the franchise system, state-specific disclosure requirements are more likely than not to be implemented across all markets the franchisor operates in. A similar spillover effect is likely to obtain for relationship law as well. Consistent with the purpose of promulgating relationship law, franchisees in relationship law states are likely empowered. Such empowerment is unlikely to stay contained within relationship law states alone. Thanks to franchisee associations and other such interactions among franchisees system-wide, once termination for “good cause” is in effect in some (regulated) markets, it is more likely to be in effect system-wide.

The implications of such system-wide “contagion” of franchise practices are profound (McFarland, Bloodgood, and Payan 2008). When assessing the impact of regulation, it becomes
necessary to distinguish between system-wide consequences across regulated and non-regulated states alike and localized outcomes that remain pertinent to the specific regulatory regime. The question of whether registration law and relationship law engender or discourage serious conflict between franchisors and their franchisees is an example of the former system-wide concern; their direct impact on both parties’ litigation initiation and resolution choices as they occur within specific regulatory regimes calls for a distinct level of analysis. In what follows, we hypothesize both system-wide and regulatory context-specific effects of franchise regulation.

**RESEARCH HYPOTHESES**

*The Role of Registration Law and Relationship Law*

Registration law provides for additional scrutiny of the information that franchisors provide to franchisees, including a full record of their litigation history over the previous decade. In addition, the filing requirement ensures additional oversight by state authorities of franchisors. Several states require franchisors deemed under-capitalized to set aside enough funds in escrow to meet their financial commitments to their franchisees; yet others require the franchisor to obtain regulatory approval of all advertising material used to attract franchisees, and to disclose any “material change” with respect to fees charged, mutual obligations, the operating system, the legal structure, or financial information (Shane 2005).

With each additional registration law state the franchisor operates in, the greater the franchisor’s scope of disclosure, and the greater the regulatory oversight of its operations (Murphy 2006). So as to reduce the cost of compliance and protect against allegations of discriminatory treatment, such disclosure by the franchisor is likely to persist even in markets that are not subject to registration law. The resulting higher system-wide disclosure of the
franchisor’s operations affords less leeway for franchisor moral hazard (Blair and Lafontaine 2010). As well, the potential for misunderstandings or miscommunication between franchisors and their franchisees is also reduced (Kashyap, Antia, and Frazier 2012). The end result of such disclosure is a likely reduction in manifest conflict and therefore litigation system-wide.

**H₁:** The greater the number of registration law states the franchisor operates in, the lower the incidence of litigation across the franchise system.

Notwithstanding the system-wide reduction in misunderstandings and the potential for franchisor moral hazard brought about by information disclosure, the impact of regulation law is likely to be markedly different within the regulatory regimes that adopt it. In registration law states, our expectation is that increased information disclosure likely reduces the franchisor’s cost of litigation, and increases its probability of success. The logic for such an effect rests on the reduction in uncertainty brought about by franchise disclosure requirements (Shane 2005).

The more complete the information regarding each contracting party’s rights and obligations, the greater the ability of the franchisor to determine franchisee non-compliance with the explicitly specified obligations (Mooi and Ghosh 2009). The act of explicitly specifying performance standards provides a more objective benchmark of performance against which franchisee efforts may be evaluated and franchisee non-compliance with explicitly stated obligations may also be verified more easily by relevant third parties (i.e., courts) (Drahozal and Hylton 2003). The relative ease of establishing its claims in court likely prompts the franchisor to adopt a less conciliatory stance – reflected in an increased likelihood of the franchisor initiating litigation, and a decreased likelihood of settling for anything less than its full claim.

**H₂:** In registration law states, litigation is (a) more likely to be initiated by the franchisor, and (b) less likely to be settled by ADR.
Relationship law regimes circumscribe franchisors’ ability to terminate franchisees for “good cause” only (Benoliel 2009). Although the motivation for this statute is in ensuring continuity of the relationship and protecting franchisees from termination at the franchisors’ whims, it also has two potential unanticipated attendant outcomes. First, empowered by the relationship law regime, franchisees in relationship law states are likely to be more cognizant of their legal rights. No longer threatened by the impending likelihood of termination at will, franchisees are also likely to be more willing to press suits against their franchisor principal in the event of perceived transgressions by the latter.

A second more insidious possible consequence is that the credible threat of franchisor termination of the relationship is weakened. Termination for “good cause” raises the cost of terminating franchisees and makes the franchisor’s task of quality assurance more difficult (Brickley, Dark, and Weisbach 1991). Aware of the increased cost of termination, franchisees are more likely to indulge in shirking, in turn forcing the franchisor to undertake corrective action (Antia and Frazier 2001). The outcome from such interactions is likely to be heightened conflict and an increase in the incidence of litigation system-wide, in regulated and non-regulated markets alike.²

H₃: The greater the number of relationship law states the franchisor operates in, the higher the incidence of litigation across the franchise system.

The much sought after outcome of “franchisee day in court” finds particular expression in relationship law states. Aware of the higher cost of termination imposed by “good cause” statutes in these states, franchisees could grow more emboldened (Benoliel 2009). The natural outcome

² It is worth noting that although both franchisee empowerment as well as their potential shirking would result in a higher likelihood of litigated conflict, the former is more likely to result in franchisees initiating litigation to safeguard their rights. In the latter case, the initiator of the litigation is more likely to be the franchisor seeking compliance with operational stipulations. Our data and analysis enable us to draw this critical distinction.
of such empowerment is an increased willingness to initiate litigation against the franchisor; once initiating litigation, franchisees are also more likely to take a more aggressive stance with respect to their subsequent litigation resolution choices. The outcome is a higher propensity to opt for adjudication in what they perceive to be franchisee-friendly courts, rather than settle for ADR.

**H₄:** In relationship law states, litigation is (a) more likely to be initiated by the franchisee, and (b) less likely to be settled by ADR.

*The Moderating Role of Dual Distribution*

Franchisors’ reliance on dual distribution reflects the simultaneous use of independently owned (franchised) units and vertically integrated (company-owned) units (see, for example, Dutta, Bergen, Heide, and John 1995). Also known as “hybrid channels” or “plural forms”, such an approach represents an intermediate mode of governance that attempts to leverage the strengths of each approach – market and hierarchy – while minimizing its weaknesses. Franchisors’ reliance on dual distribution brings with it processes and outcomes attendant to both market and hierarchy (Srinivasan 2006); each of these attendant characteristics is hypothesized to temper the earlier discussed main effects of regulation on franchisor-franchisee conflict.

Dual distribution implies the direct participation by the franchisor via company-owned units. The presence of company-owned outlets in the local market goes a long way toward reducing the information asymmetry between the franchisor and their franchisees with respect to local market conditions (Dutta *et al* 1995). The company-owned outlets provide important intelligence to the franchisor on local market conditions (Srinivasan 2006). The increased verification ability, when combined with clearer and more highly specified contractual obligations that are a direct outcome of registration law, enables the franchisor to enforce
contractual obligations (Mooi and Ghosh 2009). We would therefore expect a significant weakening of the negative association between the franchisor’s presence in multiple registration law states and the incidence of litigation.

The reduction in information asymmetry regarding local market conditions, brought about by company-owned outlets also serves to significantly temper the positive association between relationship law deployment and system-wide litigation. Cognizant of the intelligence-gathering role played by company-owned outlets and the increased performance verification ability conferred on the franchisor by such outlets, local franchisees are less likely to shirk. The perceived benefits of shirking are likely to be reduced significantly by the franchisees’ consideration of their franchisor’s improved detection ability and the higher likelihood of compliance-inducing enforcement (Antia, and Frazier 2001). Should such shirking nevertheless occur, well-informed franchisors are also more able to document franchisee transgressions. The “good cause for termination” requirement of relationship law is more likely to be demonstrably met, thanks to improved intelligence-gathering by the franchisor in the local market (Dutta et al 1995). We therefore expect a downward tempering of the positive association between operating in relationship law states and the incidence of litigation.

**H5:** Franchisors’ reliance on dual distribution weakens the negative (positive) association between registration (relationship) law and litigation incidence across the system.

Legal scholars have long acknowledged the significant role played by experience with litigation – the skill gained from participating in prior instances of litigation – in determining parties’ conflict management choices (Galanter 1983; Priest and Klein 1984). Of the two parties involved, the franchisor is likely to have greater experience with litigation relative to the franchisee. This greater experience brings with it an increased appreciation of the relative costs
and benefits of adjudication and ADR (Sitkin and Bies 1994). Mindful of these and the imperative to avoid a conflict spiral (Kumar, Scheer, and Steenkamp 1998), franchisors initiating litigation will also likely be more willing to stand down (Leng 2004). Franchisors’ greater experience with litigated conflict confers on them a strategic viewpoint, rather than the overriding aim of obstructing their partners’ goals (Hibbard, Kumar, and Stern 2001). The result is an increased willingness to adopt a conciliatory position.

H₆: The likelihood of conflict resolution by ADR is increased when franchisors initiate litigation.

As discussed earlier, regulation regimes (registration law or relationship law) are likely to lead to a greater propensity for aggression and a correspondingly lower likelihood of conflict resolution by ADR. Whereas relationship law empowers franchisees to not back down (Murphy 2006), registration law facilitates franchisors’ performance verification efforts (e.g., Mooi and Ghosh 2009). In addition to the preceding main effect of regulation on ADR, we also expect a tempering downward of the positive association between franchisors’ litigation initiation and the likelihood of ADR. The additional disclosure attendant to registration law and the higher level of verifiability brought about by such disclosure is likely to persuade the franchisor to seek adjudication rather than settle for the compromise inherent to ADR. In contrast, in relationship law states, franchisees likely higher aggressive tendencies make conflict resolution by ADR less likely. Since ADR must be agreed to by both parties to the conflict, an unwillingness to settle on the part of either the franchisor or the franchisee will scuttle any ADR efforts.

H₇: Registration (relationship) law weakens the positive association between franchisors’ litigation initiation and the likelihood of resolution by ADR.

Dyadic (Immediate) versus Systemic (Longer Term) Outcomes
Given that both parties’ litigation initiation and resolution choices are made with a view to pressing their unresolved claims, it is worth considering whether the initiator of the litigation achieves what it set out to in the conflict at hand. The probability of prevailing in the focal conflict is a dyadic outcome of immediate relevance to both litigants.

When considering the likelihood of the party initiating the litigation prevailing in the conflict at hand, it is worth recalling that franchisors’ relatively greater experience with litigation enable them to consider the decisions to initiate and resolve litigated conflict as carefully thought through strategic choice variables (Priest and Klein 1984). Rational parties are apt to steer away from efforts likely to be unsuccessful (ibid.). Accordingly, the franchisor’s very acts of litigation initiation are undertaken with expectations of prevailing in the conflict. In contrast to the careful selection by the franchisor of issues worth litigating (Bebchuk 1984), franchisees are likely to be less strategic in their conflict management. Their relative lack of litigation experience manifests itself in “picking fights” for the wrong reasons, and conducting litigation in a less effective manner (Galanter 1983). We would therefore expect franchisors initiating litigation to achieve greater levels of success in the immediate conflict, relative to their less experienced franchisee partners.

Regardless of who initiates the litigation, however, resolution by ADR significantly reduces the probability of either disputant achieving all its claims. By its very nature, ADR involves compromise (Goldberg, Sander, and Rogers 1999). To the extent that the litigants attempt to resolve the focal conflict in a conciliatory manner, it signals their resolve to “work things out” rather than win at all costs (Macaulay 1963). The give and take that characterizes compromise (Goldberg, Sander, and Rogers 1999) significantly reduces the probability of either disputant achieving all its claims.
H₈ₐ: Franchisors (franchisees) initiating litigation are more (less) likely to prevail in the focal conflict.
H₈₉: ADR is less likely to result in the either party prevailing in the focal conflict.

Prevailing in the immediate conflict, while important, is by no means the only outcome of interest to the franchisor. Firms are also keenly aware of the need to manage their reputation as reliable partners (Macaulay 1963), and frequent recourse to litigation will likely lead to negative perceptions among current and potential partners (Macaulay 1963).³ It is very possible for the litigious franchisor to “win the battle, but lose the war,” i.e., prevail in the conflict at hand, yet damage its reputation and consequent ability to retain existing franchisee partners (Macaulay 1963), or attract potential franchisees as needed (Justis and Judd 2002). It is this very trade-off between achieving dyadic, immediate goals and compromising systemic, more long-term outcomes pursuant to conflict management that we hypothesize.

As the incidence of franchisor-initiated litigation increases, the relationships between the franchisor and its existing franchisees become ever more fractious (Galanter 1983), in turn leading to increased rates of relationship dissolution. Moreover, the franchisor gains a well-deserved reputation for litigiousness (Macaulay 1963), thus driving away potential franchisees who might otherwise have joined the system. The twin challenges of retaining existing franchisees and attracting new ones translates to unmet growth objectives. The spillover from the dyadic, immediate conflict to the systemic, more long-term franchisor aspirations is expected to be significant and negative.

In marked contrast to the ill effects of a reputation for litigiousness, adopting a conciliatory position sends a signal that the franchisor is willing to negotiate. Existing

³ Although this holds true for franchisor and franchisee alike, the onus of franchise system growth rests on the franchisor. In what follows, therefore, we consider solely the franchisor’s perspective.
franchisees become aware of, and appreciate, the franchisor’s willingness to seek a compromise rather than prevail at the expense of its franchisee partner. Likewise, potential franchisees are likely to take note of the franchisor’s propensity for ADR, and be more willing to become members of the franchise system. This should translate to an increased franchisor ability to achieve its system growth objectives.

H$_{9a}$: Franchisors initiating litigation are less likely to achieve system growth goals.
H$_{9b}$: Reliance on ADR results in greater franchisor achievement of system growth goals.

RESEARCH METHOD

Data Collection and Unit of Analysis

Although FDD are available in the public domain on a scattered basis, our longitudinal examination of litigated conflict required us to obtain multiple FDD for each franchise firm in our sample. Since each FDD provides relevant information for a three-year window, we obtained the FDD filed in the years 1997, 2000, and 2003 by a randomly selected sample of 75 franchisors offering business format franchise opportunities so as to afford ourselves an uninterrupted window of observation per firm for the nine-year period 1995 through 2003. The requirement of disclosure of litigation over the prior 10 years enabled us to gain information on litigated conflicts involving our sample of franchisors for an even longer period, from 1987 to 2003. For each instance of reported litigation, the FDD identifies whether the franchisor was the plaintiff (the party bringing the claim to court) or the defendant (the party being sued), as well as information on the date of litigation initiation, the jurisdiction, the means of resolution - adjudication versus ADR, and the terms of the judgment or settlement. We verified the details reported and filled in missing information by referring to case docket information available on
In addition to these two sources, we relied on Bond’s Annual Franchise Listings and Entrepreneur magazine’s Franchise 500 (we used the latter as a convergent validity check, and as a supplemental source of information when it was missing from Bond’s) to acquire information on the location of headquarters, franchising history, royalty rates, etc. for each of the franchisors in our sample. Finally, we obtained information on economic and regulatory conditions from web sources (http://www.bea.gov). Table 1 provides information on the data source(s) for each variable in our study.

Our unit of analysis is the individual instance of litigated conflict. Our examination of the FDD and PACER yielded information on 526 instances of litigation across the 75 franchise firms in our sample. After removing 89 cases not involving franchisor-franchisee conflict and 26 cases with excessive missing information, we retain 411 litigated instances of conflict.

Measures

Regulatory Environment and Litigation Incidence. For each of the 75 franchisors in our sample, we created a measure REGISNUM\(_{it}\) (RELNUM\(_{it}\)) representing the count of the number of registration (relationship) law states that the franchisor \(i\) was operating in, in year \(t\). Furthermore, for each litigated conflict \(j\) contested by franchisor \(i\) in our sample, we code whether the particular jurisdiction was a Registration Law (REGIS\(_{ij}\)) and/or Relationship Law (REL\(_{ij}\)) state. REGIS\(_{ij}\) was assigned a code of 1 if the conflict was litigated in a registration law state, and zero otherwise. We adopted a similar coding scheme for REL\(_{ij}\). For each of the franchise systems in

\(^4\) Public Access to Court Electronic Records (PACER) is an electronic public access service that allows registered users to obtain case and docket information from federal appellate, district and bankruptcy courts, and the PACER Case Locator via the Internet. PACER is provided by the federal judiciary in keeping with its commitment to providing public access to court information via a centralized service.
our sample, the variable $INCID_{it}$ took the value 1 if litigation was reported for franchise system $i$ in year $t$; else, $INCID_{it} = 0$.

**Franchisor’s Dual Distribution Structure.** We considered two different aspects of franchise system structure. $DUAL_{it}$ reflects the extent to which franchisor relies on a dual distribution strategy. Based on Srinivasan (2006), we operationalize $DUAL_{it}$ as the number of franchisee-operated units standardized by the total number of operating units for franchisor $i$ in year $t$.

**Litigation Initiation and Resolution.** Our interest focuses on both parties’ litigated conflict management efforts – initiation as well as resolution. We operationalize the franchisor’s decision to initiate litigation with the dichotomous variable $FRINIT$ which takes the value of 1 if the franchisor initiates litigation, and 0 otherwise. Given the dichotomous operationalization, $FRINIT=0$ reflects initiation by the franchisee. Although either party may initiate litigation, the choice of resolving the litigation by alternate conflict resolution (ADR) procedures – arbitration, mediation, or negotiation must be agreed to by both litigants (Golberger, Sander, and Rogers 1999). We therefore operationalize resolution choice as a binary variable $ADR$, taking the value 1 when the litigated conflict, whether franchisor or franchisee initiated, is resolved by ADR, and 0 otherwise.

**Litigation Outcomes.** We measure outcome favorability with the variable $OUTCOME_{ij}$, coded as 1 if the outcome favored the franchisor, and as 0 otherwise. Two independent coders examined and coded the preceding three measures and the reasons underlying the conflict for each of the 411 reported conflicts, with inter-coder agreement of 95%. The few instances of coding disagreement were resolved by discussion. The franchisors’ achievement of system expansion goals was measured on an annual basis for each year in our sample. For each year, we
first calculated the number of new franchise outlets, $\Delta FRANUNITS_t$, as the difference between the number of franchise outlets reported in the current year and the year before ($FRANUNITS_t - FRANUNITS_{t-1}$). This difference was then standardized by the number of new outlets each franchisor planned on opening the next year ($PROJUNITS_{t-1}$), reported in year $t-1$, so as to assess the extent to which each franchisor’s expansion goals stated in year $t-1$ were met in year $t$. We then undertook a natural logarithmic transformation of the preceding variable after adding a constant $c$ so as to avoid negative values, resulting in the measure $EXPAN = \ln\left(\frac{\Delta FRANUNITS_t}{PROJUNITS_{t-1}} + c\right)$.

**Control Variables.** In addition to the preceding hypothesized predictors, we also control for the potential impact of several other factors on both parties’ litigation initiation and resolution decisions. Franchisees making significant investments ($TOTINV$) are more likely to safeguard these investments, if necessary by litigation. In times of plenty, the franchise relationship is less likely to experience stresses, and parties are more likely to adopt a cooperative stance. We therefore control for the GDP growth rate ($GDP$) and its likely negative (positive) impact on litigation initiation ($ADR$). Prior research suggests the royalty rate ($ROYAL$) to be an important determinant of franchisor behavior (Lafontaine 1992); we therefore control for royalty rate as well. Franchisors that have had more franchising experience, as reflected by the years elapsed since they began franchising ($DUR$), are also more (less) likely to initiate litigation (choose $ADR$).

Furthermore, prior litigation success ($FRWIN$) is hypothesized to play a critical role in determining its conflict management approach. To the extent that the franchisor has been able to prevail in prior conflicts, its expectation of obtaining a favorable outcome pursuant to conflict escalation is correspondingly higher. We reflect this expectation by computing the cumulative
numbers of conflicts in which the franchisor has prevailed, standardized by the total instances of litigation involving the franchisor, up to but not including the current case. Finally, the dissolution of a relationship (RELDISS), whether at the behest of the franchisor or the franchisee, likely reduces any tendency for forbearance (Heide and Miner 1992). We account for this possibility with a dichotomous variable that takes the value 1 if either party terminates the relationship prior to litigation ensuing.

We also controlled for FRUNITSiₜ, the natural log-transformed number of franchisee-owned units of franchise i in year t. As well, the incidence of moral hazard by both parties was also included. For franchisee moral hazard, we coded the binary variable UNPAID as 1 if dues remaining unpaid by the franchisee were the reported reason for the conflict (UNPAID=0 otherwise); we coded the variable TRADEMK as 1 if the reason reported for the conflict was trademark misappropriation by the franchisee (TRADEMK=0 otherwise). We then computed the index FEMHᵢⱼ as the sum of UNPAID and TRADEMK. Similarly, we coded INFO (BREACH) as 1 if information disclosure (breach of contract) was the cited reason for the litigation, and 0 otherwise. The index FRMHᵢⱼ was then computed as the sum of INFO and BREACH, and reflects franchisor moral hazard. Table 2 provides the descriptive statistics and correlation matrix for all variables included in the study.

**Model Specification**

The incidence of litigation is by no means a random occurrence. Rather, parties “select” litigation as a means to achieve an end. It is therefore necessary to account for the “selection” of litigation with a first-stage Heckman selection model (Heckman 1979). Conditioning on litigation incidence, we must then account for four additional characteristics of our data. First, we have a mix of binary (FRINIT, ADR, and OUTCOME) and continuous (EXPAN) dependent
variables. Second, the litigation initiation and resolution decisions and their corresponding dyadic and system-wide outcomes are likely related, requiring the specification of a correlated error structure among the four outcomes of interest to us (Greene 2003). Third, assessing the impact of litigation initiation and resolution choices on outcome favorability and the franchisor’s achievement of its expansion goals requires recognition of the endogeneity of the former regressors. Finally, we must also account for the clustering of individual observations (litigated conflicts) within franchise systems (Hsiao 2003).

The first stage sample selection model (see Equation 1) includes the 437 cases of franchisor-franchisee litigation observed for the 75 firms in our sample, each observed over 17 years. Conditioning on litigation incidence not only allows us to account for litigation selection, but also enables us to estimate the probability that either party may initiate litigation; whereas \( p \) represents the probability of the franchisor initiating litigation against a franchisee, \((1-p)\) denotes the likelihood of the franchisee initiating litigation against the franchisor.\(^5\) We have 411 conflicts reported by 61 of the 75 franchisors in our sample (see Equations 2-5). We therefore specify the following recursive system of five equations:

\[
\begin{align*}
\text{INCID}_{it} &= \beta_{10} + \beta_{11}\text{REGISNUM}_{it} + \beta_{12}\text{RENUM}_{it} + \beta_{13}\text{DUAL}_{it} + \\
&\quad \beta_{14}\text{DUAL}_{it}^{*}\text{REGISNUM}_{it} + \beta_{15}\text{DUAL}_{it}^{*}\text{RENUM}_{it} + \sum_{16}^{17} \beta \text{ Controls} + \omega_{1i} \tag{1} \\
\text{FRINIT}_{ij} &= \beta_{20} + \beta_{21}\text{REGIS}_{ij} + \beta_{22}\text{REL}_{ij} + \beta_{23}\text{DUAL}_{ij} + \sum_{24}^{212} \beta \text{ Controls} + \omega_{2i} \tag{2} \\
\text{ADR}_{ij} &= \beta_{30} + \beta_{31}\text{REGIS}_{ij} + \beta_{32}\text{REL}_{ij} + \beta_{33}\text{DUAL}_{ij} + \beta_{34}\text{FRINIT}_{ij} + \\
&\quad \beta_{35}\text{FRINIT}_{ij}^{*}\text{REGIS}_{ij} + \beta_{36}\text{FRINIT}_{ij}^{*}\text{REL}_{ij} + \sum_{37}^{313} \beta \text{ Controls} + \omega_{3i} \tag{3} \\
\text{OUTCOME}_{ij} &= \beta_{40} + \beta_{41}\text{FRINIT}_{ij} + \beta_{42}\text{ADR}_{ij} + \omega_{4i} \tag{4} \\
\text{EXPAN}_{ij} &= \beta_{50} + \beta_{51}\text{FRINIT}_{ij} + \beta_{52}\text{ADR}_{ij} + \omega_{5i} \tag{5}
\end{align*}
\]

\(^5\) Had we not specified the first stage Heckman selection model in Eq(1), \((1-p)\) would confound the odds of the franchisee initiating litigation with those of observing litigation for franchise system \(i\) in year \(t\). The latter is now explicitly and separately accounted for in Eq(1). It is this feature of our model that enables us to account for two-sided moral hazard.
where

- \( \text{INCID}_{it} \) = the incidence of litigation for franchisor \( i \) in year \( t \),
- \( \text{REGISNUM}_{it} \) = count of the registration law states the franchisor \( i \) is operating in, in year \( t \),
- \( \text{RELNUM}_{it} \) = count of the relationship law states the franchisor \( i \) is operating in, in year \( t \),
- \( \text{FRINIT}_{ij} \) = franchisor \( i \) initiating litigation in conflict \( j \),
- \( \text{ADR}_{ij} \) = conflict \( j \) involving franchisor \( i \) settled by ADR,
- \( \text{REGIS}_{ij} \) = conflict \( j \) involving franchisor \( i \) in registration law state,
- \( \text{REL}_{ij} \) = conflict \( j \) involving franchisor \( i \) in relation law state,
- \( \text{DUAL}_{it} \) = extent of dual distribution by franchisor \( i \) in year \( t \),
- \( \text{OUTCOME}_{ij} \) = outcome of conflict \( j \) in favor of franchisor \( i \),
- \( \text{EXPAN}_{ij} \) = extent of desired expansion achieved by franchisor \( i \) in the year following conflict \( j \),
- \( \text{Controls} \) = the vector of coefficients corresponding to ROYAL, TOTINV, GDP, DUR, RELDISS, FRWIN, FRUNITS\(_{it} \), FEMH\(_{ij} \), and FRMH\(_{ij} \) respectively,

and the variance-covariance matrix \( \Omega \sim \text{MVN}(\mu, \sigma^2) \).  

We jointly estimate the preceding system of equations (including the selection model) using Roodman’s conditional mixed process (CMP) regression procedure (Roodman 2009). CMP enables a simultaneous estimation of all five equations, and uses a simulated maximum likelihood algorithm (Geweke 1989; Hajivassiliou and McFadden 1998; Keane 1994) to directly estimate the cumulative higher-order likelihood function (for a similar approach and additional details on the method, see Kashyap, Antia, and Frazier 2012) using a seemingly unrelated regression (SUR) estimator.

\textbf{Results} 

Table 3 displays the CMP regression estimates. The results provide considerable support for our hypotheses. The significant Wald chi-square statistic of 135.3 \((p < .001)\) demonstrates that across the system of equations estimated, the predictors do have satisfactory explanatory power. The positive and significant coefficient for \( \rho_{12} \), the error correlation coefficient for the first-stage selection equation and Equation (2), may be interpreted as the selection effect.
that is accounted for by our model specification. With respect to litigation incidence, we find consistent with \( H_1 \) and \( H_3 \), that the greater the number of registration (relationship) law states the franchisor competes in, the lesser (greater) the incidence of litigation \( (b_{11} = -.31, b_{12} = .40, \text{both } p < .01). \) These strong main effects of the regulatory context on the franchise system-wide incidence of litigation are, however, significantly weakened by the dual distribution structure of the franchisor. Specifically, the reliance by franchisors on dual distribution is associated with a significant uptick in litigation incidence, notwithstanding the number of registration law states they compete in \( (b_{14} = .44, p < .01). \) A similar significant weakening of the positive main effect of relationship law on litigation incidence is also in evidence \( (b_{15} = -.50, p < .01). \) Together, these results provide strong support for hypothesis \( H_5 \).

Conditional on the observance of litigation, we also observe further effects of the regulatory context on franchisors’ and franchisees’ litigation initiation and resolution choices. Consistent with \( H_2 \), in registration law regimes, franchisors are not only more likely to initiate litigation \( (b_{21} = .44, p < .01), \) but also are less likely to rely on ADR for conflict resolution \( (b_{31} = -.72, p < .001) \). \( H_4 \) is partially supported, as relationship law states do elicit higher odds of franchisees initiating litigation \( (b_{22} = -.58, p < .01), \) but have no significant impact on their resolution choices \( (b_{32} = .30, \text{n.s.).} \) Furthermore, as hypothesized in \( H_6 \), franchisors initiating litigation do tend to resolve conflict with their franchisee partners by ADR \( (b_{34} = .65, p < .01). \) We find mixed support for \( H_7; \) whereas registration law does not appear to moderate the franchisor’s tendency for compromise when initiating litigation \( (b_{35} = .30, \text{n.s.),} \) relationship law does temper downward the likelihood of conflict resolution by ADR \( (b_{36} = -.51, p < .05). \)

We find strong support for hypotheses \( H_8 \), relating each party’s decision to initiate litigation \( (b_{41} = 1.01, p < .001) \) and rely on ADR \( (b_{42} = -1.05, p < .001) \) to their odds of
prevailing in the focal conflict. Consistent with H$_{9a}$, franchisor litigiousness is associated with lower levels of expansion goals achieved ($b_{51} = -.24$, $p < .001$). Reliance on ADR, however, does result in increased achievement of system expansion goals ($b_{52} = .44$, $p < .001$). This provides evidence in support of hypothesis H$_{9b}$.

Turning to the control variables, we find higher levels of franchisee investment (GDP growth rates) to be associated with greater (lesser) odds of litigation incidence ($b_{16} = .18$, $b_{17} = -.14$, both $p < .01$). GDP growth rates, royalty rate, and franchising experience have no significant impact on parties’ litigation initiation or resolution choices ($b_{24} = .13$, $b_{25} = -.03$, $b_{37} = .04$, $b_{38} = -.01$, $b_{210} = .49$, $b_{310} = -.27$, all n.s.). Whereas relationship dissolution has no impact on litigation initiation ($b_{29} = .19$, n.s.), the termination of the relationship prior to litigation ensues significantly reduces the likelihood of resolution by ADR ($b_{39} = -.33$, $p < .001$). We also find that the greater the franchisor’s record of prior litigation success, the higher (lower) the likelihood of litigation initiation (ADR resolution) ($b_{211} = .93$, $p < .01$; $b_{311} = -.76$, $p < .001$). Finally, and as expected, the likelihood of the franchisor (franchisee) initiating litigation is increased in response to franchisee (franchisor) moral hazard ($b_{312} = 1.76$, $b_{313} = -1.22$, both $p < .001$).

Post hoc Probing of Significant Interactions. So as to gain a better understanding of the significant interactions, we conducted tests of the simple slopes at low and high values of the moderator variables (Cohen, Cohen, West, and Aiken 2003). Panel A (B) in Figure 2 represents the simple slope of the number of registration (relationship) law states on litigation incidence for low and high reliance on dual distribution. The inverse association between $REGISNUM$ and $INCID$ is significantly reduced for franchisors with high levels of $DUAL$ (see Panel A). For $RELNUM$, the effect of $DUAL$ is even more pronounced (see Panel B). For franchisors with low reliance on dual distribution, the association between $RELNUM$ and $INCID$ is positive; the
opposite is observed under conditions of high *DUAL*. Finally, Panel C in Figure 2 represents the effect of the franchisor’s initiating litigation on the likelihood of ADR, depending on whether the conflict occurs in a relationship law state or not. As is evident from Panel C, in non-relationship law regimes, franchisors initiating litigation are predisposed to ADR; this predisposition is significantly reduced in relationship law regimes. All in all, the post hoc probing of the significant interactions provides strong support for our hypotheses, and facilitates a clearer understanding of the subtleties of conflict management.

**DISCUSSION**

The objective of this research is to provide a better understanding of the impact of franchise regulation on the incidence, nature, and outcomes of franchisor-franchisee conflict. Our work acknowledges the significant impact of the institutional context in which business operates (Dant and Schul 1992; Grewal and Dharwadkar 2002), and extends prior research on channel conflict by identifying the drivers and consequences of serious conflict between channel partners. We now discuss how the regulatory context frames franchisors’ and their franchisees’ litigation choices by itself and in combination with franchisors’ dual distribution structure, and the theoretical and managerial implications thereof. Our findings enable the marketing discipline to inform an important public policy issue regarding a critical sector of our economy.

*Does Franchise Regulation Reduce or Promote Conflict?* As with most phenomena, the answer is not unambiguous. Rather, whether franchise regulations serve to ratchet conflict up or down depends on (a) whether we adopt a system-wide perspective or choose instead to focus on particular regulatory contexts (regulated versus non-regulated states), (b) the particular regulation we consider (registration versus relationship law), and (c) the dual distribution
structure of the channel system – the extent to which the franchisor relies simultaneously on company owned and franchised outlets.

Our study of 75 franchise systems observed over nearly two decades yields evidence that the additional disclosure elicited by registration law serves to reduce the incidence of serious conflict (i.e., litigation) between franchisors and their franchisees system-wide. Across regulated and non-regulated markets alike, registration law-induced transparency with respect to franchisors’ operations effectively reduces miscommunication and unmet expectations, thereby promoting more harmonious relations. This conflict dampening effect of registration law on system-wide litigation incidence is, however, not only weakened but reversed when litigation does occur in states subject to registration law. Specifically, in registration law regimes, the well-specified nature of mutual obligations enables easier and more complete verification of performance or the lack thereof. Franchisors are therefore less reticent to press their claims in court; indeed, our results clearly demonstrate a more aggressive stance throughout the litigation episode by the latter in registration law regimes. Whereas, ceteris paribus, franchisors are more likely to settle claims initiated by them by ADR (note the positive and significant main effect of $FRINIT$ on $ADR$), the existence of registration law not only increases their odds of initiating litigation, but also significantly reduces their odds of settling.

Relative to registration law, the impact of relationship law on litigation is more straightforward. The increased difficulty of terminating franchisees brought about by relationship law clearly results in a corresponding increase in the incidence of franchisor-franchisee litigation. Such an increase may be anticipated either as a function of the empowerment of franchisees by relationship law, or as a direct result of increased franchisee shirking and the enforcement response it elicits from franchisors. The present analysis appears to provide greater
support for the former thesis. Note that our findings clearly suggest that it is the franchisee who is more likely to initiate litigation in relationship law states, typically in response to perceived franchisor moral hazard. Although the end result of increased litigation is not likely what regulators sought, it is clear that relationship law has prompted a greater appreciation among franchisees of their rights.

The preceding findings do not necessarily imply the franchisor to be a hapless recipient of the cards it is dealt by the operating environment. On the contrary, our findings suggest that franchisors making use of dual distribution gain significant leverage in their conflict management efforts. The additional information gained from having a direct presence in local markets translates to higher levels of performance verifiability and stronger credibility of imposing sanctions on franchisees (Dutta et al 1995). This, in turn, translates into a weakening of the inverse association between the number of registration law states the franchisor competes in and the incidence of litigated conflict. It also gives franchisees pause for thought before “taking on” their more powerful franchisor partners, notwithstanding the existence of “good cause” termination regulation. Dual distribution structures are thereby demonstrably effective channel coordination mechanisms.

On balance, our own assessment of franchise regulation is a positive one. We find little evidence of franchisees shirking in relationship law states. Rather, the data demonstrate franchisees to be significantly empowered and more willing to take on the historically more powerful franchisor in relationship law regimes. Although registration law does result in lowered incidence of litigation across regulated and non-regulated markets alike, paradoxically, it has the opposite effect in the registration law regimes themselves. It is worth noting, however, that the increased assertiveness of the franchisors is primarily related to realizing unpaid dues by
franchisee partners and correcting trademark violations, both of which are directly related to the
continued health and viability of all franchisees and the franchise system as a whole. Although
too much of anything (including regulation) can be a bad thing, in our opinion, the additional
transparency elicited by registration law and the countervailing power brought about by
termination law bode well for franchisor-franchisee relationships.

Theoretical Implications

Perhaps the most important theoretical implication that emerges from our study is that the
decision regarding when to initiate litigation and how to resolve it are distinct yet highly inter-
related strategic choices. Parties making these choices appear to be very cognizant of the
regulatory context they operate in. Specific dimensions of this context work to either dissuade or
persuade a proclivity for litigation and its resolution. To the best of our knowledge, our study is
the first rigorous, multi-year, multi-franchise system assessment of both pertinent laws. In
emphasizing the role of the regulatory context, we build on recent theoretical treatments of how
the imposition of regulation might affect “…the internal polity (e.g., by influencing decision
making in channels)” (Grewal and Dharwadkar 2002, pp.89-90).

The results from our analysis provide strong support for the notion that franchisors adopt
a strategic cost-benefit calculative approach to litigation with their franchisee partners. The
sparing use of litigation is noteworthy, as is the discerning recourse to ADR as a means of
resolving the issue in question. Across the franchise systems we studied, we find franchisors’
litigation choices to be consistent with policing and quality assurance – ensuring the appropriate
use of valuable trademarks underlying their brand equity (Shane 2005), and the payment of
royalties and advertising fees that underwrite franchisors’ monitoring and market development
efforts respectively (Blair and Lafontaine 2010). What is also worth noting is that, all things
remaining constant, franchisors initiating legal claims against their franchisees are also more likely to agree to ADR, rather than insist on adjudication. The picture that emerges from this is not one of a power-hungry litigant that is eager to “punish” even the slightest transgression, but rather that of a thoughtful partner who is nevertheless willing to do what is necessary to safeguard the franchise brand and its promise.

Our assessment of both immediate and more long-term outcomes pursuant to both parties’ litigation choices also extends what is currently known about conflict management. Each conflict management choice – the initiation of litigation, as well as its resolution – has a significant impact on the decision maker’s achievement of objectives. Although the party initiating the litigation (relying on ADR) is more (less) likely to achieve the immediate goal it seeks, the situation is completely reversed when it comes to longer-term strategic objectives. The present research thus identifies a distinct trade-off that must be weighed by channel partners facing conflict, consideration of which may provide an effective brake to inexorable conflict.

Managerial Implications

Our study provides useful guidance to franchisors and their franchisees alike. To franchisors, perhaps the most important learning point is the strong evidence we provide regarding the trade-off between the achievement of immediate and more long-term objectives. No doubt, the likelihood of achieving its immediate purpose is increased by adopting an aggressive conflict management approach. The “payback” for such aggression, however, is a demonstrated inability to retain and attract suitable franchisee partners. Franchisor managers cognizant of this trade-off are likely to make better informed conflict resolution decisions.

By identifying when each party is more apt to litigate, we provide a useful benchmark to franchisors and franchisees dealing with unresolved conflict. Rather than risk needless
provocation or being perceived as being weak, each party may calibrate their conflict management response effectively. Franchisees would do well to eschew any attempt at misusing or appropriating franchise trademarks, or to not make timely royalty payments to their franchisor. For their part, franchisors might want to pay particular attention to the claims they make when attempting to sign up new franchisees, as these tend to be the most commonly observed grounds for franchisee-initiated litigation. Knowing this, both channel partners can make better decisions about their own conflict management approaches.

Limitations and Future Research Directions

Although our use of archival data from multiple sources provides rich information on multiple franchisors’ conflict management choices over an extended window of observation, it nevertheless results in at least two limitations. First, we must rely on indicators for, rather than more direct measures of, the theoretically relevant variables in this study. Future studies of conflict management would do well to integrate archival and more direct (perhaps survey-based) operational measures of the theoretical constructs. Such an approach would likely pay rich dividends in terms of insights gained.

Second, although we adopt the perspectives of both parties to the conflict, relevant information on individual franchisees is limited solely to the contents of the franchisor-reported litigation summaries we examined. Future research could make use of court docket information on record to faithfully recreate an account of the conflict. Although very time- and effort-intensive, such research would have rich complementary insights to offer on the critical phenomenon of channel partner conflict management.
REFERENCES


Galanter, Marc (1983), “Reading the Landscape of Conflicts: What We Know and Don’t Know (And Think We Know) About Our Allegedly Contentious and Litigious Society,” *UCLA Law Review*, 31 (October), 4-71.


## TABLE 1
### DATA SOURCES AND VARIABLES

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<td>Franchisor Moral Hazard</td>
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<tr>
<td>16.</td>
<td>Ln(DUR)</td>
<td>.37*</td>
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<tr>
<td>17.</td>
<td>FRWIN_{t+1}</td>
<td>-</td>
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<td>18.</td>
<td>Ln(FRUNITS)</td>
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| Mean |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| (SD) | (.45) | (.48) | (.46) | (.74) | (5.20) | (4.00) | (.21) | (.49) | (.50) | (1.47) | (.57) | (.56) | (1.28) | (2.04) | (.49) | (.58) | (.29) | (1.61) |

* p < .05

^ Variables indicated by – are only observed when INCID=1; hence, their correlations with INCID are not reported.
<table>
<thead>
<tr>
<th>Independent Variables</th>
<th>INCID</th>
<th>FRINIT</th>
<th>ADR</th>
<th>OUTCOME</th>
<th>EXPAN</th>
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<tr>
<td>Intercept</td>
<td>-2.04 (-1.24)</td>
<td>-2.51 (-1.90)*</td>
<td>1.81 (2.46)**</td>
<td>-0.00 (-0.01)</td>
<td>2.18 (21.36)***</td>
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<tr>
<td>REGISNUM</td>
<td>-.31 (-2.45)**</td>
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<tr>
<td>RELNUM</td>
<td>.40 (2.49)**</td>
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<tr>
<td>DUAL</td>
<td>-.75 (-.76)</td>
<td>1.51 (2.36)**</td>
<td>-.50 (-1.09)</td>
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<tr>
<td>REGISNUM*DUAL</td>
<td>.44 (2.86)**</td>
<td></td>
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<tr>
<td>RELNUM*DUAL</td>
<td>-.50 (-2.56)**</td>
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<tr>
<td>REGIS</td>
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<td>-.72 (-4.00)***</td>
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<tr>
<td>REL</td>
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<td>.30 (1.43)</td>
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<tr>
<td>FRINIT*REGIS</td>
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<td>.30 (.99)</td>
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<td>-.51 (-1.77)*</td>
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<tr>
<td>FRINIT</td>
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<td>.65 (2.80)**</td>
<td>1.01 (5.52)***</td>
<td>-.24 (-3.01)***</td>
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<td>ADR</td>
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<td>Ln(TOTINV)</td>
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<tr>
<td>GDP</td>
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<td>.13 (1.59)</td>
<td>.04 (.54)</td>
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<td>ROYAL</td>
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<td>-.01 (-.33)</td>
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<tr>
<td>RELDISS</td>
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<td>FRWIN(t-1)</td>
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<td>-.76 (-3.99)***</td>
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<td>Ln(FRANUNITS)</td>
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<td>.04 (.68)</td>
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<td>Wald χ² (p-value)</td>
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<td>135.30 (.000)</td>
</tr>
</tbody>
</table>

Notes: n = 411, z-statistics are in parentheses. *p < .05; **p < .01; ***p < .001 (all one-tailed)
FIGURE 1
STAGES IN A SERIOUS CONFLICT EPISODE
FIGURE 2
SIMPLE SLOPES ANALYSIS OF SIGNIFICANT MODERATORS

A. REGISNUM x DUAL

B. RELNUM x DUAL

C. FRINIT x REL