FRANCHISING IN MALAYSIA: ISSUES AND RESEARCH AGENDA

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ABSTRACT

The franchising concept has become a dominant method inter firm (business-to-business) in the distribution of products and services throughout the local and global market to their target end customer. Franchising is also known as a strategic alliance which relatively enduring inter-firm cooperative arrangement between franchisor and franchisee. Franchising has shown the substantial growth and significant success in most of the developed countries, especially in Western countries. In Malaysia, franchising industries has grown steadily during the past decade through intensively franchise development programme conducted by government agency such as Perbadanan Nasional Berhad (PNS). Nevertheless, there is a still lack of study related the franchising in Malaysia, particularly in franchise business survival. Thus, this paper will be explored the issues in franchising and proposed the conceptual framework for effective franchise business model. The framework developed in this paper will provide a guide to the factors that may affect franchise firm's performance.

INTRODUC TION

Franchising is a way of doing and expanding business in the global environment business. Franchising has been the leading edge of business since 1950 by showing the impressive growth rate in sales and market share. In the global economic down turn, franchising still can survive by decreasing the operation cost and able to increase of unit sales and take a leading position in the economy recovery (Justis and Judd, 2003). Franchising can be explained as a contractual agreement between two parties (franchisor and franchisee) in which, franchisee who pays to franchisor for the right to sell products or services and/or the right to use trademarks and business format n a given location for a specified period of time (Blair & Lafontaine, 2005).

The terms of franchising were used in referring to a variety of business activities, but the contemporary franchise system is referred to business format franchising. The business-format franchising is where franchisor will grant the right and license to franchisees to sell the product or services, or both, by using the trade mark and the business system developed by franchisor in order to run the business operations (Khan, 1999). The example of business format franchising in restaurant (KFC, McDonaldộs, Pizza Hutt), education (Kumon, Yamaha Music School, Smart Readers), retail (Blockbuster Video, Radio Shack, The Athleteộs Foot), Convenience (7-Eleven, FamilyMart), maintenance/cleaning (Jani-King International, The ServicesMaster Company, Merry Maids) etc. Even though there is little economic difference between traditional and business-format franchising in term of type of agreement, type of support provided and control by franchisor, the business-format franchising has grown much faster than product distribution/traditional franchising (Blair & Lafontaine, 2005).

The recent report released by IFA (2008) also found that the business format franchising was more dominant than product distribution franchising in 2005 that accounting for about 5.7 times as many establishments and nearly 3.1 times as much economic output compared with product distribution franchise in US. Thus, the business format franchise was found as successful method of cloning success by duplicating an operation format of proven business (Stanworth, 1991).

This paper has three sections. Firstly, the authors will explain the scenario franchise business in Malaysia. Secondly, the main issues related franchising is briefly discussed and finally the conceptual framework will be proposed for future research.

FRANCHISING IN MALAYSIA

Franchising in Malaysia is still in the early stages, with growth really starting only in1992 when the government began promoting the sector at the beginning stage of the introduction of franchise business in Malaysia, only a few franchise businesses were operated in Malaysia such as Singer, Bata, Petrol Station and car authorized dealers. The franchise started became famous in Malaysia, after the government has started launching The Franchise Development Program (FDP) in 1992. This program was established under the Prime Ministerơs Department to administer this program with the following objectives: a) to increase the number of entrepreneurs in the franchise sectors; b) to develop home grown products and services into franchise businesses. In conjunction with the FDP, the Malaysia Franchise Association (MFA) was formed in 1994 to support the implementation of the Government program and to promote entrepreneurship through franchising. The MFA establishment will help government to serve as a resource center for both current and prospective franchisors and franchisee. The MFA has played important roles in ensuring and supporting the franchise in becoming the successful business model especially among new entrepreneur to venture in the new business.

In 1995, the Franchise Development Program (FDP) was later transferred to the Ministry of Entrepreneur Development. 1n 2009, under new cabinet reshuffle, MECD has been abolished from Malaysia Ministry and the Franchise Development Division has been transferred to Ministry of Domestic Trade, Cooperative and Consumerism (MDTCC). The Ministry of MDTCC, Datoô Sri Ismail Sabri Yaakob, addressed in Franchise International Malaysia 2009 in order to stimulate the franchise growth in this country, the slogan ñ Malaysia, The Franchise-Friendly Countryò has been introduced (Utusan Malaysia, 2009). He also added that his ministry will improve the communication system to deliver the information and create awareness to public as well as entrepreneur pertaining franchise industry in Malaysia.

Many countries have established the laws that related to franchising. The franchise laws will regulates and governs franchise arrangement in respective country. In Malaysia, the Franchise Act was introduced to regulate the industry in 1998. Under this act, all franchisors that are selling their franchises in Malaysia are required to register with the Registrar of Franchise (ROF) under the Ministry of Entrepreneur Development and Cooperation (MECD). This action was taken for the government to control the development of this industry and also to create new business opportunity to potential franchisors and franchisees. Under the 8th Malaysia Plan (2001-2005), franchising business has been identified as one the growth areas for the structural change and upgrading of the distributive trade industry. Malaysian government had allocated RM100 million to MECD to promote, market, train and finance the Franchise Development Program with the objective of establishing 1,000 franchisees and 50 new franchisors over the five-year period. Thus, the efforts played by government have shown their commitment to boost the franchise industry in Malaysia.

The intensive programs conducted by government agencies have assist the rapid development of franchising industries in Malaysia. Permodalan Nasional Berhad (PNS), wholly-owned subsidiary of the Ministry of Finance has played the main roles in developing the FDP under 9th Malaysia Plan. PNS have focuses on the development of domestic and international franchise by providing total franchise solutions such as franchise investment, promotional activities, financing, training, networking, franchise development, networking and conduct research & development. Apart from that, the Ministry also had set up the main committee of Product Development consisting of a few agencies such as Majis Amanah Rakyat (MARA), PNS and SME Bank to support and develop the franchise industry in Malaysia. The main purpose of this Committee is to attract the involvement of existing entrepreneur to market their product and services by using franchise format business. Through this program, the qualified entrepreneur will be assisted in product development and business system by the consultant who was appointed by PNS. The financial grant or assistant will also be provided to qualified entrepreneur by commercial banks such as Maybank and CIMB.

ISSUES IN FRANCHISE BUSINESS

Many programme were implemented by government in promoting franchising as successful business model for both public and entrepreneurs in Malaysia. For example, PNS who design the special development programme such as Youth Franchise Scheme, Executive Franchise Scheme, Graduate Franchise Program and Women Franchise Program. Although many programs were established to assist and support a potential entrepreneur to become franchisor/franchisee, the achievement of successful franchisor/franchisee is still low is comparable with Singapore and Australia. According to Chief Executive Officer SMIDEC Datuk Hafshah Hashim, he noted that Malaysia which have population for almost 26 million, unfortunate to have achieved for 318 of registered franchise companies compared with Singapore which their populations is about 3.7 million people had achieved for more than 380 franchise, meanwhile Australia which its population for 20 million people had owned of 960 brands have been franchised (Utusan Malaysia, 2008). This gap shall need the urgent research to investigate the entrepreneurõs attitudes towards the acceptance of franchise business in Malaysia.

Table 1: Franchising Development Program According to Strategic Malaysia Plan

Malaysia Plan	Franchisor	Franchisee
8th Malaysia Plan (2001-2005)	50	1000
9th Malaysia Plan ï (2006-2010)	50	1000

The effectiveness for Franchise Development Program is still questionable, particularly for *"bumiputra"* entrepreneur achievement. Many programs and activities have been implemented, the quantity of successful franchisor and franchisee especially *bumiputera* still low is compared with ministryõs target. Moreover, based on MECD statistic in 2008, 343 franchise companies which were registered in Malaysia, 227 companies were identified as local home-grown franchisor and only 94 companies were identified as *"bumiputra"* entrepreneurs which represented only 27.4% of the total registered under franchise business (Utusan Malaysia, 2008). Even though, the aggressive actions taken by government in order to develop the new franchisors and franchisees, but the achievement of successful entrepreneur who appointed as franchisee through these programs are still very low (Sallehuddin, 2009). In addition, he also highlighted that the potential applicants who participate in FDP to drop out is very high before they can be appointed as franchisee by panel committee. Thus, the proper study shall be conducted to exploring the applicant attitude towards the effectiveness of FDP.

Table 2: Franchisor Composition in Malaysia

Categories of franchisor	No of franchisor	%
International franchisor	116	33.8%
Local franchisor (*non-bumiputra*)	133	38.8%
Local franchisor (*bumiputra*)	94	27.4%
Total	**343**	**100.0%**

The survival and successful of franchise business system was still debated among academic and practitioners. Stanworth, Purdy and Price (1997), claimed that despite the franchising industry claims of strong growth and low failure rates, the reality appear to have been of generally modest growth and high failure rates. Bates (1995) found that 34.9% of franchise business failed compared to 28% of non-franchised business. The real growth of USA franchising for 1975- 1990 was drastic plunged from 284.6% to 58.5% and the average annual growth rate was declined from 9.4% to 3.1 % (Stanworth, Purdy and Price, 1997). Shane (1996) found that three quarters of all new franchise systems failed within ten (10) years after their formation. La Fontaine and Kauffman (1994) have argued that the high failure rate of the new franchise systems suggests that the survival of a new franchise system over time is an important measure of performance. Indeed, Shane (1998) has highlighted that approximately three-quarters of all new franchise systems failed within twelve years. He also mentioned that the high death rate of new systems suggests that franchising is not an easy business to succeed and demonstrates a good model to explain the survival of the new franchise system. Even though the franchise system was being tested and proven, it canốt guarantee the success to entrepreneurs. The future study shall study the key factors that contributed to the success of franchise system especially from franchiseeốs perceptive.

Indeed, the growth of Malaysia franchise sector was moved aggressively, there is no a failure case or data reported by ministry to give the real picture of development of franchise business system. Anyway, the failure of existing franchisesô companies definitely will happen in franchise business and no proper study was found to clarify the problem faces by the franchisor and franchisee in Malaysia context. There are very limited study related franchising was conducted in Malaysia (Mohd Ali, 1995). Furthermore, recent study reported that franchise survival rates and profitability are much lower than previously thought when compared to independent businesses (Bates, 1995). The survival in franchising are very important because each parties franchisor and franchisee have invested their resources (franchisor resources ï concept, brand, standard operating procedures, franchisee - royalty fees, initial fees) in franchise business model. Thus, this future study will be necessary to assist the practitioners and government agencies mainly PNS to understand and establish an effective franchise management model for franchisee and franchisor in Malaysia.

In general, franchising is an under researched area that is not well understood and this sector was found lack of reliable information (Dyl 1991; Frazer 1998; Wlesh 1996). Franchising in Malaysia is still suffers from a lack of reliable information and under researched area (Mohd Ali, 1995). In Malaysia, there was very limited information and research focus in franchising sector compared to developed countries such as the United States of America, Canada and Australia. In Malaysia context, many franchisees were found facing the problem in managing their business and to some cases they have to be terminated due to poor performance. Thus, the future study may help to investigate the critical factors that lead to the successful franchise business system in Malaysia. This factor can help the Malaysian government agency especially PNS and MFA to formulate the new strategy in order to enhance the franchising development program for the new potential entrepreneur to become the successful franchisee in the long run.

From the theory perspective, the researcher found out that the literature reviews consisting of different theories derived the conflicting guidance in handling the franchise issues. Agency theory and Resource Scarcity theory were found to become very dominants theories in discussing the franchising issues. Agency theory posits that the franchisee is primarily economically self-interested and motivated by incentives. Therefore, agency theory de-emphasizes the management of the relationship between franchisees and franchisors such that the relationship is considered successful when costs of monitoring are minimized between two parties. In other perspectives, this theory fails to look that relationship can be managed in order to create the unique values that can contribute to the long term relationship in business. Thus, the future research shall included the relational view in order to look at the importance of relationship quality that can be managed to create competitive advantage. The relational view which has gained important for explaining long-term inter-firm cooperation (Dyer & Chu, 2003; Dyer & Singh, 1998), it has not yet been adapted to explaining the franchising issues. The problem here is not only that the relational view has rarely been explored and tested but also that its practical guidance to franchisors conflicts with agency theory. While franchise system survival has been studied extensively (Shane, 1996; 1998; 2001), extent literature offers little guidance on how franchising affect among surviving organizations. Thus, this paper will apply different theory in order to get better explanation especially the low explained variance of existing franchising research.

THE PROPOSED FRAMEWORK FOR DIRECTION OF FUTURE RESEARCH

The conceptual franchising business model will be included an integration of concept from the motivation to become as franchisee, the perception of franchises towards quality relationship and to identify the critical factors towards the section of successful franchisee in business. The model uses concepts from resources scarcity theory, relational theory and agency theory.

The Franchising Relationship Quality.

Relationship quality (RQ) has become an important issue in maintaining continuity of any partnership businesses especially in franchising. When firm goes beyond the transaction-based exchange and develop long term relationships, inter-organizational operation could lead to a competitive advantage (Dyer and Sigh, 1998). In this franchise field, several studies have focused on variables such as trust, commitment, conflict, relationalism, and cooperation among others to describe the relational behavior in franchise networks (Dant and Schul, 1992; Cox, 1995; Dahlstrom and Nygaard, 1995). Monroy and Alzola (2005) had reported that based on their review of the literature shows the lack of research that examines the quality of relationship between franchise partners as a global construct. They also mentioned to consider it very important to measuring the quality of the franchisor-franchisee relationship in order to assess the strength of those dyadic relationships and to explain not only the behavior of the network partners, but also the franchise performance. Two dimensions of trust and commitment were identified and will be included to measure the level of franchisee-franchisor relationship quality:

i) Trust

The previous study has recognized trust as an important determinant of successful cooperation (Dwyer et al., 1987; Ganesan, 1994; Mohr and Spekman, 1994). Trust generally has been described through two distinct components: credibility and benevolence (Ganesan, 1994; Mayer et al., 1995; Andaleeb, 1996). Credibility will be referred to the extent to which one partner believes that the other has the required expertise to perform the job effectively and reliably; while benevolence is based on the extent to which one partner believes that the other has intentions and motives beneficial to the former when new conditions arise (Monroy and Alzola, 2005).

ii) Commitment

Several studies have noted that commitment is an essential ingredient for successful relationships (Dwyer et al., 1987; Ganesan, 1994; Mohrn and Spekman, 1994; Gundlach et al., 1995; Andaleeb, 1996). Thus commitment is important insofar as it results in cooperation, reduces the potential of attractive short-term alternatives and enhances profitability (Morgan and Hunt, 1994; Andaleeb, 1996). Geyskens et al. (1996) argue that the differentiation between affective commitments is the most frequent in the literature and seems to be one of the most important in interorganizational relationships.

In general term, affective commitment relates to a desire to continue a relationship because of the positive effect toward and identification with the partner. (Kumar et al., 1995). In contrast calculative commitment is a more instrumental type of commitment and is based on the extent to which partners perceive the need to maintain the relationship due to the significant anticipated termination or switching costs associated with leaving (Geyskens et al., 1996).

Franchisor Resources

i) Brand Name

Brand names provide identity to products and allow firm to differentiate their offerings in the global marketplace. Brand name can help firms in retaining loyal customers and in attracting new customers. Thus, brand names are firm-specific assets that facilitate transactions. Brand image can be defined as the perceptions if the brand that reflect consumer associations of the brand in memory (Keller, 1993; 1998). Consumer and companies are willing to pay high prices for brand names because of the perception that they add value. The brand equity can help company to protect from the risk of competition. By recognizing the important of brand names, normally the firm will spend considerable amounts on promotion and advertising. The power (value) of the brand name could itself discourage franchisees from behaving opportunistically. Franchisee may recognize the importance of brand names in achieving personal goals and the need for continuous marketing support from franchisors. In order to establish a good brand name, the franchisors will seek adequate returns when they authorize franchisees to market products with their brand names. In order to retain their goodwill of brand name, the franchisor normally will set initial fees depending on the reputation of brand names. Shane (1996) suggest that a high initial fee relative to ongoing royalty and advertising payment acts as an ñax anteò bond to prevent opportunistic behavior by franchisee.

ii) Operational Routine

Standardization organizational routines are another key to success among franchise chains (Kaufmann and Eroglu, 1999). Michael and Combs (2008) also argued that it is important the franchise develop firm-specific human capital by learning the organizationalós valuable knowledge and routine. Normally, when the firms possess valuable operating routines they are more likely to have better performance (Barney, 1991; Dierickx & Cool, 1989). Knott (2003) found in her study that when operating routines are developed and implemented properly, they can result in better performance. Knott and McEvily (1999) compared the performance generated by operating routines with the performance generated by governance structure and found that operating routines were much more strongly associated with higher performance. This paper suggests that the superior implementation of a set of operating routines in a franchising setting directly improves performance.

Franchisee Resources

i) Active Ownership

Although the franchising business significantly reduces the moral hazard of not being able to observe outlet managers, some franchisors take an additional step by insisting that potential franchisees be active owner-managers and not passive investors (Michael and Combs, 2008). Passive franchisees need to hire employee-managers to monitor day-to-day activities, which can transfer the agency cost from franchisor to the passive franchisee. Moreover, passive ownership adds a layer of agency cost, that between the passive owner and the outlet manager which has to be managed. The passive franchiseesô employee-managers will still withhold some effort because they do not possess powerful ownership incentives (Williamson, 1991).

ii) Franchisee Experience

According to Michael and Combs (2008), one of policy that some franchisors used to help screen potential franchisees and thus further reduce adverse selection is to require prior industry experience. They explained that through this policy the franchisor can be assured that potential franchisees have baseline levels of industry-specific human capital. They also added that the presence of such a baseline ensures that new franchisee have the basic background knowledge to understand why the franchisorôs operation activities are important. Thus by establishing a minimum level of industry-specific human capital, and be reducing the probability of accepting new franchisees who overestimate their ability (moral hazard), higher quality and greater standardization should benefit existing franchisees.

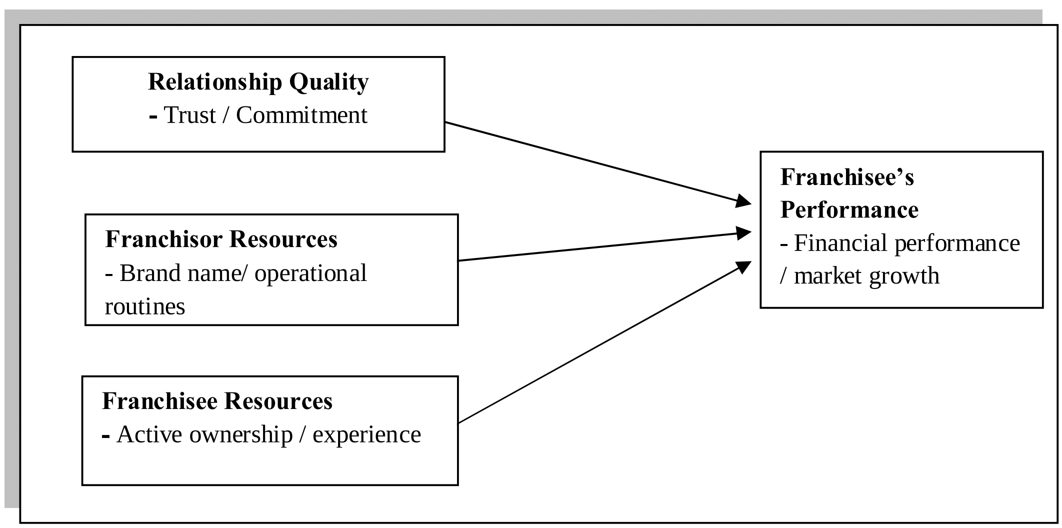
The variable in this category are prior experience, prior self-employment own other businesses and manage operation. The factors were extensively cited in the literature as key factors used by franchisors in their selection process. Prior experience is defined as the extent to which franchisee had previous experience a similar business. Tatham et al. (1972), Edens et al. (1976) and Olm et al. (1988) argued that prior experience is an important selection criterion. Owen (1989) emphasized that franchisors should select prospect with at least five years of prior business experience in similar businesses. But other scholar in franchise, Axelrad and

Rudnick (1987) suggested that prior experience in the same business may caused the difficulties of franchisee to adapt new and different business standards of the franchisor. In fact, the company prefers to start with people new to the businesses who do not have pre-conceived ideas about running a catering operation (Franchise World, 1978).

Dependent Variable – Franchisee's Performance

Performance outcomes can be perceived as the primary indicator of franchisee success. Examining franchisee performance, Combs et al. (2004) suggest four categories on performance outcomes: i) Financial performance, ii) Growth and survival, iii) Innovation and iv) Coordination & conflict. However, in this paper the author only focuses on financial performance and market growth, as the other categories of performance are outside the scope of discussion. Performance outcomes in franchise relationships will be included in the financial performance. These measures will be assessed by market share, sales performance or others objectives measures such as gross operating profits.

Figure 1: Conceptual Framework



CONCLUSION

The future research pertaining the franchise success business model is expected to advance the understanding of franchisee profile who can sustain and survive in a long term. This information is expected to be useful for policy-making on how to improve the franchising program in Malaysia. The finding will help to contribute the development of training module and guidelines to be used in a selection process of new franchisee under Franchise Development Program. Second, many authors have argued that franchising requires a multiï theoretical framework (Combs et al., 2004). Most of literature has focused primarily on the agency theory and resource scarcity explanations. However other theoretical such as relational view might help explain better important additional variance in explaining franchising firmĝs performance. This paper has included one additional theoretical view, particularly from relational view. Finally, the proposed conceptual framework can guide researchers for the future studies in identifying the critical success factors in franchising business model. By determining the relative and interactive impacts to franchisee and firm performance, future study hopes to offer more guidance to franchisee on how to manage factors affecting firm performance.

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