

Franchise relationships are prone to conflict. To safeguard the rights of individual franchisees, several states have legislated greater franchisor disclosure (registration law) *ex ante* and/or franchisor "termination for good cause" (relationship law) *ex post*. The impact of regulatory oversight on franchisor–franchisee conflict, however, remains unclear. Relying on agency theory arguments, the authors first assess the influence of the regulatory context, both by itself and in combination with the franchise ownership structure, on the incidence of litigated conflict. Conditional on litigation, they also predict the impact of franchise regulation on both the parties' litigation initiation and resolution choices and the resulting outcomes. The authors test the hypotheses using a unique multisource archival database of 411 instances of litigation across 75 franchise systems observed over 17 years. The results indicate that the regulatory context, by itself as well as in combination with the franchise ownership structure, significantly shapes parties' conflict management choices. The authors also find evidence of a trade-off between prevailing in the particular conflict and achieving franchise system growth objectives.

Keywords: franchise registration law, relationship law, ownership structure, conflict

Conflict Management and Outcomes in Franchise Relationships: The Role of Regulation

Franchising is a mainstay of the U.S. economy, with more than 825,000 franchised outlets accounting for \$2.1 trillion of U.S. gross domestic product (GDP) (International Franchise Association 2013). 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 franchisees and

monitors and enforces quality standards across members of the franchise system on a continual basis (Shane 2005). Violations or missteps by either party could cause conflict if one partner perceives the other as indulging in acts that impede the achievement of its own goals (Etgar 1979). If the aggrieved partner's claim for redress is denied or contested, this constitutes a dispute (Galanter 1983). Left unresolved, serious disputes may lead to costly litigation, dysfunction, and even termination of the relationship.

In an attempt to minimize such costly dysfunctional conflict and to safeguard the interests of individual franchisees, 15 states now require franchisors to register with state regulators before offering franchise opportunities. Furthermore, 22 states have enacted laws that require franchisors to provide "good cause for termination" of their franchisees. Although these laws are long-standing (both were enacted in 1974), such regulation of franchising has always been controversial. Whereas supporters of regulation laud the transparency and the "franchisee day in court" elicited by such laws (Benoliel 2009), its detractors cite the high cost of compliance and the additional burden it

*Kersi D. Antia is Associate Professor of Marketing, Richard Ivey School of Business, Western University (e-mail: kantia@ivey.uwo.ca). Xu (Vivian) Zheng is Assistant Professor of Marketing, College of Business, City University of Hong Kong (e-mail: xuzheng@cityu.edu.hk). Gary L. Frazier is Richard and Jarda Hurd Professor of Distribution Management, Marshall School of Business, University of Southern California (e-mail: frazier@marshall.usc.edu). The authors are grateful for the feedback from seminar participants at the 2011 Haring Symposium at Indiana University and at the University of Alberta and Oklahoma University. They also thank Jan B. Heide and Aric Rindfleisch for their insightful comments on previous versions of this article as well as Tsai-Fang Chen and Neel Khurjekar for their data collection and coding assistance. Christine Moorman served as associate editor for this article.

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 member conflict (see, e.g., Brown and Day 1981; Ganesan 1993; Hibbard, Kumar, and Stern 2001). Such reticence may be attributed to two related limitations of prior research. First, although acknowledging that conflict is "a dynamic process composed of a series of conflict episodes" (Brown and Day 1981, p. 263), previous studies in marketing have relied overwhelmingly on cross-sectional, survey-based assessments that are incapable of shedding light on unfolding conflict dynamics. A second significant gap in understanding pertains to the "conflict aftermath," or the outcomes associated with both parties' conflict management efforts (Pondy 1967). Prior attempts to assess conflict management consequences have tended to focus on immediate and dyad-specific outcomes (Ganesan 1993; Hibbard, Kumar, and Stern 2001). Such an emphasis 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). As a result, the central issues of whether the franchise regulatory context serves to reduce or increase the incidence of serious conflict between franchisors and their franchisee partners as well as the implications of both parties' conflict management efforts for dyadic and franchise system-wide outcomes remain unaddressed. Therefore, a rigorous longitudinal study of actual conflict episodes based on relatively objective accounts of their initiation, resolution, and corresponding outcomes is necessary.

The present study addresses this need. We regard litigation between franchise partners as representative of serious manifest conflict, defined as open behavioral disagreements between the firms that hamper their respective goal attainment (Pondy 1967). We examine both parties' litigation initiation and resolution choices and the dyadic and system-wide consequences attributable to these choices. Relying on agency theory-based arguments, we assess the impact of regulation on the incidence of litigated conflict between franchisors and their franchisees. We hypothesize the impact of such regulation to vary significantly by (1) the level of analysis, either across the franchise system (regulated and nonregulated markets) or within the particular market in which the conflict occurs; (2) the specific regulation considered (registration law or relationship law); and (3) the ownership structure of the channel system—specifically, the extent to which the franchisor relies on franchisee-owned outlets. We collect multisourced 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 the party more likely to initiate the litigation, predict the likelihood of the litigation being settled by alternative dispute resolution (ADR) rather than adjudication, and assess the dyadic and systemwide outcomes that result from 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, 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 into the interplay between regulatory and distribution structure-related 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 franchise system-wide, long-term outcomes attendant to such choices. As we subsequently demonstrate, a single-minded focus on prevailing in the immediate issue at hand could prove counterproductive to long-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, our examination of actual litigation choices and outcomes gleaned from franchise disclosure documents (FDDs; formerly known as uniform franchise offering circulars), 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 outcomes.

In the sections that follow, we first provide an overview of the anticipated role of registration law and relationship law in mitigating conflict between franchisors and their franchisees. We then propose hypotheses linking each law, by itself as well as in combination with the franchisor's ownership structure, to franchisor–franchisee conflict management choices and their attendant outcomes. This is followed by a description of our empirical context and data collection and analysis methods. We conclude with the managerial and theoretical implications of our study.

THE FRANCHISE RELATIONSHIP AND ITS REGULATION

Franchise relationships are subject to agency problems, whereby incentives exist for both the agent (the franchisee) and the principal (the franchisor) to misrepresent themselves and/or their abilities before the relationship begins (*ex ante* adverse selection) as well as to renege on their performance obligations (moral hazard) during the course of the relationship (Bergen, Dutta, and Walker 1992; Rubin 1978). Franchisors safeguard their interests by designing and offering relatively complete and one-sided contracts (Kashyap, Antia, and Frazier 2012) specifying their franchisees' obligations before, during, and after the relationship. Although such contracts safeguard the franchisor's interests well, they remain conspicuously 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).

Franchisors may frequently misrepresent themselves to potential franchisees with regard to (1) their abilities, resources, and prior success and/or (2) their intentions to continue the relationship (Rubin 1978). Whereas the former reflects an *ex ante* inability of franchisees to obtain critical information with respect to their franchisors' ability and motivation to perform, the latter represents franchisees' *ex post* vulnerability to unanticipated changes or relationship dissolution at the franchisor's whim. Both situations can result in serious conflict and potentially "the failure of par-

ties' ability to reach an acceptable solution by interpersonal means" (Dant and Schul 1992, p. 40). We regard the incidence of litigation as indicative of serious manifest conflict between franchisor and franchisee, undertaken as a conflict management strategy.

In response, several measures designed to safeguard franchisees' interests have been legislated. First, the Federal Trade Commission 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 registration law and relationship law statutes regulating the franchise relationship to varying degrees. Figure 1 summarizes the regulatory emphasis of each statute. Registration law specifies the information franchisors must disclose to potential franchisees before 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; posttermination noncompete clauses; exclusive territories; and the number of franchisees assigned, transferred, and terminated over the past three years. Although similar to and drawing from the Federal Trade Commission disclosure requirement, regulation law states also require franchisors to file FDDs with the state's regulatory authorities before they may begin to sell franchises in the state. In imposing full disclosure requirements on franchisors, registration law is primarily concerned with making as much information about franchisors' operations available to prospective franchisees *before* the latter's induction into the franchise system (Murphy 2006).

Relationship law restricts 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" for termination,

typically interpreted as the franchisee's failure to comply with the franchise agreement (Shane 2005). In contrast to the emphasis registration law places on addressing the *ex ante* adverse selection problem, relationship law focuses on minimizing the potential for *ex post* franchisor moral hazard (see Figure 1). Full disclosure (registration law) and good cause termination (relationship law) are designed to safeguard the interests of franchisees within the state where the particular regulation is in effect.

RESEARCH HYPOTHESES

Impact of Regulation

Both prospective and existing franchisees have more information available to them pertaining to franchisor operations in registration law states. Moreover, as a franchisor expands outlets in more registration law states, it will likely pay greater attention to the scope and accuracy of disclosure within and across each of them (Murphy 2006). Together, franchisee access to information and franchisor attention to the details of disclosure should reduce the potential for miscommunication and misunderstandings between them (Kashyap, Antia, and Frazier 2012). Thus, the adverse selection problem franchisees face should be alleviated to some degree in registration law states (Bergen, Dutta, and Walker 1992). The probable end result of such access and disclosure is a reduction in levels of manifest conflict within the franchise system. That is, greater information sharing should lead to fewer disagreements between the firms that require litigation. As the number of registration law states in which the franchisor operates increases, the greater the likelihood that franchisees will fall within the purview of the protections afforded by franchise regulation.

H₁: The greater the number of registration law states in which the franchisor operates, the lower the systemwide litigation incidence.

When serious, unresolvable disputes occur within registration law states, however, franchisors may be emboldened by the reduction in uncertainty brought about by franchise disclosure requirements (Shane 2005). That is, the franchisor may view the increased information disclosure required by registration law as reducing its costs of litigation and increasing its likelihood of prevailing in the dispute.

Franchisors that aim to comply with registration law requirements explicitly specify performance standards, thus providing a more objective benchmark of performance against which they may evaluate franchisee efforts. Perhaps most importantly, franchisee noncompliance with explicitly stated obligations is also more easily verifiable by relevant third parties (i.e., legal courts) (Drahozal and Hylton 2003). Enhanced verifiability and greater ease of demonstrating franchisee noncompliance in registration law states may prompt the franchisor to adopt a less conciliatory stance when serious disputes arise. This is reflected in an increased likelihood of the franchisor initiating litigation and a decreased likelihood of it 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 procedures.

In relationship law regimes, franchisors can attempt to terminate franchisees only with good cause (Benoliel 2009).

Figure 1
AGENCY PROBLEMS IN FRANCHISING AND THEIR
SOLUTIONS

Type of Agency Problem	Party Facing Agency Problem	
	Franchisee	Franchisor
Adverse Selection	Registration Law	Franchise Contract
Moral Hazard	Relationship Law	

Although relationship law statutes were created to ensure continuity of the relationship and to protect franchisees from termination at the whim of the franchisors, they also have two potentially unanticipated 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 file suit against their franchisor 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). Just as with registration law states, the greater the number of relationship law states in which the franchisor operates, the greater the likelihood that good cause termination clauses protect franchisees. Heightened manifest conflict and an increase in the incidence of litigation systemwide are likely to result as the number of relationship law states in which a franchisor has a presence increases.¹

H₃: The greater the number of relationship law states in which the franchisor operates, the higher the systemwide litigation incidence.

The much sought-after outcome of franchisee empowerment is particularly salient in relationship law states. Franchisees aware of the higher cost of termination imposed by good cause statutes in these states could become more emboldened (Benoliel 2009). The natural outcome of such empowerment is an increased willingness to initiate litigation against the franchisor; after initiating litigation, franchisees are also more likely to take a more aggressive stance with respect to their litigation resolution choices. Anticipating a more sympathetic judicial forum in relationship law states, franchises are more likely to opt for a court decision (adjudication) rather than rely on ADR methods such as negotiation, mediation, or arbitration.

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 procedures.

Impact of Franchise Ownership Structure

The high-powered incentives for franchisees to provide their best efforts on behalf of the franchisor also create a greater potential for franchisee free riding (Lafontaine 1992; Lal 1990). To minimize shirking, it is common for franchisors to own and operate some outlets while relying on independent franchisees to operate others (Bradach 1997; Bradach and Eccles 1989). The knowledge the franchisor gains from operating its own outlets may enhance its ability to evaluate franchisee efforts (Parmigiani and

Mitchell 2009), including areas in which the franchisee's performance might not be up to standard. Moreover, the presence of company-owned outlets serves as a credible threat of franchisee termination (Dutta et al. 1995; Williamson 1996) because the franchisor "puts partners on notice ... if desired price and quality are not delivered" (Perreman and Combs 2012, p. 374).

The greater the reliance on franchisee-owned outlets, the less the presence of company-owned and -operated outlets. With fewer company-owned outlets systemwide, the franchisor lacks information about the appropriate behaviors and outcomes it may require of its franchisees, resulting in a higher probability of conflict between the parties (Michael 2000). The credibility of the threat of replacing marginally performing franchisees is weakened (Heide 2003); in addition, with increasing franchisor reliance on franchisee-operated outlets, the likelihood of a nearby company-owned outlet also decreases. The result is a probable increase in franchisees' propensity to safeguard their interests and a weakening of the disclosure-induced reduction in systemwide litigation incidence brought about by the franchisors' presence in multiple registration law states.

H_{5a}: The greater the franchisors' reliance on franchisee-owned outlets, the weaker the negative association between the extent of franchisors' presence in registration law states and systemwide litigation incidence.

Notably, franchisors' reliance on franchisee-owned outlets may also significantly weaken the positive association between the extent of their presence in relationship law states and systemwide litigation. The key to understanding this conflict-dampening effect lies in acknowledging the regulatory context and its (mis)fit with the franchise ownership structure (Barthélemy 2008). Consider the situation of a franchisor with a low level of reliance on franchisee-owned outlets. Recall that one of the pertinent effects of relationship law is to reduce the threat of franchisors terminating the franchise relationship (Brickley, Dark, and Weisbach 1991). As the number of relationship law states in which the franchisor operates increases, so does the number of franchisees covered by relationship law statutes; in turn, more franchisees gain a sense of increased security and an expectation of continuity (Benoliel 2009). This expectation stands in stark contrast to the credible threat of replacement that franchisors' reliance on company-owned outlets poses for franchisees (i.e., due to lower levels of reliance on franchisee-owned outlets). The lack of fit between expectations engendered by relationship law regimes and those implied by the franchise ownership structure creates the spark for a heightened likelihood of serious conflict.

As franchisors rely increasingly on their franchisees for market presence, the credible threat of franchisee replacement by company-owned outlets is weakened (Dutta et al. 1995). Moreover, the de-escalation of this ownership structure-elicited threat is in conformance with the relationship law-induced erosion of the credible threat of termination. The alignment of franchisor-franchisee expectations and perceptions is likely to create a less litigious mood on the part of both parties.

H_{5b}: The greater the franchisors' reliance on franchisee-owned outlets, the weaker the positive association between the extent of franchisors' presence in relationship law and systemwide litigation incidence.

¹Note that although both franchisee empowerment and potential franchisee shirking would result in a greater 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.

Dyadic (Immediate) Versus Systemwide (Longer-Term) Outcomes

Given that both parties' litigation initiation and resolution choices are made with the intent of 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 that the party initiating the litigation will prevail in the conflict at hand, note that franchisors' relatively greater experience with litigation enables them to view the decisions to initiate and resolve litigated conflict as carefully considered strategic choice variables (Priest and Klein 1984). Rational parties are apt to steer away from efforts that are likely to be unsuccessful (Priest and Klein 1984). Accordingly, franchisors typically only undertake litigation initiation with expectations of prevailing in the conflict. In contrast to franchisors' careful selection of issues worth litigating (Bebchuk 1984), franchisees are likely to be less strategic in their conflict management. Their relative lack of litigation experience manifests in "picking fights" for the wrong reasons and conducting litigation in a less effective manner (Galanter 1983). We therefore expect that franchisors initiating litigation will achieve greater levels of success in the immediate conflict compared with their less experienced franchisee partners.

Regardless of who initiates the litigation, however, resolution by ADR significantly reduces the probability of the franchisor 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 the franchisor achieving all its claims.

H_{6a}: Franchisors that initiate litigation are more likely to prevail in the focal conflict.

H_{6b}: Alternative dispute resolution is less likely to result in the franchisor prevailing in the focal conflict.

Although prevailing in the immediate conflict is important, it 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).² It is very possible for the litigious franchisor to "win the battle but lose the war"—that is, prevail in the conflict at hand and 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 trade-off between achieving dyadic, immediate goals and compromising systemwide, long-term outcomes pursuant to conflict management that we hypothesize in this article.

As the incidence of franchisor-initiated litigation increases, the relationships between the franchisor and its existing franchisees become ever more fractious (Galanter 1983),

leading to increased rates of relationship dissolution. Moreover, the franchisor gains a reputation for litigiousness (Macaulay 1963), thus driving away potential franchisees that might otherwise have joined the system. The double jeopardy of losing existing franchisees and becoming less attractive to new ones translates into unmet growth objectives. We expect the spillover from the dyadic, immediate conflict to the systemwide, long-term franchisor aspirations to be significant and negative.

In marked contrast to the ill effects of a reputation for litigiousness, the adoption of a conciliatory position sends a signal that the franchisor is willing to negotiate. Existing franchisees become aware of and appreciate the franchisor's willingness to compromise rather than prevail at the expense of its franchisee partner. Likewise, potential franchisees may take note of the franchisor's propensity for ADR and be more willing to become members of the franchise system. This should translate into an increased franchisor ability to achieve its system growth objectives.

H_{7a}: Franchisors that initiate litigation are less likely to achieve system growth goals.

H_{7b}: Reliance on ADR results in greater franchisor achievement of system growth goals.

The regulatory context is likely not only to affect the parties' conflict management choices but also to influence dyadic and systemwide outcomes directly. Recall that registration law states are likely to have the administrative and judicial infrastructure that facilitates third-party verification of adherence (or otherwise) to the franchise's contractual agreement. We would therefore expect franchisors to leverage the existing judicial infrastructure to their advantage, resulting in a greater likelihood of their achieving favorable outcomes (Galanter 1983). This may be a Pyrrhic victory, however, owing to the very disclosure such regulation is designed to provide. Specifically, information about the franchisor's disputes with its franchisees is likely not only to give pause to those considering entry into the franchise system (i.e., potential new franchisees) but also to persuade existing franchisees to exit the relationship (Macaulay 1963). The end result is an inability on the part of the franchisor to achieve its system growth goals.

H₈: Litigation in registration law states (a) leads to outcomes favoring the franchisor and (b) reduces the franchisor's likelihood of achieving system growth goals.

In contrast to registration law, we expect relationship law states to provide a supportive forum to franchisees aiming to address perceived franchisor misdeeds (Benoliel 2009). In such judicial regimes, the franchisee is likely to be given the benefit of the doubt (at least marginally), resulting in a greater likelihood of a favorable outcome for the franchisee. Similar to registration law states, we expect a reduction in the extent to which the franchisor is able to achieve its system growth goals. Such a reduction, however, probably results from the heavier burden of proof placed on the franchisor when terminating franchisees. The franchisor must deploy greater resources to establish good cause for termination (Brickley, Dark, and Weisbach 1991), resources that could have been deployed toward growing the franchise system and maintaining existing franchise relationships.

²Although this need to protect reputation holds true for both franchisors and franchisees, the onus of franchise system growth rests on the franchisor. Therefore, we consider solely the franchisor's perspective.

H₃: Litigation in relationship law states (a) leads to outcomes favoring the franchisee and (b) reduces the franchisor's likelihood of achieving system growth goals.

RESEARCH METHOD

Data Collection and Unit of Analysis

Our longitudinal examination of litigated conflict required us to obtain information about each franchisor's legal suits. Such information is provided in the FDDs filed with states' regulatory authorities and is publicly available for each franchise firm in our sample. Because each FDD provides relevant information for a three-year window, we obtained FDDs filed in 1997, 2000, and 2003 by a randomly selected sample of 75 franchisors offering business format franchise opportunities to afford ourselves an uninterrupted window of observation per firm for the nine-year period of 1995–2003. The requirement of litigation disclosure over the previous ten years enabled us to gain information on litigated conflicts involving our sample of franchisors for an even longer period, 1987–2003.

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 vs. ADR), and the terms of the judgment or settlement. We verified the reported details and filled in missing information by referring to case docket information available on Public Access to Court Electronic Records (PACER).³ In addition, we relied on *Bond's Franchise Guide* and *Entrepreneur* magazine's Franchise 500 (we used the latter as a convergent validity check) to acquire information on the

headquarters location, franchising history, royalty rates, and so on for each of the franchisors in our sample. Finally, we obtained information on economic and regulatory conditions from a web source (<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. The FDDs and PACER yielded information on 526 instances of litigation across the 75 franchise firms in our sample. After removing 89 cases that did not involve franchisor–franchisee conflict and 26 cases with excessive missing information, we retained 411 litigated instances of conflict.

Measures

Regulatory environment and litigation incidence. For each of the 75 franchisors in our sample, we created a measure $REGIS_{it}$ ($RELNUM_{it}$) representing the number of registration (relationship) law states in which the franchisor i operated during 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. We assigned $REGIS_{ij}$ a code of 1 if the conflict was litigated in a registration law state and 0 otherwise. We adopted a similar coding scheme for REL_{ij} . For each of the franchise systems in our sample, the variable $INCID_{it}$ took a value of 1 if litigation was reported for franchise system i in year t ; otherwise, $INCID_{it} = 0$.

Franchise ownership structure. Consistent with prior research (Perryman and Combs 2012; Srinivasan 2006), we operationalize the franchise ownership structure in terms of the franchisor's reliance on franchisee-owned outlets for market presence. The variable $PROPFE_{it}$ reflects the number of franchisee-operated units standardized by the total number of operating units for franchisor i in year t .

Litigation initiation and resolution. We focus on both parties' litigated conflict management efforts, examining initiation as well as resolution. We operationalize the fran-

Table 1
DATA SOURCES AND VARIABLES

Data Sources	Theoretical Constructs	Variables
FDDs (1997, 2000, and 2003)	Litigation incidence	Occurrence of litigation (INCID)
	Franchisee shirking	Index of unpaid dues and trademark misappropriation (FESH)
	Franchisor shirking	Index of information disclosure and breach of contract (FRSH)
	Litigation initiation by franchisor	Franchisor initiating (FRINIT)
	Resolution by ADR	Use of ADR (ADR)
	Relationship dissolution	Relationship dissolution (RELDISS)
	Prior litigation success	Franchisor win ratio (FRWIN)
<i>Bond's Franchise Guide</i> (1991–2004)	Outcome favorability	Outcome favorability (OUTCOME)
	Number of registration law states in which the franchisor competes	Number of registration law states (REGISNUM)
	Number of relationship law states in which the franchisor competes	Number of relationship law states (RELNUM)
	Number of franchised units	Number of franchised units (FRUNITS)
	Extent of franchisor reliance on franchisee-owned units	Ratio of franchised units to total units (PROPFE)
<i>Entrepreneur</i> magazine (1987–2003)	Achievement of system growth goals	Expansion ratio (EXPAN)
	Franchisor incentive to perform	Royalty rates (ROYALTY)
	Franchisee incentive to perform	Total investment (TOTINV)
Web sources	Economic environment	U.S. GDP (GDP)
	Regulatory environment: registration law state	Registration law (REGIS)
	Regulatory environment: relationship law state	Relationship law (REL)

³Public Access to Court Electronic Records is an online public access service that enables registered users to obtain case and docket information from federal appellate, district, and bankruptcy courts as well as the PACER Case Locator index. The federal judiciary provides PACER in keeping with its commitment to provide public access to court information through a centralized service.

chisor'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, both litigants must agree to resolve the litigation by ADR procedures (arbitration, mediation, or negotiation) (Goldberger, Sander, and Rogers 1999). We therefore operationalize resolution choice as binary variable ADR, which takes a value of 1 when the litigated conflict (regardless of which party initiated it) 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, resulting in intercoder agreement of 95%. The few instances of coding disagreement were resolved by discussion. We measured the franchisors' achievement of system expansion goals on an annual basis for each year in our sample. For each year, we first calculated the number of new franchise outlets, $\Delta\text{FRANUNITS}_t$, as the difference between the number of franchise outlets reported in the current year and the year before ($\text{FRANUNITS}_t - \text{FRANUNITS}_{t-1}$). Then we standardized this difference by the number of new outlets each franchisor planned to open the following year (PROJUNITS_{t-1}), reported in *Bond's Franchise Guide* in year $t-1$, so we could assess the extent to which each franchisor's expansion goals stated in year $t-1$ were met in year t . To avoid negative values, we then undertook a natural logarithmic transformation of the preceding variable after adding a constant c , resulting in the measure $\text{EXPAN} = \ln[(\Delta\text{FRANUNITS}_t / \text{PROJUNITS}_{t-1}) + c]$.

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 and may do so by litigation, if necessary. In times of plenty, the franchise relationship is less likely to experience stress, and parties are more likely to adopt a cooperative stance. We therefore control for the GDP growth rate (GDP) and its probable negative (positive) impact on litigation initiation (ADR). Prior research suggests the royalty rate (ROYAL) to be an important determinant of franchisor behavior (Lafontaine 1992); therefore, we control for it as well. Franchisors that have had more (less) franchising experience, as reflected by the years elapsed since they began franchising (DUR), are also more (less) likely to initiate litigation (choose ADR).

Furthermore, we hypothesize prior litigation success (FRWIN) to play a critical role in determining a franchisor's 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 number 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 possibil-

ity with a dichotomous variable that takes the value 1 if either party terminates the relationship before litigation.

We also controlled for FRUNITS_{it} , the natural log-transformed number of franchisee-owned units of franchise i in year t . In addition, we included the incidence of shirking by both parties. For franchisee shirking, we coded the binary variable UNPAID as 1 if unpaid dues by the franchisee were the reported reason for the conflict (0 otherwise); we coded the variable TRADEMK as 1 if the reason reported for the conflict was trademark misappropriation by the franchisee (0 otherwise). We then computed franchisee shirking (FESH_{ij}) as the sum of UNPAID and TRADEMK. Similarly, we coded INFO as 1 if the franchisor's failure to provide adequate information disclosure or provision of misleading information was the cited reason for the litigation and as 0 otherwise. We coded the variable BREACH as 1 if breach of contract was claimed by the franchisee and as 0 otherwise. We then computed franchisor shirking (FRSH_{ij}) as the sum of INFO and BREACH. 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 (1979) selection model. 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 systemwide outcomes are probably related, requiring the specification of a correlated error structure among the four outcomes of interest to us (Greene 2003). Third, to assess the impact of litigation initiation and resolution choices on both outcome favorability and the franchisor's achievement of its expansion goals, recognition of the endogeneity of the former regressors is required. Fourth, 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 all cases of franchisor-franchisee litigation observed for all 75 firms in our sample, each observed over multiple years. Although this initial sample comprised 1,133 observations, missing data on franchisors' presence across multiple states and ownership structures resulted in 622 complete observations for the selection regression estimation.⁴ Conditioning on litigation incidence enables us not only to account for litigation selection but also 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

⁴Paired t-tests conducted on the incidence of litigation across the observations excluded and included in the first-stage selection model yielded nonsignificant differences ($p > .10$), suggesting no systematically missing values (Little and Rubin 2002).

⁵Had we not specified the first-stage Heckman selection model in Equation 1, $(1 - p)$ would confound the odds of the franchisee initiating litigation with those of observing litigation for franchise system i in year t . In our model, the latter is explicitly and separately accounted for in Equation 1, which enables us to account for two-sided moral hazard.

Table 2
DESCRIPTIVE STATISTICS AND CORRELATION MATRIX

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1. INCID	— ^a																	
2. FRINIT	—	—																
3. ADR	—	.08																
4. OUTCOME	—	.12*	.15*															
5. REGISNUM	.14*	-.06	-.04	.01														
6. RELNUM	.12*	-.02	-.06	.00	.86*													
7. PROPFE	.00	.07	-.06	-.05	-.01	-.01												
8. REGIS	—	-.05	-.12*	-.05	-.12	-.11	.19*											
9. REL	—	-.11*	.01	-.03	-.03	-.07	-.11	.51*										
10. Ln(TOTINV)	.18*	-.01	-.02	.01	.09*	.07	-.31*	-.08	-.06									
11. FESH	—	.64*	.08	.10	.02	-.00	.03	-.04	.01	.05								
12. FRSH	—	-.47*	-.06	-.08	.03	.01	.09	.11*	.04	-.06	-.28*							
13. GDP	-.00	.03*	.19*	-.10	-.02	-.01	-.02	-.06	-.13*	.07*	-.08	-.12*						
14. ROYAL	.01	-.04	-.07	-.01	-.06	-.06	.05	.07	.04	-.07*	-.03	-.03	.02					
15. RELDISS	—	.15*	-.10*	-.17*	.03	.03	.05	.05	.06	.02	.11*	-.03	-.07	.06				
16. Ln(DUR)	.37*	.05	.02	.08	.27	.26*	-.01	-.04	-.04	.36	-.02	-.10*	.03	-.04	.04			
17. FRWIN _{t-1}	—	.16	-.01	.07	-.01	.07	-.07	-.06	-.03	.23*	.15	-.10	-.03	.03	-.03	.25*		
18. Ln(FRUNITs)	.32	-.04	-.03	-.06	.53*	.49*	.29*	.05	-.07	.06*	-.02*	.02	.02	-.06	.04	.59*	.01	
M	.29	.36	.69	1.11	13.13	9.97	.86	.38	.50	11.92	.38	.38	3.11	6.42	.39	3.18	.30	5.61
(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)

* $p < .05$.

^aVariables indicated by — are only observed when INCID = 1; therefore, we do not report their correlations with INCID.

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:

$$(1) \text{ INCID}_{it} = \beta_{10} + \beta_{11}\text{REGISNUM}_{it} + \beta_{12}\text{RELNUM}_{it} + \beta_{13}\text{PROPFE}_{it} + \beta_{14}\text{PROPFE}_{it} \times \text{REGISNUM}_{it} + \beta_{15}\text{PROPFE}_{it} \times \text{RELNUM}_{it} + \sum_{16}^{17} \beta \text{Controls} + \omega_{1i}.$$

Conditional on $\text{INCID}_{it} = 1$ ($n = 411$),

$$(2) \text{ FRINIT}_{ij} = \beta_{20} + \beta_{21}\text{REGIS}_{ij} + \beta_{22}\text{REL}_{ij} + \beta_{23}\text{PROPFE}_{ij} + \sum_{24}^{210} \beta \text{Controls} + \omega_{2i},$$

$$(3) \text{ ADR}_{ij} = \beta_{30} + \beta_{31}\text{REGIS}_{ij} + \beta_{32}\text{REL}_{ij} + \beta_{33}\text{PROPFE}_{ij} + \beta_{34}\text{FRINIT}_{ij} + \sum_{35}^{310} \beta \text{Controls} + \omega_{3i},$$

$$(4) \text{ OUTCOME}_{ij} = \beta_{40} + \beta_{41}\text{FRINIT}_{ij} + \beta_{42}\text{ADR}_{ij} + \beta_{43}\text{REGIS}_{ij} + \beta_{44}\text{REL}_{ij} + \omega_{4i}, \text{ and}$$

$$(5) \text{ EXPAN}_{ij} = \beta_{50} + \beta_{51}\text{FRINIT}_{ij} + \beta_{52}\text{ADR}_{ij} + \beta_{53}\text{REGIS}_{ij} + \beta_{54}\text{REL}_{ij} + \omega_{5i},$$

where

INCID_{it} = incidence of litigation for franchisor i in year t ;
 REGISNUM_{it} = count of the registration law states in which franchisor i operates during year t ;
 RELNUM_{it} = count of the relationship law states in which franchisor i operates during year t ;
 FRINIT_{ij} = franchisor i initiating litigation in conflict j ;
 ADR_{ij} = conflict j involving franchisor i settled by ADR;

REGIS_{ij} = conflict j involving franchisor i in registration law state;

REL_{ij} = conflict j involving franchisor i in relationship law state;

PROPFE_{it} = franchisor i 's reliance on franchisee-owned units in year t ;

OUTCOME_{ij} = outcome of conflict j in favor of franchisor i ;

EXPAN_{ij} = extent of desired expansion achieved by franchisor i in the year following conflict j ;

Controls = the vector of coefficients corresponding to ROYAL, TOTINV, GDP, DUR, RELDISS, FRWIN, FRUNITS_{it}, FESH_{ij}, and FRSH_{ij}, respectively; and

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

We jointly estimate the preceding system of equations (including the selection model) using Roodman's (2009) conditional mixed-process regression procedure. This 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 estimator.

RESULTS

Table 3 displays the conditional mixed-process regression estimates. The results provide considerable support for our hypotheses. The significant Wald chi-square statistic of 145.2 ($p < .001$) demonstrates that across the system of equations estimated, the predictors have satisfactory explanatory power.

Table 3
CONDITIONAL MIXED-PROCESS REGRESSION ESTIMATES

	Dependent Variables									
	n = 622		n = 411							
	INCID		FRINIT		ADR		OUTCOMEFR		EXPAN	
Independent Variables										
Intercept	-2.02	(-1.23)	-2.45	(-1.84)*	1.44	(1.96)*	.00	(.00)	2.35	(19.30)***
REGISNUM	-.32	(-2.49)**								
RELNUM	.41	(2.50)**								
PROPFE	-.77	(-.76)	1.51	(2.36)**	-.48	(-.98)				
REGISNUM × PROPFE	.45	(2.90)**								
RELNUM × PROPFE	-.51	(-2.57)**								
REGIS			.20	(.93)	-.53	(-2.74)**	.22	(.82)	-.16	(-2.17)*
REL			-.58	(-2.79)**	.28	(1.33)	-.28	(-1.04)	-.07	(-1.14)
FRINIT					.55	(2.03)*	.99	(4.84)***	-.29	(-3.91)***
ADR							-.95	(-3.07)***	.44	(2.59)***
Control Variables										
Ln(TOTINV)	.18	(2.35)**								
FESH			1.80	(7.94)***						
FRSH			-1.59	(-4.62)***						
GDP	-.14	(-2.24)*	.19	(2.37)**	.07	(.77)				
ROYAL			-.03	(-.44)	-.01	(-.53)				
Ln(DUR)			.29	(.81)	-.20	(-.94)				
RELDISS			.24	(1.24)	-.37	(-3.22)***				
FRWIN(t – 1)			.85	(2.19)*	-.78	(-3.61)***				
Ln(FRANUNITS)			-.25	(-3.72)***	.01	(.21)				
Wald χ^2 (p-value)	145.20	(.0000)								

* $p < .05$ (one-tailed).

** $p < .01$ (one-tailed).

*** $p < .001$ (one-tailed).

Notes: z-statistics are in parentheses.

Impact of Regulation and Franchise Ownership Structure

With respect to litigation incidence, we find, consistent with H_1 and H_3 , that the greater the number of registration (relationship) law states in which the franchisor competes, the lower (higher) the incidence of litigation ($b_{11} = -.32$, $b_{12} = .41$, both $ps < .01$). These strong main effects of the regulatory context on the franchise system-wide incidence of litigation are, however, significantly weakened by the franchisor's ownership structure. Specifically, franchisors' reliance on franchisee-owned outlets is associated with a significant uptick in litigation incidence, notwithstanding the number of registration law states in which they compete ($b_{14} = .45$, $p < .01$). A similar significant weakening of the positive main effect of relationship law on litigation incidence is also in evidence ($b_{15} = -.51$, $p < .01$). Together, these results provide strong support for H_{5a} and H_{5b} .

To gain a better understanding of the moderating impact of franchise ownership structure, we conducted tests of the simple slopes at low (-1 SD), high ($+1$ SD), and mean values of PROPFE (Cohen et al. 2003). Figure 2, Panel A (B), represents the simple slope of the number of registration (relationship) law states on litigation incidence for low and high reliance on franchisee-owned outlets. The inverse association between REGISNUM and INCID (simple slope of REGIS = $-.04$) is reversed for franchisors with high levels of PROPFE (simple slope of REGIS = $.12$; see Figure 2, Panel A). For RELNUM, the effect of PROPFE is just as

pronounced (see Figure 2, Panel B). For franchisors with low reliance on franchisee-owned outlets, the association between RELNUM and INCID is positive (simple slope of REL = $.09$); we observe the opposite under conditions of high PROPFE (simple slope of REL = $-.09$). The post hoc probing of the interactions provides strong support for our hypotheses and facilitates a clearer understanding of the subtleties of conflict management.

Franchisor–Franchisee Litigation Choices

Conditional on the observance of litigation, we find mixed evidence for the hypothesized effects of the regulatory context on franchisors' and franchisees' litigation initiation and resolution choices. Although franchisors are not more likely to initiate litigation in registration law states ($b_{21} = .20$, n.s.), they are less likely to rely on ADR for conflict resolution ($b_{31} = -.53$, $p < .01$). Thus, H_{2a} is rejected, but H_{2b} is supported. We find partial support for H_4 as well, because relationship law states elicit greater odds of franchisees initiating litigation ($b_{22} = -.58$, $p < .01$) but have no significant impact on their resolution choices ($b_{32} = .28$, n.s.). We thus find support for H_{4a} but reject H_{4b} .

We find strong support for H_6 , relating franchisors' litigation initiation ($b_{41} = .99$, $p < .001$) and reliance on ADR ($b_{42} = -.95$, $p < .001$) to their odds of prevailing in the focal conflict. Furthermore, franchisor litigiousness is associated with lower levels of expansion goals achieved ($b_{51} = -.29$, $p < .001$). Reliance on ADR, however, does result in increased achievement of system expansion goals ($b_{52} = .44$, $p < .001$), in support of H_7 .

Litigation Outcomes

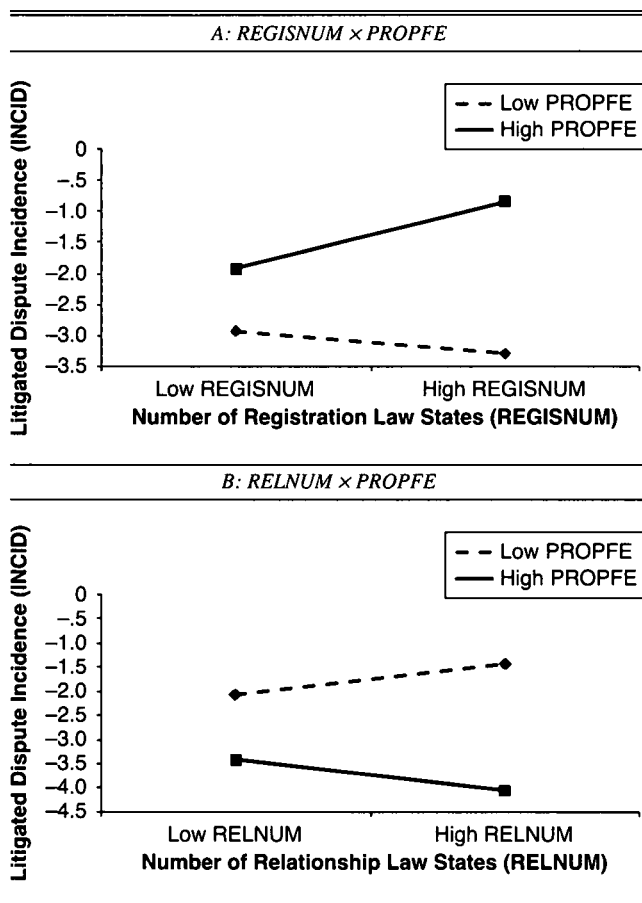
Turning to the direct effects of the regulatory context, we find evidence in support of only H_{8b} ($b_{53} = -.16$, $p < .05$). None of the other hypothesized direct effects of regulation find support ($b_{43} = .22$, $b_{44} = -.28$, $b_{54} = -.07$, all n.s.). With respect to the control variables, we find higher levels of franchisee investment (GDP growth rates) to be associated with greater (lesser) odds of litigation incidence ($b_{16} = .18$, $p < .01$; $b_{17} = -.14$, $p < .05$). The GDP growth rates are associated with a significant increase in franchisor odds of litigation initiation ($b_{24} = .19$, $p < .01$), but they do not appear to affect ADR reliance ($b_{34} = .07$, n.s.). Royalty rate and franchising experience have no significant impact on parties' litigation initiation or resolution choices ($b_{25} = -.03$, $b_{35} = -.01$, $b_{26} = .29$, $b_{36} = -.20$, all n.s.). Whereas relationship dissolution has no impact on litigation initiation ($b_{27} = .24$, n.s.), the termination of the relationship before litigation ensues significantly reduces the likelihood of resolution by ADR ($b_{37} = -.37$, $p < .001$). We also find that the greater the franchisor's record of prior litigation success, the greater (lesser) the likelihood of litigation initiation (ADR resolution) ($b_{28} = .85$, $p < .05$; $b_{38} = -.78$, $p < .001$). Finally, as we expected, the likelihood of the franchisor (franchisee) initiating litigation increases in response to franchisee (franchisor) moral hazard ($b_{29} = 1.80$, $b_{210} = -1.59$, both $ps < .001$).

Alternative Model Specifications

Could the impact of each regulation (registration law and relationship law) be amplified by the presence of the other? To test this possibility, we estimated several alternate model

Figure 2

SIMPLE SLOPES ANALYSIS OF SIGNIFICANT MODERATORS



specifications. First, we attempted to include the multiplicative interaction of $\text{REGISNUM} \times \text{RELNUM}$ as an additional predictor in the selection model of litigation incidence (Equation 1). We also included the multiplicative interaction of $\text{REGIS} \times \text{REL}$ in the subsequent models predicting litigation initiation, resolution, and the dyadic and systemwide outcomes, both separately for each outcome as well as together (Equations 2–5). Across all alternative model specifications, the interaction term remained non-significant and the fit statistics suffered relative to the hypothesized model. At least within the present context, there seems to be no evidence of such amplification of the impact of regulation.

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 businesses operate (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 next discuss how the regulatory context frames franchisors' and franchisees' litigation choices both by itself and in combination with franchisors' ownership structure and explore the theoretical and managerial implications thereof. Our findings inform marketers about an important public policy issue regarding a critical sector of the economy.

Does Franchise Regulation Reduce or Promote Conflict?

As with most phenomena, the answer is not straightforward. Rather, whether franchise regulations serve to ratchet conflict up or down depends on (1) whether we adopt a systemwide perspective or choose instead to focus on particular regulatory contexts (regulated vs. nonregulated states), (2) the particular regulation we consider (registration vs. relationship law), and (3) the ownership structure of the channel system—specifically, the extent to which the franchisor relies on 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 systemwide. Across regulated and nonregulated markets alike, registration law–induced transparency of franchisors' operations effectively reduces miscommunication and unmet expectations, thereby promoting more harmonious relations. This negative association between registration law and systemwide litigation incidence is, however, reversed when litigation occurs in states subject to registration law. Within registration law regimes, the well-specified nature of franchisee obligations enables easier and more complete verification of (non)performance. Franchisors are therefore less reticent to press their claims in court.

Relative to registration law, the impact of relationship law on litigation is more straightforward. The increased difficulty of franchisee termination brought about by relationship law 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 provides greater support for the former thesis. Note that our findings explicitly suggest that the franchisee 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 probably not what regulators intended, it is evident that relationship law has prompted a greater appreciation among franchisees of their rights.

The preceding direct effects of regulation are, however, significantly tempered by increases in franchisors' reliance on their franchisees for market presence. We find that a higher proportion of franchisee-owned outlets translate to a greater likelihood of litigation, probably caused by the lack of fit between the reduced cost of franchisor enforcement efforts and the resultant weakening of the credible threat of termination. In contrast, franchise systems that have a significant presence in relationship law states and rely on a higher proportion of franchisee-owned outlets experience greater environment–strategy alignment. Specifically, franchisors seem to realize that the franchisee has the upper hand not only because the latter owns and operates a higher proportion of outlets but also because relationship law implies a “franchisee day in court.” The result is a reduced propensity for litigation between the parties.

Overall, our own assessment of franchise regulation is positive. 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 franchise operation in multiple registration law states is significantly associated with lower systemwide incidence of litigation, within individual registration law regimes, franchisors are less prone to rely on ADR methods. It is worth noting, however, that franchisors' increased assertiveness is primarily related to their 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 relationship law bode well for franchisor–franchisee partnerships.

Theoretical Implications

Perhaps the most important theoretical implication to emerge from our study is that the decisions regarding *when* to initiate litigation and *how* to resolve it are distinct yet highly interrelated strategic choices. Parties making these choices seem to be cognizant of the regulatory context in which they operate. Specific dimensions of this context work to either encourage or discourage a proclivity for litigation and its resolution. To the best of our knowledge, our study is the first rigorous, multiyear, multifranchise 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 of our analysis provide strong support for the notion that franchisors adopt a strategic cost–benefit calcu-

lative 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: they ensure 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).⁶ Note also that, all else remaining constant, franchisors initiating legal claims against their franchisees are more likely to agree to ADR rather than insist on adjudication. The picture that emerges here is not one of a power-hungry litigant that is eager to "punish" even the slightest transgression but rather that of a thoughtful partner that is nevertheless willing to do what is necessary to safeguard the franchise brand and its promise (Antia and Frazier 2001).

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 its immediate goal, the situation is completely reversed for longer-term strategic objectives. The present research thus identifies a distinct trade-off that channel partners must weigh as they face a dispute, the consideration of which may provide an effective brake to inexorable conflict. Note that, for the most part, the regulatory environment seems to affect both dyadic and system-wide outcomes indirectly. Contrary to our expectations, only registration law has a negative effect on franchisors' achievement of systemwide expansion goals. Instead, the regulatory context seems to significantly inform both parties' conflict initiation and resolution choices and, in turn, their corresponding outcomes. Our findings are consistent with the notion that the regulatory context serves as a backdrop against which firms conduct their operations (Grewal and Dharwadkar 2002).

Managerial Implications

Our study provides useful guidance to both franchisors and their franchisees. 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. Undoubtedly, by adopting an aggressive conflict management approach, the likelihood of the franchisor achieving its immediate purpose is increased. 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 risking need-

less provocation or being perceived as being weak, each party may calibrate its conflict management response effectively. Franchisees would do well not to misuse or appropriate franchise trademarks and should make timely royalty payments to their franchisor. For their part, franchisors should pay particular attention to the claims they make when attempting to obtain new franchisees, because these claims tend to be the most commonly observed grounds for franchisee-initiated litigation. With this knowledge, both channel partners can make better decisions about their own conflict management approaches.

Limitations and Further Research Directions

Our study is subject to some limitations, which provide worthwhile future research opportunities. First, although our use of archival data from multiple sources provides rich information on multiple franchisors' conflict management choices over an extended window of observation, we must rely on indicators for the theoretically relevant variables in this study. Future studies of conflict management would benefit from integrating archival and more direct (perhaps survey-based) operational measures of the theoretical constructs. Second, despite considering both parties' perspectives of the conflict, relevant information on individual franchisees is limited solely to the contents of the franchisor-reported litigation summaries we examined. Further research could make use of the court docket information on record to recreate a richer account of each conflict as it evolved.

A third limitation of the present research lies in our conceptualization and operationalization of franchise ownership structure at an aggregate, systemwide level. We are therefore unable to speak to the possibility of state-by-state variations in the proportion of franchisee-owned outlets and their implications for franchisors' conflict management choices across individual regulatory jurisdictions. A rigorous assessment of the drivers and consequences of local variations in ownership structure would likely prove promising.

REFERENCES

- Antia, Kersi D. and Gary L. Frazier (2001), "The Severity of Contract Enforcement in Interfirm Channel Relationships," *Journal of Marketing*, 65 (October), 67–81.
- Barthélemy, Jérôme (2008), "Opportunism, Knowledge, and the Performance of Franchise Chains," *Strategic Management Journal*, 29 (13), 1451–63.
- Bebchuk, Lucian A. (1984), "Litigation and Settlement Under Imperfect Information," *RAND Journal of Economics*, 15 (3), 404–415.
- Benoliel, Uri (2009), "The Expectation of Continuity Effect and Franchise Termination Laws: A Behavioral Perspective," *American Business Law Journal*, 46 (1), 139–77.
- Bergen, Mark, Shantanu Dutta, and Orville C. Walker Jr. (1992), "Agency Relationships in Marketing: A Review of the Implications and Applications of Agency and Related Theories," *Journal of Marketing*, 56 (July), 1–24.
- Blair, Roger D. and Francine Lafontaine (2010), *The Economics of Franchising*. New York: Cambridge University Press.
- Bradach, Jeffrey L. (1997), "Using the Plural Form in the Management of Restaurant Chains," *Administrative Science Quarterly*, 42 (2), 276–303.

⁶As pointed out by an astute reviewer, franchisees look to the franchisor for policing and enforcement of critical performance obligations and are not likely to oppose such efforts (Lal 1990).

- and Robert G. Eccles (1989), "Price, Authority, and Trust: From Ideal Types to Plural Forms," *Annual Review of Sociology*, 15, 97–118.
- Brickley, James A., Frederick H. Dark, and Michael S. Weisbach (1991), "The Economic Effects of Franchise Termination Laws," *Journal of Law and Economics*, 34 (1), 101–132.
- Brown, James R. and Ralph L. Day (1981), "Measures of Manifest Conflict in Distribution Channels," *Journal of Marketing Research*, 18 (August), 263–74.
- Cohen, Jacob, Patricia Cohen, Stephen G. West, and Leona S. Aiken (2003), *Applied Multiple Regression/Correlation Analysis for Behavioral Sciences*, 3d ed. Hillsdale, NJ: Lawrence Erlbaum Associates.
- Dant, Rajiv P. and Patrick L. Schul (1992), "Conflict Resolution Processes in Contractual Channels of Distribution," *Journal of Marketing*, 56 (January), 38–54.
- Drahozal, Christopher R. and Keith N. Hylton (2003), "The Economics of Litigation and Arbitration: An Application to Franchise Contracts," *The Journal of Legal Studies*, 32 (2), 549–84.
- Dutta, Shantanu, Mark Bergen, Jan B. Heide, and George John (1995), "Understanding Dual Distribution: The Case of Reps and House Accounts," *Journal of Law, Economics, and Organization*, 11 (1), 189–204.
- Etgar, Michael (1979), "Sources and Types of Intrachannel Conflict," *Journal of Retailing*, 55 (1), 76–78.
- 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 (4), 4–71.
- Ganesan, Shankar (1993), "Negotiation Strategies and the Nature of Channel Relationships," *Journal of Marketing Research*, 30 (May), 183–202.
- Geweke, John (1989), "Bayesian Inference in Econometric Models Using Monte Carlo Integration," *Econometrica*, 57 (6), 1314–39.
- Goldberg, Stephen B., Frank E.A. Sander, and Nancy H. Rogers (1999), *Dispute Resolution: Negotiation, Mediation, and Other Processes*. New York: Aspen Publishers.
- Greene, William H. (2003), *Econometric Analysis*, 5th ed. Upper Saddle River, NJ: Prentice Hall.
- Grewal, Rajdeep and Ravi Dharwadkar (2002), "The Role of Institutional Environment in Marketing Channels," *Journal of Marketing*, 66 (July), 82–97.
- Grueneberg, Susan (2008), *The FTC Franchise Rule: Analysis and Commentary*. Chicago: American Bar Association.
- Hajivassiliou, Vassilis and Daniel McFadden (1998), "The Method of Simulated Scores for the Estimation of LDV Models," *Econometrica*, 66 (4), 863–96.
- Heckman, James (1979), "Sample Selection Bias as a Specification Error," *Econometrica*, 47 (1), 153–61.
- Heide, Jan B. (2003), "Plural Governance in Industrial Purchasing," *Journal of Marketing*, 67 (October), 18–29.
- and Anne S. Miner (1992), "The Shadow of the Future: Effects of Anticipated Interaction and Frequency of Contact on Buyer–Seller Cooperation," *Academy of Management Journal*, 35 (2), 265–91.
- Hibbard, Jonathan D., Nirmalya Kumar, and Louis W. Stern (2001), "Examining the Impact of Destructive Acts in Marketing Channel Relationships," *Journal of Marketing Research*, 38 (February), 45–61.
- Hsiao, Cheng (2003), *Analysis of Panel Data*. Cambridge, UK: Cambridge University Press.
- International Franchise Association (2013), "Franchising," (accessed June 25, 2013), [available at <http://buildingopportunity.franchise.org/>].
- Justis, Robert T. and Richard J. Judd (2002), *Franchising*. Cincinnati: South-Western Publishing.
- Kashyap, Vishal, Kersi D. Antia, and Gary L. Frazier (2012), "Contracts, Extracontractual Incentives, and *Ex Post* Behavior in Franchise Channel Relationships," *Journal of Marketing Research*, 49 (April), 260–76.
- Keane, Michael P. (1994), "A Computationally Practical Simulation Estimator for Panel Data," *Econometrica*, 62 (1), 95–116.
- Klein, Benjamin (1980), "Transaction Cost Determinants of 'Unfair' Contractual Arrangements," *American Economic Review*, 70 (2), 356–62.
- Lafontaine, Francine (1992), "Agency Theory and Franchising: Some Empirical Results," *RAND Journal of Economics*, 23 (2), 263–83.
- Lal, Rajiv (1990), "Manufacturer Trade Deals and Retail Price Promotions," *Journal of Marketing Research*, 27 (November), 428–44.
- Little, Roderick J.A. and Donald B. Rubin (2002), *Statistical Analysis with Missing Data*. Hoboken, NJ: John Wiley & Sons.
- Macaulay, Stewart (1963), "Non-Contractual Relations in Business: A Preliminary Study," *American Sociological Review*, 28 (1), 55–67.
- Michael, Steven C. (2000), "Investments to Create Bargaining Power: The Case of Franchising," *Strategic Management Journal*, 21 (4), 497–514.
- Murphy, Kevin (2006), *Franchise Handbook: A Complete Guide to All Aspects of Buying, Selling, or Investing in a Franchise*. Ocala, FL: Atlantic Publishing Company.
- Parmigiani, Anne and Will Mitchell (2009), "Complementarity, Capabilities, and the Boundaries of the Firm: The Impact of Within-Firm and Interfirm Expertise on Concurrent Sourcing of Complementary Components," *Strategic Management Journal*, 30 (10), 1065–91.
- Perryman, Alexa A. and James G. Combs (2012), "Who Should Own It? An Agency-Based Explanation for Multi-Outlet Ownership and Co-Location in Plural Form Franchising," *Strategic Management Journal*, 33 (4), 368–86.
- Pondy, Louis R. (1967), "Organizational Conflict: Concepts and Models," *Administrative Science Quarterly*, 12 (2), 296–320.
- Priest, George L. and Benjamin Klein (1984), "The Selection of Conflicts for Litigation," *Journal of Legal Studies*, 13 (1), 1–55.
- Roodman, David (2009), "Estimating Fully Observed Recursive Mixed-Process Models with CMP," Working Paper No. 168, Center for Global Development.
- Rubin, Paul H. (1978), "The Theory of the Firm and the Structure of the Franchise Contract," *Journal of Law and Economics*, 21 (1), 223–34.
- Shane, Scott (2005), *From Ice Cream to the Internet: Using Franchising to Drive the Growth and Profits of Your Company*. Upper Saddle River, NJ: Prentice Hall.
- Srinivasan, Raji (2006), "Dual Distribution and Intangible Firm Value: Franchising in Restaurant Chains," *Journal of Marketing*, 70 (July), 120–35.
- Williamson, Oliver E. (1996), *The Mechanisms of Governance*. New York: Oxford University Press.

Copyright of Journal of Marketing Research (JMR) is the property of American Marketing Association and its content may not be copied or emailed to multiple sites or posted to a listserv without the copyright holder's express written permission. However, users may print, download, or email articles for individual use.