A STUDY OF CONTEMPORARY FRANCHISING, WITH PARTICULAR EMPHASIS ON FACTORS LEADING TO THE REPURCHASE OF FAST-FOOD SERVICE FRANCHISES

DISSERTATION

Presented to the Graduate Council of the North Texas State University in Partial Fulfillment of the Requirements

For the Degree of

DOCTOR OF PHILOSOPHY

By

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August, 1972

Tinney, Terry Jack, A Study of Contemporary Franchising, With Particular Emphasis on Factors Leading to the Repurchase of Fast-Food Service Franchises. Doctor of Philosophy (Business Administration), August, 1972, 170 pp., 12 tables, bibliography, 64 titles.

The franchise system of distribution has been credited with capacity to preserve the status of small business in a complex economic system. Service-franchise systems combine the enthusiasm and dedication of individual entrepreneurs with the size, knowledge, and experience of large-scale business economies. Within the system of service franchising, however, forces may exist which lead parent companies to repurchase service establishments from franchisees. Such forces may reverse the influence of franchising on the status of small business.

This study explores the question of whether repurchasing of service establishments is an inherent characteristic of service franchising. The answer to this question holds substantial consequences for the economy and for public policy toward franchising.

Concentrating on contemporary franchising, this study relies heavily upon secondary data concerning the nature and development of franchising and the posture which public policy has taken toward franchise practices. Data needed for analysis of forces leading franchisors to purchase service

establishments are provided by thirty-three responses to a questionnaire sent to fast-food service franchisors. Case studies of twenty-four franchisees are utilized in an assessment of the willingness of franchisees to sell their businesses.

It is asserted that two rationales may explain franchisors' desire to own their franchised establishments. First, franchising may be adopted as a temporary expediency to finance expansion. Thus, as a franchisor develops a larger revenue base, the need to franchise dissipates. Second, frustrations of interorganizational administration may eventually lead a franchisor to revert to a wholly owned chain.

Among firms responding to the questionnaire, 21 per cent of the fast-food service establishments in operation in 1970 were owned by the parent company. Sixty-six per cent of the total revenues of responding firms were derived from parent-company establishments. Both of these proportions rose during the period from 1960 to 1970. However, no significant correlation is found to exist between the above proportions and total revenues or length of time during which the franchisor had engaged in franchising.

Most of the parent-company-owned establishments among franchisors studied had never been franchised. Only 9 per cent of all establishments operating under the trademark of franchisors studied were franchised and later repurchased by the parent company.

Franchisees may desire to sell their businesses for two reasons. First, training and experience gained from the franchise decrease the level of dependency on the franchisor for assistance. This may lead to a desire to sell the franchise and initiate another business which will not require franchise royalty payments. Second, over time, franchisees may experience a heightening of aspirations which the small, service franchise cannot satisfy.

Case studies of franchisees reveal that the willingness to sell the franchise is greatest during early years of operation. In time, franchisees become more adjusted to the business and less willing to sell. This suggests that the desire to sell one's franchise is more likely to result from an erroneous decision to purchase a franchise than from the effects of time and experience.

This study finds that repurchasing is not an inherent characteristic of service franchising. As a result, although many franchise practices have been found to be in conflict with public policy, no recommendation is made for regulation of repurchasing.

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INTRODUCTION

Much has been written about franchising as the method of business operation that may preserve the status of small, independent businessmen in the retail structure. Over the past fifteen years, the expansion of franchising has stimulated a growing interest in its potentials. Few topics have received as much attention in business literature as franchising. The era of franchising has produced two dissertations. The first, written by Michael Ingraham of the University of California at Berkeley in 1963, is entitled *Management Control Potentials and Practices of Franchise Systems*. The second, written by Roger Wylie Best of the University of Arkansas in 1967, is entitled *An Investigation Comparing Franchised and Nonfranchised Firms*.

Although the existence of certain fraudulent operations in franchising has been recognized for some time, the general assessment of franchising in the literature has been favorable. In recent months, however, a rising tide of criticism has been reported. Contrary to previous criticisms, the recent disfavor has been leveled against the more established firms in the industry. These criticisms have been concerned primarily with franchising in the field of services, and particularly fast-food operations. Common among these criticisms have been over-expansion, lack of managerial services, restrictive contracts, arbitrary terminations, unfulfilled promises, and unfair buy-back clauses.[1]

Franchising has not gone unnoticed in the regulatory sphere. The Senate recently concluded a series of hearings in connection with full-disclosure legislation proposed by Senator Harrison Williams. Senator Williams' bill also proposed to regulate advertising and the use of celebrity names in connection with franchise promotion. The Federal Trade Commission has also initiated an investigation into the entire realm of franchising practices.[2] Elsewhere, class-action suits have become quite frequent as means of combating the powers of franchising companies. Most important among these have been suits concerning the right of a franchisor to require franchisees to purchase certain items from a prescribed source. A federal district court in San Francisco recently found such restrictions in violation of antitrust law.[3]

Obviously, one can foresee some changes in the nature of franchising in the future. Many of the optimistic potentials attributed to this industry in previous years may not be realized. The attitudes of the public, the business community,

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[1]<u>Wall Street Journal</u>, May 29, 1970, p. 1.

[2]<u>Wall Street Journal</u>, May 18, 1970, p. 2.

[3]<u>Wall Street Journal</u>, July 14, 1970, p. 14.

and the makers of public policy can be expected to redirect the efforts of franchising companies.[4]

Trend Toward Franchisor-Owned Establishments

It has been observed that some of the more successful franchising firms have begun purchasing the franchises that they previously sold. Many franchising agreements made provision for the purchase of the franchise by the franchisor at a price based upon a predetermined formula. This has led some to suggest that franchising was merely an expediency used to supply the interim capital requirements of the franchisor.[5] Others have indicated the possibility that the aspirations and capabilities of both franchisors and franchisees tend to change over time and that this led to the repurchase of franchised outlets by the franchisor.[6]

The assertion that franchising was primarily a method of financing expanding operations for an interim period of time appears particularly valid in those instances where the sales of the franchisor to the franchisee were not predominantly for resale or were only incidental to the sales of the franchisee. It was, however, this type of franchise that

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[4] Wall Street Journal, May 29, 1970, p. 1.

[5] "The Chains Profit by Buying the Links," Business Week, No. 2130 (June 27, 1970), p. 55.

[6] Alfred R. Oxenfeldt and Anthony A. Kelly, "Will Successful Franchise Systems Ultimately Become Wholly-Owned Chains?," Journal of Retailing, XLIV (Winter, 1968-1969), 70-72.

experienced the greatest amount of growth during the past fifteen years. Franchising, in such cases, was not a method of distribution to the ultimate consumer. As a result, the revenues of the franchisor usually represented a much smaller percentage of the retail sales of franchised outlets than was the case where franchising was a method of distribution to the ultimate consumer. Recent rulings on the right of the franchisor to require franchisees to purchase specific items from specified sources or from the franchisor tended to amplify this difference. The potential for profit and expansion for firms of this nature was limited unless they diversified or consolidated by reinvesting their profits in the business with which they were more familiar, their franchised outlets.

Implications of Franchisor Purchases of Franchised Establishments

The implications of repurchasing franchised outlets may be severe for the franchisee. First, many franchise agreements provide for the repurchase of the franchise on the basis of a predetermined formula which makes no allowance for the value of goodwill created by the franchisee. Thus, the efforts of the franchisee in getting the business developed may be without reward. Second, the franchisee may find himself without gainful employment or, at minimum, faced with the alternative of becoming a salaried manager, lacking the independence which motivated him to purchase a franchise. Third, the position of the small businessman in the retail structure may be lessened, rather than enhanced, by franchising. As a fourth implication, it can be asserted that the process of franchising and later repurchasing not only finances interim capital needs but also shifts the risk associated with each individual unit to the franchisee. Thus, the franchisor is not burdened with those outlets which proved to be mistakes. The result of this process is that only those franchisees operating less profitable outlets are assured of continued independence.

Purpose of Study

It is not known that franchising leads to wholly-owned chains. If, however, this is the case, it is a process of which potential franchisees, existing franchisees, and regulatory bodies should be aware. The purpose of this study is to explore one of the fields of franchising in which the franchisor does not, as a major part of its business, supply goods or services for purposes of resale to the ultimate consumer. This is to determine the extent to which franchising is a temporary expediency in the development of a chain of wholly-owned establishments.

Hypotheses

The extent to which franchising is transitional and the importance of this process have been determined by testing the following hypotheses.

Hypothesis I

Franchising, as a business in itself, for a particular type of outlet, ultimately reaches a state of maturity. Maturity, in this case, is defined as a state in which the rate of increase in the number of establishments in operation declines.

Hypothesis II

Over time and as the financial strength of the franchisor permits, the franchisor purchases the more profitable existing franchises. This action leads to an increase in the ratio of the sales of company-owned outlets to the total revenue of the franchisor. The implication of this action is that the principle activity of the franchisor becomes that of operating a chain of outlets rather than franchising. Thus, the net effect of franchising in terms of enhancing the status of small businessmen is substantially lessened. Any preferential status granted to franchising because it presumably favors the development of small business should be based on this net effect.

Hypothesis III

As a result of the tendency, on the part of the franchisor, to purchase only the more successful franchises, the sales volume of the remaining franchises tends to reflect a declining average.[7]

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[7]For example: Company A has five franchisees, with sales volumes of $100,000; $60,000; $50,000; $50,000; and $40,000 respectively. The average sales volume is $60,000. The parent company purchases the franchise having $100,000 in sales. The remaining franchises have an average sales volume of $50,000.

Hypothesis IV

As a franchisee matures in his ability to run his own operation, some of the services, such as managerial assistance, formerly provided by the franchisor are no longer needed. Because franchise royalties continue at their previous level, the franchisor becomes increasingly viewed as a parasite.

Hypothesis V

The willingness of some franchisees to sell their franchises increases over time as a result of a desire for change and a decreased dependency on the franchisor which fosters the feeling on the part of the franchisee that he could initiate another business and be successful.

Methodology

The sources of information for this study were both primary and secondary. Background information was plentiful in books and journal articles. Data concerning franchise operations and its legal status were available in Congressional Hearings and in other governmental publications.

The testing of hypotheses one through three was carried out by use of correlation analyses based upon questionnaires sent to each of the 308 franchising firms in the fast-food service field listed in the 1970 edition of the Franchise Annual.[8] The field of fast-food service was deemed suitable

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[8]The 1970 Franchise Annual (Chicago, 1970), pp. 28-84.

for two reasons. First, it satisfied the distinction concerning whether or not the franchisor sold items to the franchisee for resale. Second, it was deemed by many to have approached the point of market saturation.

The questionnaire was used to ascertain the following information for 1960, 1965, 1968, and 1970.

A. The number of franchised establishments in operation.

B. The number of establishments owned by the franchisor.

C. The total revenues derived from establishments owned by the franchisor.

D. The total revenues derived from franchised businesses.

E. The average sales volume of franchised establishments.

F. The per cent of franchisor-owned establishments which were originally franchised.

This information was used to determine whether or not the following conditions existed.

A. A negative correlation between the number of establishments in operation and the rate of increase in the number of establishments to indicate whether or not a state of maturity was reached as the industry grew.

B. A positive correlation between the total revenues of the franchisor and the number of establishments owned by the franchisor to indicate whether or not the franchisor repurchased franchises as his financial strength permitted.

C. A positive correlation between the total revenues of the franchisor and the percentage of the franchisor's total revenues which was derived from establishments owned by the franchisor to indicate whether or not growth of the franchisor led the firm to become primarily a chain operation.

D. A positive correlation between the age of the franchisor and the number of establishments owned by the franchisor.

E. A positive correlation between the age of the franchisor and the percentage of the franchisor's total revenues which was derived from establishments owned by the franchisor.

Hypotheses four and five were tested by case studies of selected franchisees in the fast-food service field. Franchisees were selected from Lubbock, Dallas, and Dallas suburbs. Six franchisees were selected from each of the following categories.

A. Franchises in business less than one year.

B. Franchises in operation from one to three years.

C. Franchises in operation from three to five years.

D. Franchises in operation more than five years.

The information sought concerned their satisfaction with their relationship with the franchisor, the degree to which they relied upon the franchisor for managerial services, the inadequacies of the franchisor, their satisfaction with the routine which the franchise imposed upon them, and their attitude toward selling and becoming a salaried manager.

Limitations

The methodology employed in testing hypotheses one through three has four major limitations. First, it is applicable to service franchising only to the extent that fast-food service franchising is representative of service franchising. Second, it assumed that the past was indicative of the future and that legal developments would not impede the process. Third, it assumed that the pattern followed by the respondents was not the unique product of economic conditions. Fourth, the conclusions drawn from this study are not necessarily applicable to fast-food service franchisors which were not part of the sample.

The methodology employed in testing hypotheses four and five is subject to three additional limitations. First, it assumed that the franchisees selected provided a reasonably representative cross-section of views. Second, it assumed that franchisees revealed their true attitudes. Third, it assumed that franchisees who failed during the period are similar to those studied. These assumptions and those concerning the first three hypotheses limit this study to the determination of tendencies toward the transformation of franchised systems into wholly-owned chains.

Definition of Franchising

For purposes of this study, a definition of franchising recently adopted by the Federal Trade Commission was utilized. The Federal Trade Commission defined franchising in regard to its investigation as "an arrangement in which the owner of a trademark, tradename, or copyright licenses others, under specific conditions or limitations, to use the trademark, tradename, or copyright in purveying goods or services."[9]

Organization of the Study

This investigation is divided into six chapters. Chapter I is an introductory chapter which defines the problems and sets forth the method of investigation. Chapter II traces the development of franchising from its inception through the many forms it has taken to the present. Chapter III examines the factors leading franchisees to desire to sell their franchised business and evaluates the impact of these forces on twenty-four franchisees. Chapter V explores a variety of governmental and judicial activities as they relate to franchising and presents some options on the need for regulation of repurchasing. Chapter VI provides a summary and the conclusions of this investigation.

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[9]"Legal Note," Franchise Journal (July, 1970), p. 16.

CHAPTER II

DEVELOPMENT OF FRANCHISING

The term franchise stems from the French infinitive affranchir meaning "to set free."[1] For many years it has been used to refer to the granting of a right or privilege. Its original usage and legal meaning even today lies in the context of privileges granted by governing bodies.[2] Illustrative of such applications are utility and railroad franchises,[3] municipal franchises for the operation of a public conveyance,[4] and the right to vote.[5] Although not termed franchising at the time, such arrangements have existed for centuries. During the fifth and sixth centuries, kings granted to individuals the right to collect taxes within a specified area in return for certain considerations. The era of economic policy generally termed as Merchantilism was a similar form of franchising in that the government

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[1]Denis Girard, editor, The New Cassell's French Dictionary (New York, 1967), p. 16.

[2]"Law Shapes Up On Franchising," Business Week, No. 2109 (January 31, 1970), p. 30.

[3]Robert Rosenberg and Madelon Bedell, Profits from Franchising (New York, 1969), p. 9.

[4]Harry Kursh, The Franchise Boom (New Jersey, 1969), p. 4.

[5]"Law Shapes Up On Franchising," op. cit., p. 30.

frequently reserved the right to grant trading privileges to specific companies in various lines of trade.[6]

As commonly conceived today, however, franchising refers to an arrangement between two or more private parties involving the distribution of goods or services. The arrangement is one by which the owner of a product, tradename, or process grants to another the right to deal in the product, tradename, or process in return for certain considerations.[7] Conceptually and historically, franchising belongs to a range of activities. One often encounters the term licensing in place of franchising. Patented processes for the production of a good or service may be used by others if the owner licenses others to use the process. Because many of today's franchises are structured around processes, many firms, such as Kentucky Fried Chicken, refer to their franchises as licenses. For practical purposes, these two instruments have become synonymous in the service fields.[8] In marketing spheres, phrases such as "quasi-integration" and "contractual integration" are often used to make reference to the range of activities commonly called franchising. Within these categories are

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[6]Eric Roll, A History of Economic Thought (London, 1962), p. 63.

[7]Edwin H. Lewis and Robert S. Hancock, The Franchise System of Distribution (Washington, 1963), p. 1.

[8]The franchise contracts for Whataburger Franchise, Inc., Mr. T's Pizza, Inc., and The Travellers Reservation Association use both franchise and license to refer to their agreement.

pooled buying and advertising groups, wholesaler-sponsored voluntary cooperatives, voluntary associations of retailers, voluntary associates of corporate chains, and franchised outlets of manufacturers.[9]

Thus, even within the context of arrangements between businessmen, franchising has taken several forms over time. In order to facilitate the examination of the wide range of franchise forms, it is helpful to classify the types of franchises in some logical fashion. One of the more commonly accepted methods of classification is that of grouping franchises according to the nature of the parties involved. As such, franchises may be classified as (1) manufacturer-retailer, (2) manufacturer-wholesaler, (3) wholesaler-retailer, or (4) service-sponsor.[10] A better understanding of the nature and scope of franchising may be gained from an exploration of the origins of each of these structural types of franchise arrangements.

Manufacturer-Retailer Franchise

Manufacturer-retailer franchises tend to follow three patterns. They may cover (1) the entire retail outlet, (2)

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[9]Theodore N. Beckman and William R. Davidson, Marketing (New York, 1967), pp. 293-296.

[10]William P. Hall, "Franchising--New Scope for an Old Technique," Harvard Business Review, XLII (January-February, 1964), 62-63.

an entire department within the retail outlet, or (3) a single product or product line. As early as 1863, the Singer Sewing Machine Company initiated the idea of commercial franchising when it adopted a program to develop entire retail outlets to market Singer products.[11] In 1874, Wilcox and Gibbs Sewing Machine Company adopted a franchised dealer system.[12] However, these early franchises were isolated and apparently without impact on traditional distribution channel relationships. It was not until 1898 that the chain of events which led to a widespread adoption of franchising began. At this time the first automobile franchise was granted to William E. Metzger, a Detroit dealer in electric and steam-driven cars.[13]

Prior to 1898, and for several years thereafter, numerous methods were employed in the distribution of automobiles. Direct sale to consumers was commonplace in the early years of the industry. In such cases, contact with the consumer was made by company salesmen or by direct mail. These practices continued for some time in areas where manufacturers were not represented by an intermediary. On occasion, large

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[11]Rosenberg and Bedell, _op_. _cit_., p. 9.

[12]Charles M. Hewitt, _Automobile Franchise Agreements_ (Illinois, 1956), pp. 18-19.

[13]Charles M. Hewitt, _The Development of Automobile Franchises_ (Indiana University, 1960), p. 10.

department stores dealt in automobiles. Wanamaker's Department Store, for example, is known to have served as a dealer for Searchmont and Ford in 1902 and 1903.[14] Other forms of indirect distribution included using the retail outlets of manufacturers of similar or related products and the use of one distributor for the entire output of the firm.[15]

Several explanations have been forwarded as to why the automobile industry adopted the system of franchised dealers for the distribution of their products. Charles N. Davisson has typified the distribution channel for automobiles prior to the franchise arrangement as one consisting of sales to dealers through distributors. These distributors were really large-volume, successful dealers who had extended their activities to include redistribution to smaller dealers. Manufacturers at this point in time (1900-1915) were production oriented and financially strained to the point that the distributors were granted complete freedom in handling the distribution of automobiles. As the supply of new cars increased relative to demand, manufacturers were forced to concern themselves with selling activities and began

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[14]Hewitt, Automobile Franchise Agreements, op. cit., pp. 18-19.

[15]Ibid. As cases in point, Hewitt refers to Studebaker Brothers, which in 1908 made and distributed wagons and became a dealer for E. M. F. Inc., and the case of the Reo Motor Company which sold its entire output through R. M. Owen and Company, a distributor.

establishing branches which sold directly to dealers[16] and to users.[17] Manufacturers were capable of establishing such branches by 1914 because volume had increased substantially, resources were less limited, and production was becoming more decentralized.[18] Retail branches, however, were used primarily to establish distribution in areas where dealers were difficult to obtain and soon began to decline. This decline has not been specifically explained by the manufacturers except in terms of the difficulties associated with trade-ins, an operation not easily standardized.[19] It is likely that the large capital outlay involved in building an extensive system of retail outlets was still too great for the industry despite its improved financial status.[20]

During the period of time that manufacturers were selling through distributors predominantly and throughout the era of the manufacturer's branch, the franchised dealers continued to be operative. The designation of these dealers as franchised may or may not be appropriate. At the time, they were referred to as agents, although the existing agreements binding the manufacturer and agents were essentially vendor-vendee

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[16] Charles N. Davisson, "Automobiles," in Richard M. Clewitt, Marketing Channels for Manufactured Products (Illinois, 1954), pp. 92-94.

[17] Ibid., p. 98. [18] Ibid., p. 95.

[19] Ibid., p. 99.

[20] Rosenberg and Bedell, op. cit., p. 10.

contracts.[21] The early agency agreements contained provisions, however, for an exclusive territory and certain obligations on the part of the dealer.[22] This provision, however, did not preclude the manufacturer from selling in the exclusive territory. Further, a provision granting the dealer the right to purchase automobiles at discounted prices was negated by the lack of assured deliveries.[23] Although a more detailed consideration of the evolution of the franchise contract is deferred to Chapter V, it is important to note at this point that the franchise arrangement proved valuable in several other respects which are frequently referred to as major motivations for selecting the franchise as a system of distribution. Among these are provisions regarding service, payment, quotas, and other controls instituted after 1920.[24] The ability to maintain controls of this nature requires, in most cases, a relationship more formalized than the normal vendor-vendee relationship. Because the automobile industry in its early years of development appeared to be following a pattern of trial and error for the selection of distribution channels, it seems appropriate to search for causation in maintaining a given system as well as in the initial selection.

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[21]Hewitt, _The Development of Automobile Franchises_, _op. cit_., p. 10, states this as the general court interpretation.

[22]Hewitt, _Automobile Franchise Agreements_, _op. cit_., p. 21.

[23]_Ibid_., p. 26. [24]_Ibid_., pp. 65-67.

Thus, relatively centralized production, dispersed demand, limited financial resources, the need for a ready market, and the necessity of certain types of controls over distribution are all relevant reasons for the adoption and continuance of franchised automobile dealerships.

The pattern of distribution developed by the automobile industry is said to have provided the major introduction of franchising as a system of distribution. Henceforth, this system would serve as a model of an alternative distribution system which is capable of solving problems such as those faced by the automobile industry and which may solve other types of problems. For example, the petroleum industry adopted a franchise system for reasons significantly different from those of the automobile industry. Until 1930 the petroleum industry had owned and operated the retail outlets for gasoline and oil. These centrally managed outlets were found to present problems of (1) rapidly adjusting prices in specific localities and (2) company employees demonstrating lower levels of initiative than independent retailers. Furthermore, the period of 1930's brought about numerous laws which were applicable to company-owned outlets but which did not apply to independent retailers. Among these were chain-store tax laws, the social security tax, and the wage and hour laws. To avoid the legal aspects of owning and operating outlets and to capitalize on the operating advantages of independent retailers, the refineries began leasing their retail facilities to franchisees.[25,26]

An alternative explanation for the shift from company-operated service stations to a leasing procedure is provided by Williamson:

> The principle reason for this shift in policy stemmed from the lower financial returns from retail operations brought about largely by a continued expansion in the number of service stations at a faster rate than the number of registered vehicles, and a corresponding decline in the average volume of motor fuel sales per station.[27]

The manufacturer-retailer franchises of the automobile and petroleum industries represent examples which generally involve the entire product offering of the retail outlet. Over time the franchise method has been adapted to situations where the manufacturer desires control or possesses expertise in marketing particular types of goods but which involve only part of the line of goods carried by the retailer. Many shoe departments in department stores are operated entirely under franchise arrangement[28] and the Mode O'Day Corporation

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[25]Douglas J. Dalrymple and Donald L. Thompson, Retailing: An Economic View (New York, 1969), pp. 77-78.

[26]Although petroleum companies do not consider themselves as franchisors and service station operators do not generally think of themselves as franchisees, the relationship does fit the current definition of the term franchising. "Do You Think that Service-Station Distribution Arrangements for Gasoline Are Considered Franchise Plans?," National Petroleum News, LVIII (January, 1966), 54.

[27]H. F. Williamson and others, The American Petroleum Industry (Illinois, 1963), p. 211.

[28]Kursh, op. cit., p. 31.

franchises departments selling moderate-priced style merchandise.[29] In addition, manufacturers of individual products or product lines such as televisions and appliances have come to adopt franchise agreements covering only part of the products sold in a particular department.[30]

Manufacturer-Wholesaler Franchise

On a broad scale the manufacturer-wholesaler franchise is most often associated with the field of bottled drinks.[31] For soft drinks, such as Pepsi-Cola and Coca-Cola, it is illogical to produce the finished product at one central location. Such a practice would involve the transportation expense of moving a well-dispersed resource with a low value-to-weight ratio over great distances unnecessarily. In addition, returnable bottles would be transported in both directions (manufacturer-to-consumer and consumer-to-manufacturer) over distances beyond those necessary when decentralized bottling is used.[32] Thus, local or regional bottling of such beverages is indicated by the nature of the business.

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[29] Dalrymple and Thompson, _op_. _cit_., p. 73.

[30] _Ibid_., p. 74.

[31] Kursh, _op_. _cit_., p. 31.

[32] Dalrymple and Thompson, _op_. _cit_., p. 74.

The franchised bottler and distributor evolved quite early in the soft-drink field. In the case of Coca-Cola, the practice was in use as early as 1900. Coca-Cola was invented by John S. Pemberton in 1886. Mr. Pemberton began selling the product in his Atlanta, Georgia drugstore.[33] He expanded the operation by selling the syrup to soda fountain operators. Rapid expansion to a national scale was made possible by selling the syrup to franchised bottlers. The franchises were granted in perpetuity, thus assuring the permanency of the practice.[34]

It appears, therefore, that several factors explain the adoption of franchising for the distribution of soft drinks. First, the economics of beverage distribution suggest that decentralized bottling is less expensive than centralized bottling. Second, retail distribution of a convenience good requires that the product be made available on a general or unrestricted basis. Such widespread distribution is difficult to achieve without a wholesale middleman. Third, expansion to a national and eventually international scale requires an extensive financial commitment within a short span of time. Spreading this commitment facilitates the captial accumulation process.

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[33]Robert Metz, Franchising: How To Select a Business Of Your Own (New York, 1969), p. 7.

[34]"The Greatest Franchise of All," Dun's Review and Modern Industry, XXCVIII (October, 1966), 30-31.

In addition to soft drinks, the manufacturer-wholesaler franchise is found in the beer industry in the form of the beer distributor. Although most breweries own their own decentralized brewing and bottling facilities, an exclusive distributor is enfranchised to serve specific market areas.[35] The use of a franchise in this instance is to maintain control over the distributor in terms of performing the quality control function in the distribution channel. Beer has a limited shelf life and failure to execute this function properly may permit stagnant beer to reach the consumer. The distributor, in addition to bearing the costs of transportation, is expected to repurchase beer that has been on the shelf too long.[36]

Manufacturer-wholesaler franchises have been used in a variety of industries as a reaction to competitive circumstances. The Arnold Schwinn Company, a bicycle manufacturer, adopted such a system in order to coordinate the marketing effort required to meet competition from Montgomery Wards and Sears.[37] The Snap-On Tools Corporation also uses franchised distributors to meet competition.[38]

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[35]"Shutting the Gates on Area Franchises," Business Week, No. 2160 (January 23, 1971), p. 22.

[36]Statement by William Polk, Sales Manager, Great Plains Distributors, April 13, 1971, Slaton, Texas.

[37]Donald N. Thompson, "Franchise Operations and Antitrust Law," in David J. Rachman, Retail Management Strategy (New Jersey, 1970), pp. 82-83.

[38]Marshall C. Howard, Legal Aspects of Marketing (New York, 1964), p. 101.

Wholesaler-Retailer Franchise

Wholesaler-retailer franchising may be construed to include three types of arrangements. First, there are wholesaler-sponsored voluntary cooperatives. Second, there are retailer-owned voluntary cooperatives.[39] Third, although many authors omit this variety, the voluntary affiliate of corporate chain stores operates in a pattern essentially the same as the two previous forms.[40] The strain of continuity which binds these types of franchises is that each of them is a direct outgrowth of the chain-store as a more efficient retailing method.[41] It should be noted that pooled buying and advertising groups are frequently identified in conjunction with this type of franchise arrangement.[42] As a result of (1) the frequent lack of formality of such arrangements[43] and (2) the fact that some authors do not recognize any of the cooperatives or voluntary arrangements as franchises,[44] it appears desirable to exclude pooled buying and advertising groups as such from the realm of franchising. However, as a

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[39] Beckman, op. cit., p. 293.

[40] Kursh, op. cit., p. 31, omits this arrangement.

[41] Charles F. Phillips and Delbert J. Duncan, Marketing: Principles and Methods (Illinois, 1968), pp. 144-145.

[42] Beckman, op. cit., p. 293.

[43] Rosenberg and Bedell, op. cit., p. 42.

[44] Leonard J. Konopa, "What is Meant by Franchise Selling," Journal of Marketing, XXVII (April, 1963), 35-37.

historical precedent to the retailer-owned voluntary co-operative, these arrangements must be acknowledged as a step in the direction of franchising.

The development of voluntary and cooperative chains is characterized by a delayed but consistent correlation with the introduction and expansion of corporate chain stores. Although the corporate chain store can be traced as far back as 1859 when the Great Atlantic and Pacific Tea Company opened its first retail store, the idea did not experience any appreciable expansion until the 1880's. By 1900 there were fifty-eight corporate chain store systems in operation in the United States.[45] Corresponding to this development was the establishment of the first cooperative in the drug trade, the New York Consolidated Drug Company in 1887, and the first cooperative in the grocery trade, the Frankfort Grocery Company of Philadelphia in 1888.[46] However, the strongest introduction of the cooperative came in 1902 with the formation of the Rexall Drug Company,[47] an outgrowth of the Rexall Club of Saint Louis.[48]

During the 1920's the chain store experienced phenomenal growth. Some authors refer to the period from 1918 to 1929

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[45]Phillips and Duncan, *op. cit.*, pp. 218-219.

[46]Wilford L. White, *Cooperative Retail Buying Associations* (New York, 1930), pp. 12-14.

[47]Aaron M. Rothenberg, "A Fresh Look At Franchising," *Journal of Marketing*, XXXI (July, 1967), 53.

[48]White, *op. cit.*, p. 2.

as the "chain store era." During this period the number of chain store units rose to a total of 216,524 and the percentage of total retail trade conducted by chain stores amounted to 29.6 per cent. By 1948, however, the number of chain store units had fallen to 167,027 and the percentage of total retail sales held by chain stores was still 29.6 per cent.[49] While it is true that discriminatory taxes and public opinion restrained the growth of chain stores during this period, voluntary and cooperative chain arrangements were largely responsible for enabling independent stores to withstand the competitive pressure of the chains. In effect, these arrangements enabled independent store operators to obtain the efficiency and operating advantages of the chain store concerns while retaining independent ownership.[50] Not surprisingly, the period of greatest growth for these two types of franchise arrangements occurred during the 1930's and the 1940's.[51]

Of the two, evidence suggests that the retailer-owned cooperative preceeded the wholesaler-sponsored voluntary cooperative by at least thirteen years. The actual incorporation of the New York Consolidated Drug Company did not occur until 1900. The concept moved westward in the drug trade but

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[49]Phillips and Duncan, op. cit., p. 220.

[50]Robert H. Cole, "Integrated Versus Quasi-Integrated Organizations," in John W. Wingate and Arnold Corbin, Changing Patterns in Retailing (Illinois, 1956), p. 64.

[51]Taylor W. Meloan, "The Old and the New of Franchise Marketing," Proceedings of the Fall Conference of the American Marketing Association (Illinois, 1966), p. 216.

did not reach Los Angeles until 1920. In the grocery trade the first incorporation of a retailer-owned cooperative took place in 1906 and spread quite slowly until 1912, by which time the number had reached eighteen. In 1915 the number of new cooperative firms appearing in the grocery trade began to accelerate rapidly despite the fact that the failure rate among such organizations was quite high. In 1922, for example, more than 20 per cent of the incorporated retailer-owned cooperatives in the grocery trade failed. The early experience of cooperatives in the hardware field was even less encouraging than that in groceries.[52]

While the majority of retailer-owned cooperatives appear to have resulted from an extension of less formal group buying and advertising associations, the wholesaler-sponsored voluntary cooperatives grew from existing wholesale organizations desiring to strengthen themselves against the advances of the chain store in two ways. First, the wholesalers desired to strengthen the independent retailer in order to maintain a market for their services. Second, contractual integration was desired to assure the patronage of their customers. In the wholesale trade, wholesalers operating on this basis came to be known as "contract wholesalers." The first operation of this nature was really a brokerage office dealing in the

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[52]White, op. cit., pp. 12-16.

Serv-Us label which began in 1913. In 1922 the firm began developing Red and White Stores. These stores were required to purchase all of their dry groceries from the Red and White Corporation's member wholesaler. In addition, each store adhered to an established store design and other operating stipulations. In 1925, J. Frank Grimes organized a similar organization, the Independent Grocers Alliance. Although the retailers affiliated with this firm were permitted to retain their individual identity, they were required to display an I. G. A. sign and to adhere to a set of stipulations even more rigorous than those of the Red and White Corporation.[53]

The early experience of wholesaler-sponsored voluntary cooperatives in the grocery field was quite favorable. Following the two previous examples, numerous regional operations of a similar nature were successfully implemented. Wholesalers in the non-food fields were slower to adopt this method of operation but several, such as the Butler Brothers' Ben Franklin Stores, have found it beneficial.[54]

Several well-known chain stores franchise or permit the affiliation of independent retailers with their chain operations. Among the first to adopt this method of operation was the Western Auto Supply Company in 1935.[55] The franchised outlets of Western Auto are called "associate stores" and

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[53] _Ibid_., pp. 6-8. [54] Meloan, _op_. _cit_., p. 216.

[55] Robert Metz, _Franchising: How to Select a Business of Your Own_ (New York, 1969), p. 100.

generally operate in small towns that cannot support a chain unit.[56] In more recent years some firms, such as Gibson's, which began in the 1930's as a wholesale firm and later began operating retail stores, have found that the rapid expansion which franchising permits may justify a shift to a predominantly franchised chain.[57]

The variety of relationships which may arise between wholesalers and retailers makes a comparison of the current status of chain stores versus cooperative and voluntary groups somewhat confusing. As of 1966, for example, voluntary and cooperative groups held 45 per cent of the total retail food trade. However, it is estimated that over one-half of this volume is made up of the sales of chain units operating within voluntary or cooperative groups.[58]

Service-Sponsor Franchise

In the three previous forms of franchising, the franchise arrangement served as a means to an end. In a sense, however, the service-sponsor franchise is an end in itself. While other types of franchising seek to enhance the orderly and efficient flow of goods as a primary goal, the service-sponsor franchise supposedly focuses attention on group

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[56] Rosenberg and Bedell, _op_. _cit_., p. 12.

[57] "Gibson's Lil Ole Billion-Dollar Business," _Business Week_, No. 2168 (March 20, 1971), p. 60.

[58] Phillips and Duncan, _op_. _cit_., p. 205.

advertising, standardized format, method of operation, and other activities previously considered supplementary to the franchise system. In fact, however, many firms in this field did not begin with this conception in their business and have only begun shifting to this method of operation in recent years.[59]

Essentially, the service-sponsor franchise is an arrangement whereby the franchisor, who possesses a trademark, a patent, or a knowledge concerning the operation of a particular type business, conveys such rights or knowledge to the franchisee. The principal sources of revenue to the service-sponsor franchisor are in the form of franchise fees and royalties. In addition, the franchisor may coordinate the promotion of the member franchisees and, as a secondary source of revenue, sell certain types of supplies and equipment to the franchisees. In this capacity, the franchise may function (1) in a fashion similar to a cooperative, pooling orders and advertising, or (2) in the manner of a manufacturer-retailer franchise, as a result of the franchisor's desire to retain secrecy about vital ingredients used in the business or to assure some uniformity of quality.[60]

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[59]Greater detail concerning this issue is included in Chapter V.

[60]"Franchise Selling Catches On," Business Week (February 6, 1960), in J. Howard Westing and Gerald Albaum, Modern Marketing Thought (New York, 1964), pp. 73-75.

The inception of this form of franchising took place in the years following World War II although a few such firms, notably A & W Root Beer, which began in 1919, and Howard Johnsons, which began in 1926, had already tried and proved the system.[61] The expansion following World War II is generally attributed to the return of war veterans with accumulated savings and a desire to be in business for themselves.[62] However, service franchising incurred rapid expansion before 1950 in relatively few fields. Among these fields the most notable was the soft-serve ice cream stand. These stands were franchised at an indiscriminate rate by many organizations lacking in a proper level of ethics. Not surprisingly, the industry became saturated and failures rose to an annual rate of 25 per cent.[63]

By the early 1950's the remaining service franchises were performing quite well and several new firms entered the field with amazing success. Among the newcomers were firms such as Martinizing Dry Cleaners in 1949, Dunkin Donuts in 1950, Dairy Queen in 1952, and Kentucky Fried Chicken in 1955.[64] The subsequent success of these and many other service franchises is common knowledge to Americans today.

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[61] J. F. Atkinson, Franchising: The Odds-On Favorite (Chicago, 1968), p. 3.

[62] Meloan, op. cit., p. 217.

[63] "Franchise Selling Catches On," op. cit., p. 74.

[64] Atkinson, op. cit., p. 3.

The characteristic of the service franchise which distinguishes it from most other business activities and which contributed greatly to its continued expansion from 1955 until 1970 is the small amount of capital outlay required to initiate a business of this nature. As such, the market for franchises of this type was considerably larger than that which existed for many other business opportunities. The idea spread into a variety of activities and products. In 1956, Harry Kursh wrote the first edition of The Franchise Boom and, in doing so, coined a phrase that was to be repeated many times in what may be literally described as a proliferation of articles and addresses extolling franchising as the last frontier and savior of the small businessman in a complex, capitalistic economy.

The 1970 Franchise Annual[65] lists more than 1,100 franchising firms operating in fifty-eight different business categories. Forty-two of these categories are in the service fields, thus constituting the overwhelming majority of the franchising firms included in the directory.[66] Table I on the following page reveals the number of firms franchising in each of these categories.

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[65]Rogers Sherwood, The 1970 Franchise Annual (Chicago, 1970), p. 20.

[66]Ibid., pp. 20-27.

TABLE I

NUMBER OF SERVICE SPONSOR FRANCHISORS BY BUSINESS CLASSIFICATION, 1970*

Business Classification	Number of Franchisors
Accounting and tax services	28
Auto diagnostic centers	3
Auto rentals	10
Auto transmission repair centers	7
Auto washes	22
Automotive products and services	41
Beauty and slenderizing salons	12
Building and construction	21
Business aids and services	16
Campgrounds	7
Children's products and services	3
Cleaning, maintenance and sanitation	21
Computer services	16
Credit and collection services	10
Dance studios	1
Day care centers	7
Domestic services	4
Dry cleaning and laundry services	20
Employment and temporary help services	66
Entertainment	12
Food operations	308
Fund raising	7
Furniture restoring	5
Glass tinting	3
Health aids and services	5
Home improvement	9
Industrial supplies and services	3
Lawn and garden care	6
Marketing and sales promotion	10
Motels	23
Nursing homes	5
Pet shops and services	9
Photography	7
Printing and duplication services	11
Rentals and leasing	6
Sales training	2
Schools and instruction	39
Sewer cleaning	2
Sports and recreation	20
Travel agencies	3

TABLE I--Continued

Business Classification	Number of Franchisors
Weight control	4
Miscellaneous	5
Total	819

*1970 Franchise Annual, op. cit., pp. 20-84.

As Table I reveals, food operations represent the largest category in the area of service sponsor-retailer franchises. Even to the casual observer of franchising, this should not be surprising. Worthy of note, however, is the wide variety of service activities available to prospective franchisees today as a result of the "franchise boom" of the past decade. If one considers the amounts of capital and knowledge required for each of these types of business and the relative demand for the services rendered, it becomes obvious that food operations have obtained a disproportionate share of the growth experienced by this segment of the industry in terms of the number of franchising firms. As a result an increasing number of authorities and financial statements bear witness to the maturity of fast-food service franchising.[67]

Franchise Industries Today

The body of firms engaged in franchising has frequently been referred to as the franchise industry. Technically, an industry is "a class of business enterprises which are all

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[67] *Minneapolis Tribune*, July 7, 1971, Sec. C, p. 5.

operating in the same field of endeavor."[68] As this chapter has shown, franchisors operate in many fields of endeavor. It may be more appropriate to refer to franchising as a form of business organization.[69] Nonetheless, one can assess the general level of importance of this phenomenon by measuring the number of firms engaged in its employment and the value of the goods and services exchanged on this basis. Such an assessment is provided in Table II.

TABLE II

COMPOSITION AND SIZE OF THE FRANCHISE INDUSTRIES, 1971*

Kind of Business	($ 000) Sales	Number of Franchisees
Auto and truck dealers	$69,024,000	36,630
Auto parts and services	1,979,340	15,404
Business aids and services	794,212	8,516
Construction and remodeling	83,449	812
Convenience grocery	2,002,211	4,257
Education products and services	104,493	5,105
Fast-foods	5,300,580	29,575
Gasoline service stations	27,300,000	175,600
Hotels and motels	3,935,056	2,727
Laundry and dry cleaning	170,462	4,036
Recreation, entertainment and travel	103,481	3,117
Rental services	1,342,773	10,556
Retailing	14,354,461	26,494
Soft drink bottlers	4,756,000	2,600
Vending	63,646	768
Miscellaneous	324,599	5,298
Total	$131,638,763	331,495

*Franchising in the Economy 1969-1971, U. S. Department of Commerce, in James D. Snyder, "Selling the Hastings Instead of Headquarters," Sales Management, CVIII (January 24, 1972), 21-22.

[68]Jerome Shuman, "Franchising-Quo Vadis? The Future of Franchising and Trade Regulation," Franchise Legislation, Hearings before the subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, United States Senate, (Washington, 1968), p. 515.

[69]Ibid.

CHAPTER III

OBJECTIVES OF SERVICE FRANCHISORS

In the preceding chapter, it was noted that franchisors in service fields derive their revenues from several sources. The source of a firm's revenues may be viewed as a manifestation of the business the firm is in and as an indication of its business strategy. When a firm derives the greater portion of its revenues from product sales, franchising serves as a means of controlling distribution. Among service franchisors, there is considerable variation in sources of revenues and their relative proportions.[1] To a substantial degree, this variation may be explained by an examination of the reasons underlying the decision to franchise.

Motives for Service Franchising

There are four motives commonly identified as reasons for service franchising. The first of these is, essentially, operating the franchise as a business in itself. The franchisor in this case may serve in a consulting and coordinating capacity, or he may merely provide a trademarked name and an

[1] Milton Woll, "Sources of Revenue to the Franchisor and Their Strategic Implications," Journal of Retailing, XLIV (Winter, 1968-1969), 14.

operating format. An example of this situation is the Dairy Mart franchise. Dairy Mart permits franchisees to use a trademarked sign in return for a fixed fee that is paid on an annual basis. Although Dairy Mart offers to sell materials and supplies to franchisees and assists new franchisees in purchasing equipment, the latitude given to franchisees in these regards indicates that sales to franchisees are made as a service and do not represent a primary motive of the franchisor.[2]

The second motive for service franchising is that of creating a market for capital goods. At its inception Chicken Delight was formed to create a market for a conduction cooker which was not well received by existing businesses.[3]

The third motive is that of creating a market for materials and supplies. This motive is common among soft ice cream franchisors who sell ice cream mix to their franchisees. An extreme example of this motive is the Monterey House Restaurant operation which prepares and distributes all food items on a daily basis.[4]

The fourth motive for service franchising is that of financing rapid expansion. Mr. Donut, for example, began

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[2]Statement by J. L. Dunahoo, Dairy Mart franchisee, Lubbock, Texas, December 2, 1971.

[3]Kursh, op. cit., pp. 262-263.

[4]Woll, op. cit., p. 17.

franchising because the firm lacked the capital necessary for expansion on a company-owned basis.[5]

Franchising companies frequently find that their operations eventually encompass all of these motives as a result of the total needs of their franchisees and the search for additional sources of revenue. Obviously, one may examine the sources of revenue of a franchising firm and determine the degree to which each of these motives is operative at any point in time. An overview of the service franchising field may be gained by examining the six major sources of revenue for such firms as revealed in Table III.

TABLE III

PRINCIPLE SOURCES OF FRANCHISOR INCOME*

Source	Per Cent of Income
Initial franchise fees	22.7
Franchise royalties	31.2
Real estate fees	14.0
Sales of products	4.4
Equipment sales	1.3
Sales of company-owned outlets and revenues from financing arrangements . . .	26.4
Total	100.0

*Source: Franchise Letter, Franchise Letter Corporation, Washington, D. C., September, 1971, p. 3. The information in Table III is based on a study of 223 franchisors in various service fields conducted by the Conference Board.

[5]Statement by Floyd Powell, District Director, Franchise Operations, Mr. Donut, Lubbock, Texas, June 16, 1971.

Nearly 54 per cent of the total revenues of service franchisors are from franchise fees and royalties. Less than 6 per cent of total revenues are from equipment and product sales to franchisees. Service franchising, therefore, is primarily a business in itself. Its use as a means of selling capital goods, materials, and supplies is relatively limited. It is, however, worth noting that the sales of outlets owned by the franchisor and revenues from financing arrangements constitute a significant proportion of the total revenues of service franchising firms. This fact has been acknowledged since 1968 and has led to considerable speculation as to the eventual operating methodology of service franchisors.[6]

Implications of Revenues from Company-Owned Establishments

The implications to be drawn from the observation that service franchisors derive a significant portion of their revenues from company-owned outlets are that such firms are outgrowing their capital shortage or that they are finding franchising to be less desirable than originally anticipated. During 1968 security analysts observed that company-owned outlets in franchise operations were becoming more prevalent. Major companies in the field of franchising gave two reasons for their movement in this direction. First, company-owned

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[6] "The Chains Profit by Buying the Links," Business Week, No. 2130 (June 27, 1970), p. 55.

outlets serve as a base for training new franchisees and experimenting with new methods of operation. Second, the increased cash flow provides greater profit to the franchisor.[7]

Decline of Service Franchising

Alfred R. Oxenfeldt and Anthony A. Kelly generalized from the events of the late 1960's and set forth the hypothesis that most successful franchise systems will become wholly owned chains. Oxenfeldt and Kelly approached this issue from the standpoints of both the franchisor and the franchisee. This chapter deals with the forces leading the franchisor to move in the direction of company-owned outlets. In this regard, there are two lines of reasoning which lead to the conclusion that a franchisor will eventually desire to own the outlets in the franchised chain.

The first of these is based upon the original motive for franchising. In lines of business where the investment in an individual service establishment is reasonably small, new ideas spread quickly. The innovator that is slow to expand finds that the better locations in many markets are taken by competitors. If the firm's expansion is limited by a lack of capital, franchising may enable the firm to gain a position in various markets by sacrificing ownership of the individual

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[7] _Ibid_.

outlets to franchisees. Implicit in this strategy, however, is the fact that it does not consider franchising to be the most desirable method of operation. Thus, franchising may be an alternative adopted as a result of capital shortage and, as such, its usage may cease when the capital shortage is alleviated.[8]

The second line of reasoning leading to the conclusion that franchisors will eventually desire to own the outlets in their franchise system centers on the inter-organizational conflicts that are likely to arise between the franchisors and franchisees. Although franchisees may be eager to cooperate at the inception of the arrangement, this eagerness may be based upon a perceived dependency on the franchisor for guidance. Over time this perceived dependency diminishes and the franchisee seeks greater independence. On the other side, the franchisor, in the process of perfecting the efficiency of his operating methods is continually finding that uniform group action is needed to take advantage of economies of scale and to maximize the impact of all of the establishments.[9]

Fast-Food Service Franchising as a Test Industry

Both of the above lines of reasoning may be tested by examining a service franchising field which has matured to a

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[8]Oxenfeldt and Kelly, op. cit., p. 71.

[9]Ibid., p. 76.

state enabling the influence of time and increased capital availability to have taken effect. Service franchising has been common in the field of food-service establishments since the mid-1950's, and its expansion was so rapid between 1955 and 1965 that restaurant saturation occurred. Despite rising levels of population and income, the number of restaurants in the United States decreased from 372,300 in 1965 to 359,000 in 1970.[10] For these reasons, food-service franchising should serve as a reliable basis for evaluating the hypotheses forwarded by Oxenfeldt and Kelly.

Definition of the Universe

At the time of the inception of this study, there were no reliable statistics available as to the number of food-service franchisors operating in the United States. The Franchise Annual, listing 308 firms in the field, was the most comprehensive source of identification of such firms.[11] The data needed to test the hypotheses under consideration was taken from a questionnaire, presented with its accompanying letter in Appendix A, sent to the financial vice-president

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[10]"Restaurant Trends," NAFB Letter, National Association of Franchised Businessmen (April, 1970), p. 4.

[11]The University of Wisconsin, in August, 1971, released a study prepared for the Small Business Administration in which the reported number of food-service franchisors was 749. The list, however, has yet to be released as of this writing. "Washington Wrap-Up," The Marketing News (September, 1971), p. 7.

of each of the 308 franchisors of food-service operations. The list of such firms is given in Appendix B. Appendix C identifies fifty of the firms eliminated from the universe as a result of double counting, having gone out of business, or not being engaged in franchising. The universe is thus reduced to 258.

Determination of Sample Size and Level of Confidence

In order to maximize the number of respondents to the questionnaire, a predetermined sample size was not employed in the data collection process. Rather, the questionnaire was mailed to each firm in the defined universe. The initial mailing resulted in twelve returns that could be used in the analysis. In addition to the elimination procedures described in Appendix C, responses were not utilized if the respondent reported that it had yet to open successfully a franchised outlet. A second mailing to all remaining firms in the defined universe resulted in three responses. At this point it time it was determined that a more direct method of contact would be necessary to ascertain a reasonable number of responses. Thus, the third mailing of the questionnaire was made to twenty-five randomly selected firms, and the questionnaire was followed by telephone contact with the recipient. This procedure yielded eighteen completed questionnaires. Only one of the respondents refused to complete the questionnaire, but six of the individuals receiving the questionnaire could not be contacted despite repeated efforts. The responding thirty-three firms included in this sample are listed in Appendix D.

Assuming a range of allowable error of plus or minus ten percentage points and using the sample size determination procedure for a sample drawn from a finite universe attempting to estimate a percentage characteristic, the level of confidence attributable to the sample may be derived from the following formula.[12]

$$N_s = \frac{pq(N_p)}{N_p(\frac{AE}{z})^2 + pq}$$

$$33 = \frac{.5 \times .5 \times 258}{258(\frac{.10}{z})^2 + (.5x.5)}$$

$$z = 1.23$$

$$= 78 \text{ per cent level of confidence}$$

where: N_s = sample size
p = expected percentage
q = 1-p
N_p = universe size
AE = allowable error
z = level of confidence expressed as standard errors

Redefinition of the Scope of the Study

A 78 per cent level of confidence is not suitable for statistical inference. It implies a 22 per cent chance of error. Further, the data collection procedure employed introduces the distinct possibility of nonresponse bias. Owing to the reluctance of franchisors to supply the information requested by the questionnaire, further attempts to secure additional respondents were not made.

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[12] J. B. Spalding, "Statistical Determination of Sample Size," The Business Symposium (August 5, 1970), p. 21. Although it is technically inaccurate to compute a level of confidence for a nonrandom sample, this computation is included for the reader's interest.

As a result of the above limitations, this study shall consist of an analysis of the thirty-three firms which responded to the questionnaire. The findings of this chapter apply only to these firms. Further, acceptance or rejection of hypotheses one through three is based upon and limited to their applicability to the thirty-three firms in the sample. Henceforth, the sample is referred to as the "study group."

The State of Maturity of Fast-Food Service Franchising

It may be noted from Table III that service franchising has progressed to the point that royalties from existing franchises account for a greater portion of the total revenues of service franchisors than initial franchise fees. Maturity, however, suggests a state in which the rate of growth of franchise systems is decreasing. The fact that the total number of restaurants in the United States declined from 1965 to 1970 suggests that the restaurant industry had saturated its market by 1965. This, however, does not indicate that the franchised, fast-food segment of the industry had matured as of 1970.

The hypothesis that franchising, as a business in itself, for a particular type of outlet, ultimately reaches a state of maturity could be treated under the doctrine of _res ipsa loquitor_.[13] Logically, one may deduce that the number of

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[13] "The thing speaks for itself."

restaurants in such chains cannot grow perpetually at a rate substantially greater than the rate of population growth in the society served by them. It is questionable, however, that this state had been reached as of 1970, the end of the period under study.

Table IV, on the following page, reveals the total number of establishments in operation for each of the firms in the study group. The firms are identified by number and are randomly arranged to avoid revealing information as to individual companies. The same numbers are used for each company throughout this chapter.

Several limitations as to what may be concluded from this table should be noted. First, it may not be used to assess the overall growth of fast-food service franchising between 1960 and 1970. This limitation results from the fact that firms which franchised such operations during the period but which failed prior to 1970 did not have an opportunity to be selected as part of the study group. Thus, part of the growth of the remaining firms may be offset by the failure of other firms. Second, because eight of the firms in the sample were initiated between 1965 and 1968, this table does not enable one to assess the recent rate of growth of all firms relative to their past rate of growth. Third, the level of confidence of 78 per cent does not permit reliable inference about all fast-food franchises.

TABLE IV

TOTAL NUMBER OF FOOD ESTABLISHMENTS BY COMPANY FOR 1960, 1965, 1968, AND 1970

Company	Year			
	1960	1965	1968	1970
1	90	190	275	325
2	0	13	70	43
3	0	0	120	191
4	0	0	2	5
5	0	1	7	41
6	0	46	68	78
7	0	7	91	275
8	0	0	1	4
9	2	2	4	42
10	0	66	151	248
11	228	738	1087	1592
12	6	41	80	92
13	0	27	74	93
14	0	0	33	43
15	2	4	18	27
16	5	34	316	662
17	0	24	314	449
18	0	11	31	19
19	9	13	53	165
20	0	0	9	20
21	8	16	30	49
22	300	500	550	470
23	0	8	51	133
24	82	175	361	569
25	1	110	450	1350
26	0	0	3	22
27	0	4	8	10
28	0	0	15	12
29	66	112	166	278
30	124	213	264	377
31	0	24	39	65
32	0	56	137	186
33	0	0	99	125
Total	923	2435	4977	8070

As Table IV demonstrates, twenty-five of the firms in the study group were initiated as of 1965. Of these, sixteen firms demonstrate a rate of growth during the period from 1968 to 1970 that is greater than that experienced between 1965 and 1968. That is to say, comparing the average annual increase in the number of establishments in operation for each franchisor reveals that 64 per cent of the firms in the study group show increases in their rate of growth for the years between 1968 and 1970.

Figure 1 below depicts the average number of establishments in operation per franchisor during the period under study.[14] The figure reveals that the rate of increase in the average number of establishments per franchisor was greater between 1968 and 1970 than in prior periods.

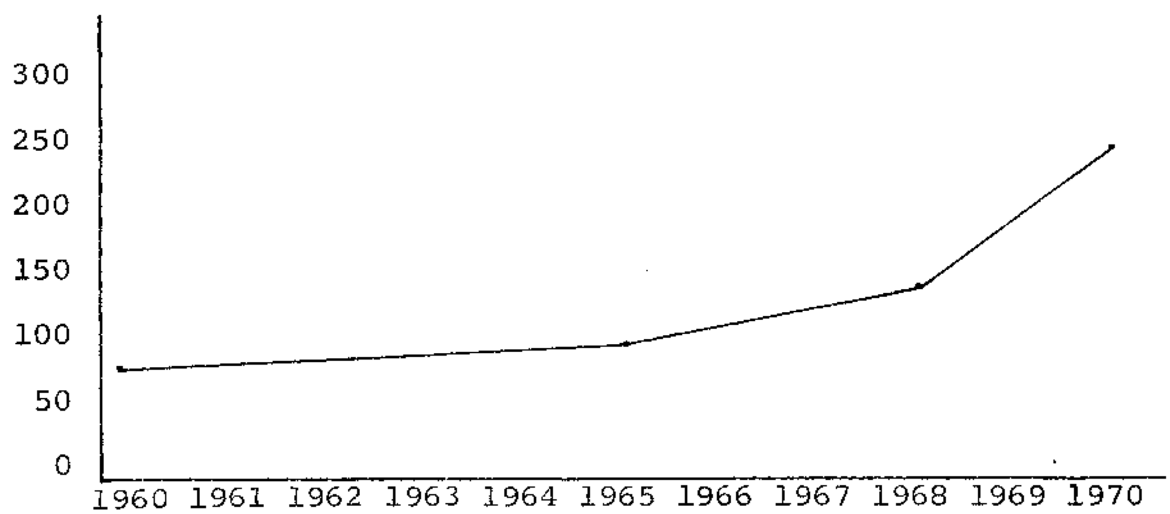

Fig. 1--Average number of food establishments per franchisor between 1960 and 1970.

[14]Total number of establishments in operation divided by the number of franchisors represented for each year.

Conclusion

These data lead to the conclusion that the average fast-food franchising firm in the study group had not reached maturity as of 1970.

Ownership of Fast-Food Service Establishments

The ownership of fast-food service establishments among the respondents has changed substantially over the past decade. As Table V on the following page illustrates, the firms operating in 1960 were of two extremes. Seven of the firms in the study group were franchising as of 1960. Of these, only four firms had company-owned establishments. The opposite extreme was made up of firms operating restaurant chains which were not engaged in franchising as of 1960. Figure 2 below illustrates that the number of franchised establishments expanded more rapidly than the number of company-owned establishments during the decade under study.

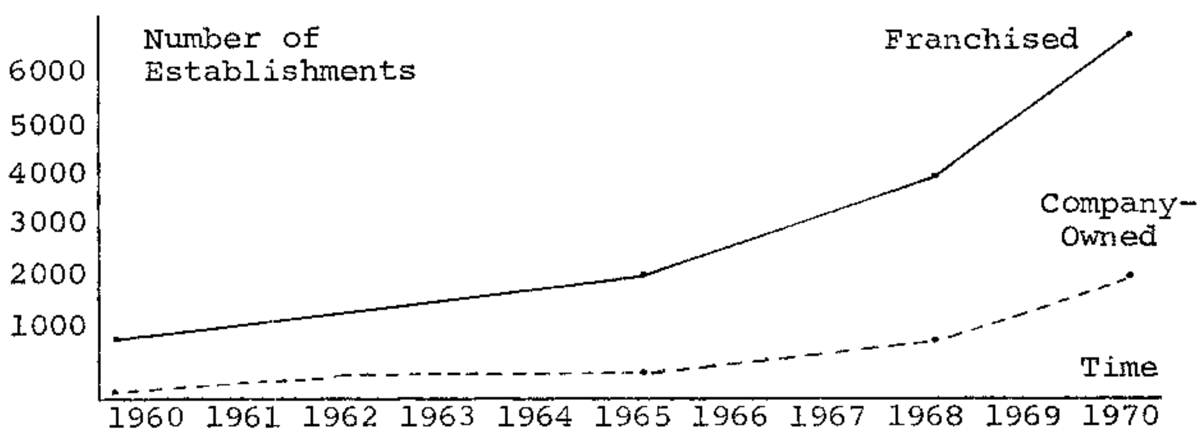

Fig. 2--Number of company-owned and franchised establishments in operation from 1960 to 1970 among responding franchisors.

TABLE V

OWNERSHIP OF FAST-FOOD SERVICE ESTABLISHMENTS OF FRANCHISE FIRMS IN 1960, 1965, 1968, AND 1970

Company	Year							
	1960		1965		1968		1970	
	C	F	C	F	C	F	C	F
1	20	70	30	160	25	250	25	300
2	0	0	0	13	8	62	7	36
3	0	0	0	0	0	120	0	191
4	0	0	0	0	1	1	2	3
5	0	0	1	0	1	6	4	37
6	0	0	16	30	18	50	18	60
7	0	0	3	4	48	43	200	75
8	0	0	0	0	1	0	3	1
9	2	0	2	0	2	2	2	40
10	0	0	37	29	67	84	101	147
11	3	225	88	650	154	933	384	1208
12	0	6	33	8	69	11	81	11
13	0	0	22	5	58	16	65	28
14	0	0	0	0	15	18	17	26
15	2	0	3	1	3	15	8	19
16	5	0	8	26	150	166	256	406
17	0	0	8	16	18	296	48	401
18	0	0	1	10	1	30	15	4
19	9	0	13	0	17	36	43	122
20	0	0	0	0	6	3	20	0
21	8	0	16	0	28	2	38	11
22	0	300	0	500	0	550	0	470
23	0	0	4	4	2	49	15	118
24	6	76	18	157	24	337	26	543
25	1	0	10	100	50	400	150	1200
26	0	0	0	0	2	1	7	15
27	0	0	3	1	3	5	3	7
28	0	0	0	0	1	14	0	12
29	14	52	34	78	60	106	113	165
30	0	124	0	213	0	264	10	377
31	0	0	10	14	26	13	54	11
32	0	0	24	32	30	107	16	170
33	0	0	0	0	0	99	0	125
Total	70	853	384	2051	888	4089	1731	6339

C = Company Owned F = Franchised

This would not appear to support the aforementioned assertions of the tendency of such firms to move in the direction of company ownership. The common approach to the initiation of a franchising firm is to begin with a going concern which has proved successful or to develop a successful business format through company-owned pilot operations.[15] This procedure would lead to a lesser rate of growth for company-owned establishments if franchising were considered as the primary objective of these firms.

Percentage Characteristics of Ownership

The ownership characteristic of the firms under study is further summarized in Table VI, which describes the ownership of establishments on a percentage basis. Analysis of this table somewhat amplifies the tendencies alluded to in the preceding paragraph. It demonstrates, for example, that most of the firms in 1960 were operating solely on a company-owned basis. The 8 per cent figure for the percentage of total establishments that were owned by the parent company is based upon the totals from Table V. Three firms which were operating almost exclusively on a franchise basis were exceedingly large in relation to the other firms in business

[15]Exceptions to this procedure were numerous in the latter part of the decade in the form of franchises centered around celebrity names. Among such firms are to be found some of the classic failures in franchising.

TABLE VI

PERCENTAGE OF TOTAL ESTABLISHMENTS OWNED BY FRANCHISORS BY COMPANY FOR 1960, 1965, 1968, AND 1970

Company	Year			
	1960	1965	1968	1970
1	22	16	9	8
2	-	0	11	16
3	-	-	0	0
4	-	-	50	40
5	-	100	14	10
6	-	35	26	23
7	-	43	53	73
8	-	-	100	75
9	100	100	50	5
10	-	56	44	41
11	1	12	14	24
12	-	80	86	88
13	-	81	78	70
14	-	-	45	40
15	100	75	17	30
16	100	24	48	39
17	-	33	6	11
18	-	9	3	79
19	100	100	32	26
20	-	-	67	100
21	100	100	93	77
22	0	0	0	0
23	-	50	4	11
24	7	10	7	5
25	100	9	11	11
26	-	-	67	32
27	-	75	38	30
28	-	-	7	0
29	21	30	36	63
30	0	0	0	3
31	-	42	33	17
32	-	43	22	9
33	-	-	0	0
Average for All Firms*	8	16	18	21

*Derived by dividing the number of company-owned establishments in operation each year by the corresponding total number of establishments in operation as shown in Table V.

as of 1960. The percentage of total establishments owned by the franchisor increased among eight firms, decreased among twenty-one firms, and remained about the same among four firms.

Effect of Time on Ownership of Establishments by Franchisors

Company-owned outlets constitute a steadily growing percentage of the total number of outlets in the study group. This would appear to support the hypothesis concerning the passage of time and the increasing tendency, on the part of the franchisor, to move in the direction of company-owned outlets. However, in order to isolate the effect of time on the tendency to own outlets from other events during the period of the study it is necessary to classify the portion of total establishments owned by the parent company according to the length of time during which the firm has been franchising. This is done in Table VII.

Although one may readily detect a lack of correlation between the number of years engaged in franchising and the percentage of total establishments which are owned by the franchisor, a calculation of the coefficient of correlation between these two variables is desirable. Exhibit I in Appendix E presents such a calculation. The derived coefficient of -.1189 is not significant.

As a further check of the effect of time on the ownership of restaurants in the study, a similar analysis is

TABLE VII

NUMBER AND OWNERSHIP OF ESTABLISHMENTS BY NUMBER OF YEARS IN FRANCHISING AS OF 1970

Years Franchising (1)	Total Establish-ments (2)	Company Owned Est.(3)	Franchised Establish-ments (4)	Per Cent 3 of 2 (5)
1	58	43	15	74
2	312	50	262	16
3	83	6	77	7
4	208	52	156	25
5	977	270	707	28
6	168	122	46	72
7	0	0	0	0
8	213	24	189	11
9	1985	261	1724	13
10	0	0	0	0
11	662	256	406	39
12	0	0	0	0
13	170	99	71	58
14	1592	384	1208	24
15	325	25	300	8
16	470	0	470	0
17	278	113	165	41
18	0	0	0	0
19	0	0	0	0
20	569	26	543	46

presented in Exhibit II of Appendix E using, as the independent variable, the number of years the franchising firm had been in business as of 1970. The resulting correlation coefficient .0683 is not significant. Exhibit III in Appendix E presents a calculation of the degree of correlation between the number of years the franchisor had been in business prior to the initiation of franchising and the percentage of total establishments owned by the franchisor. Again, the resulting coefficient of correlation of .0202 is not found to be significant.

Conclusion

All three of these analyses support the null hypothesis that there is no correlation between the length of time engaged in a particular phase of the franchise business and the ownership of food service establishments by the franchisor.

Effect of Total Revenues on Ownership of Service Establishments by Franchisors

If franchisors are moving in the direction of company-owned establishments because of increased capital availability, there should be a correlation between restaurant ownership by franchisors and capital availability. However, a specific measure of the degree of causation between these two variables is complicated by the lack of a uniform, quantifiable measure of capital availability to franchisors.

Assuming that total assets, as a potential source of collateral, serves as a valid measure encounters problems of circular reasoning. That is to say, the line of causation in any particular instance is indeterminable. Obviously, if a firm buys a previously franchised establishment with outside capital, its assets will be increased.

Ideally, profits on which the capital markets place substantial weight in supplying capital to a firm, could be used to indicate capital availability. However, many of the franchising firms are also engaged in other activities or are owned by large conglomerates. These firms are generally unwilling to reveal the profits of particular segments of their business. Most firms are, however, willing to identify revenues by source and many do so in their financial reports. Because franchises serving similar types of food have similar operating margins, revenues may serve as a reasonable indication of profits and, thus, capital availability.[16]

Total Revenues

Total revenues of the franchising firms in the study group are presented in Table VIII. Included in the amounts presented are all of the revenues traceable to the restaurant aspects of the business under consideration. Mr. Donut, for example, is owned by International Multifoods. The table

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[16]Statement by Mickey Starks, Financial Vice-President, Bonanza International, Dallas, Texas, November 9, 1970.

TABLE VIII

TOTAL REVENUES FROM FOOD OPERATIONS FOR 1960, 1965, 1968, AND 1970 (IN $ 000)

Company	Year			
	1960	1965	1968	1970
1	2873	5229	5636	6230
2	----	----	2620	1900
3	----	178	1275	2900
4	----	----	200	383
5	----	----	92	423
6	----	4460	5435	8482
7	----	751	7162	26190
8	----	----	43	154
9	140	140	152	336
10	----	8498	17051	30221
11	7883	35428	96715	191455
12	1031	5794	13225	16180
13	----	4591	11620	15637
14	----	----	10635	11300
15	240	363	425	987
16	----	1453	8329	28200
17	----	1064	5997	8450
18	----	80	178	998
19	450	700	1700	2496
20	----	----	2520	5010
21	4000	8000	12060	16390
22	1500	2000	2225	2500
23	----	400	2345	4232
24	----	6484	12163	19294
25	----	13300	38800	94000
26	----	----	168	1286
27	----	519	638	768
28	----	----	91	60
29	----	15599	31822	59004
30	----	6741	9025	14851
31	----	2704	7475	12577
32	----	6286	13524	14601
33	----	----	3506	3878
Total	18117	130762	324852	601373
Average	2265	5448	9844	18223

includes only the revenues of the Mister Donut chain and its franchised outlets which flow to the International Multifoods Corporation. Although all of the revenues of company-owned establishments meet this requirement, only part of the revenues of franchised establishments become part of the revenues of International Multifoods. This portion includes rentals, royalties, franchise fees, supplies, and batter mix.[17]

Average Total Revenue

Figure 3 presents the average total revenue per franchisor for the responding firms over the period of the study. The rate of growth in average revenues per franchisor exceeds the rate of growth in the average number of establishments per franchisor. In part, this difference may be explained by inflation. Most of the difference, however, is the result of increased franchisor ownership of food establishments. This increase has an amplified effect on total revenues because of the difference in the portion of retail sales that become revenue for the parent company. Further, as will be shown later, the average sales volume per establishment has increased throughout this period.

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[17]Statement by Floyd Powell, op. cit.

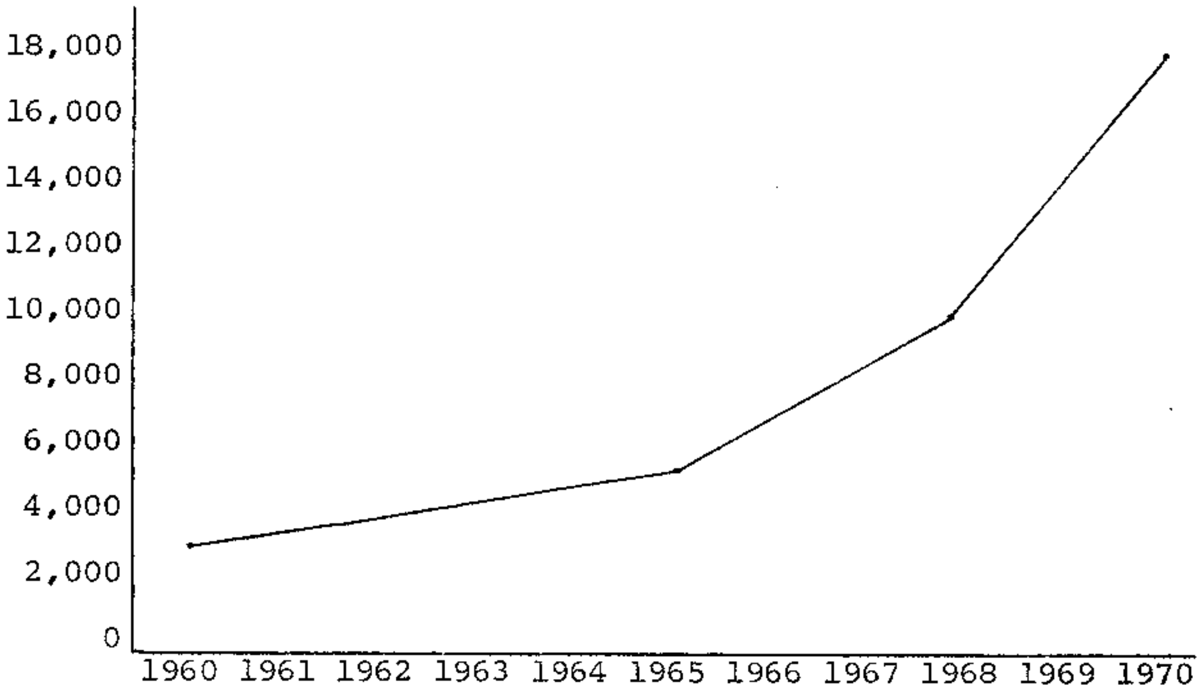

Fig. 3--Average total revenue per franchisor (in $ 000's)

Per Cent of Total Revenues Derived from Company-Owned Establishments

Table IX on the following page presents the percentage of franchisor total revenues derived from company-owned establishments. For 1960, only eight of the thirty-three firms provide data. Further, the 1960 data are skewed as a result of three large firms reporting heavy emphasis on franchising. Beyond 1960 the average for all firms in the study appears to have stabilized at about two-thirds. That is to say, about two-thirds of the total revenues of the franchisors in the study group were generated by way of sales of establishments owned by the franchisor.

TABLE IX

PERCENTAGE OF TOTAL FRANCHISOR REVENUE DERIVED FROM COMPANY-OWNED RESTAURANTS IN 1960, 1965, 1968, AND 1970

Company	Year			
	1960	1965	1968	1970
1	68	65	59	58
2	--	--	83	84
3	--	0	0	0
4	--	--	95	91
5	--	--	80	67
6	--	95	94	95
7	--	92	96	98
8	--	--	100	94
9	100	100	92	50
10	--	83	62	57
11	6	57	73	76
12	50	97	93	92
13	--	97	97	95
14	--	--	98	97
15	100	99	91	94
16	--	96	96	95
17	--	75	2	28
18	--	56	32	98
19	100	100	50	96
20	--	--	99	99
21	100	100	99	97
22	0	0	0	0
23	--	100	22	36
24	NA	17	11	9
25	--	39	43	38
26	--	--	95	54
27	--	99	97	97
28	--	--	38	0
29	NA	74	78	79
30	--	0	0	5
31	--	98	99	99
32	--	64	45	30
33	--	--	0	0
Average	43	63	66	66

NA = Not Available

Figure 4 depicts the number of firms in the study group which derived given percentages of their total revenues from company-owned establishments. This chart demonstrates the fact that the majority of the firms in the study group were emphasizing company-owned establishments in their operations as of 1970. For eighteen of the thirty-three firms, franchising has either become or is remaining a secondary business interest.

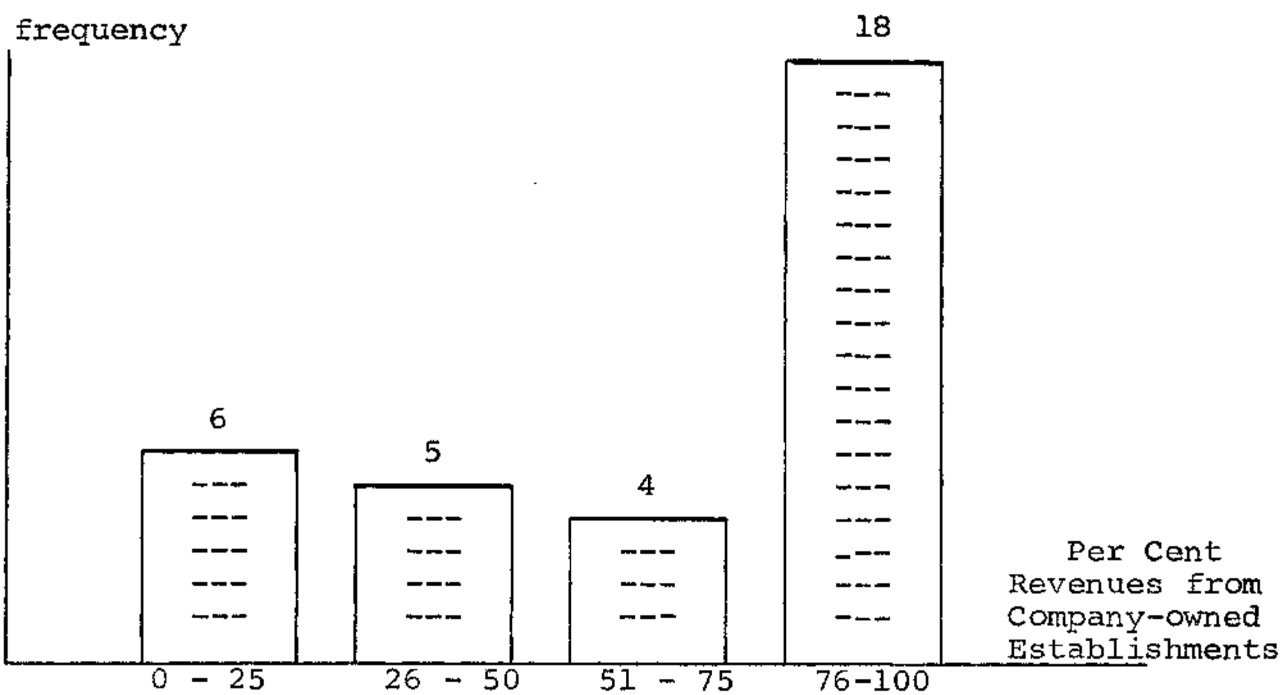

Fig. 4--Frequency distribution of group percentages of revenues derived from company-owned establishments for 1970.

Effect of Time on Source of Franchisor Revenues

The effect of time on the percentage of total revenues derived from company-owned restaurants is shown in Table X on the following page. The table demonstrates no discernible

TABLE X

SOURCES OF FRANCHISOR REVENUES BY THE NUMBER OF YEARS FRANCHISING AS OF 1970

Years Franchising (1)	Total Revenues (2) ($ 000)	Company Owned (3) ($ 000)	Franchised (4) ($ 000)	Per Cent 3 of 2 (5)
1	16927	16494	433	98
2	7660	3100	4560	40
3	759	453	306	60
4	20602	17537	3065	85
5	40438	30647	9791	76
6	28982	28205	777	98
7	0	0	0	--
8	15588	5376	10212	35
9	139072	53174	85898	38
10	0	0	0	--
11	28200	27000	1200	96
12	0	0	0	--
13	24702	23117	1545	94
14	191454	146817	44637	77
15	6230	3640	2590	58
16	2500	0	2500	0
17	59005	46395	12610	79
18	0	0	0	--
19	0	0	0	--
20	19294	1709	17585	9

pattern as a result of the number of years engaged in franchising. Exhibit IV in Appendix E verifies this lack of correlation. The negative correlation coefficient which is counter to the hypothesis under study of -.154 is not significant. Exhibit V in Appendix E correlates the percentage of total revenues derived from company-owned establishments with the number of years the firm had been in business as of 1970 and yields a correlation coefficient of .0304. Again the coefficient of correlation is not significant. Exhibit VI in Appendix E derives the degree of association between the number of years the firm had been in business prior to the initiation of franchise operations and the per cent of total revenues derived from company-owned establishments. The coefficient of .236 depicts a slight possibility of association between these two variables. If so, this association leads to the conclusion that the greatest contributor to the observation that franchising firms derive a relatively large portion of their total revenues from company-owned establishments is the fact that many of these firms have added franchise operations as an additional source of revenue while maintaining their primary activity of operating company-owned restaurants.

Conclusion

The length of time that a firm in the study group has engaged in any phase of the franchise business has had no effect on the percentage of its total revenues which were derived from company-owned establishments.

Effect of Total Revenues on Franchisor Ownership of Service Establishments

The effect of total revenues on the percentage of total establishments owned by the franchisor is derived in Exhibit VII of Appendix E. The resulting coefficient of .0692 is not significant. Thus, the hypothesis that increasing total revenues causes an increase in the per cent of total establishments owned by the franchisor is rejected with regard to the firms in the study group.

Exhibit VIII in Appendix E correlates total revenues with the per cent of total revenues derived from company-owned establishments. Again, the coefficient of .042 is found to be insignificant. Thus, within the limits of this study, no correlation may be attributed to these two variables.

Conclusion

Among the study group, the amount of a franchisor's total revenues has had no effect on the ownership of service establishments by the franchisor.

Franchisor Purchases of Franchised Establishments

The fact that a franchisor owns a particular establishment does not necessarily indicate that the establishment was purchased from a franchisee. In fact, one of the reasons cited by Oxenfeldt and Kelly for the assertion that successful franchises would become wholly owned chains is that the franchisor is in an excellent position to identify and retain the best locations as company-owned outlets.[18]

Table XI, on the following page, shows the number of establishments in the study group which are owned by the franchisor but which were originally franchised. From this table, it may be seen that 37 per cent of the company-owned establishments were originally franchised. Comparing Table XI and Table V, one may derive that only 9 per cent of the establishments which were originally franchised were repurchased by 1970. Further, only 8 per cent of the total establishments of the franchisors in the study group were franchised and later repurchased by the franchisor.

Performance of Franchised Versus Company-Owned Establishments

If franchisors, in their decisions to retain certain locations as company-owned establishments and their decisions to buy back certain locations, seek to hold the better restaurants as company-owned establishments, then it would be expected that company-owned restaurants would outperform franchised restaurants and franchised restaurant sales per establishment would decline as the better performers became company-owned.

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[18]Oxenfeldt and Kelly, op. cit., p. 70.

TABLE XI

FRANCHISOR PURCHASES OF FRANCHISED ESTABLISHMENTS AS OF 1970

Company	Total Establishments Owned	Number Originally Company-Owned	Number Purchased from Franchisees
1	25	15	10
2	7	3	4
3	0	0	0
4	2	2	0
5	4	1	3
6	18	16	2
7	200	178	22
8	3	3	0
9	2	2	0
10	101	99	2
11	384	192	192
12	81	57	24
13	65	59	6
14	17	17	0
15	8	7	1
16	256	230	26
17	48	5	43
18	15	0	15
19	43	22	21
20	20	16	4
21	38	34	4
22	0	0	0
23	15	0	15
24	26	19	7
25	150	38	112
26	7	5	2
27	3	3	0
28	0	0	0
29	113	9	102
30	10	0	10
31	54	53	2
32	16	10	6
33	0	0	0
Total	1731	1096	635

Table XII, on the following page, presents the average sales volume of company-owned and franchised restaurants during the study period. From the averages at the bottom of the table it may be seen that company-owned restaurants in the study group have, indeed, outperformed their franchised counterparts in the study group. However, the average sales volume per franchised establishment has consistently increased. This suggests that, rather than buy-back the better franchises, franchisors are able to identify these locations and retain them as company-owned establishments. Comparison of the growth characteristics of these two classes of establishments is facilitated by Figure 5.

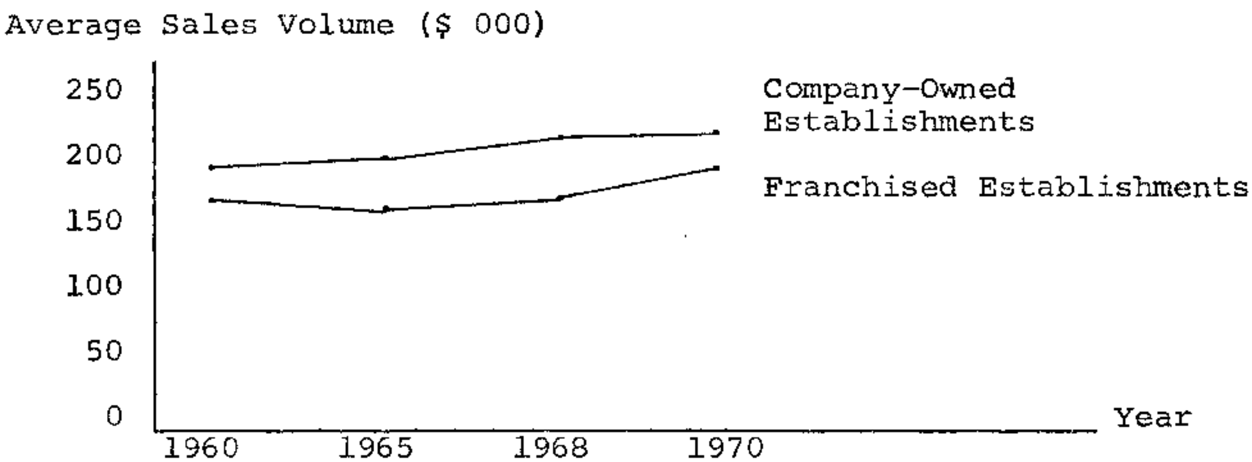

Fig. 5--Average sales volume per establishment by ownership characteristic.

It may be seen that company-owned establishments improved relative to their franchised counterparts during most of the decade. However, during the last two years of the study period, franchised establishments appear to be correcting this disparity.

TABLE XII

AVERAGE SALES VOLUME OF FRANCHISED AND COMPANY-OWNED RESTAURANTS (IN $ 000)

Company	Year							
	1960		1965		1968		1970	
	C	F	C	F	C	F	C	F
1	99	99	114	114	135	135	146	146
2	--	--	---	---	275	325	228	330
3	--	--	---	---	---	300	---	300
4	--	--	---	---	190	100	175	160
5	--	--	---	---	74	70	71	75
6	--	--	266	300	248	290	450	320
7	--	--	225	150	143	191	128	348
8	--	--	---	---	43	---	48	nil
9	70	--	70	---	70	70	70	84
10	--	--	191	190	158	258	173	300
11	168	168	232	231	459	308	382	349
12	NA	257	171	275	179	308	184	310
13	--	--	203	150	195	152	230	152
14	--	--	---	---	700	300	647	335
15	120	--	120	105	130	93	117	109
16	--	--	175	75	53	90	105	105
17	--	--	101	144	8	114	50	100
18	--	--	45	42	58	66	65	46
19	50	--	54	---	50	60	56	67
20	--	--	---	---	417	25	250	20
21	500	--	500	---	429	180	421	200
22	--	50	---	60	---	75	---	90
23	--	--	100	100	258	100	102	100
24	NA	114	61	123	54	150	66	170
25	--	--	520	260	336	270	233	280
26	--	--	---	---	80	100	100	100
27	--	--	171	160	207	180	248	220
28	--	--	---	---	35	42	---	50
29	NA	220	341	240	412	260	411	276
30	--	--	266	68	286	70	232	73
31	--	--	---	60	---	65	78	78
32	--	--	168	160	202	190	277	240
33	--	--	---	---	---	100	---	130
Total	1007	908	4094	3007	5920	5037	5774	5663
Average	168	151	195	150	204	157	198	172

C = Company Owned
F = Franchised

Franchisors were asked to explain the difference, if any, in the performance of company-owned versus franchised establishments. Forty-two per cent of the firms indicated that there was no appreciable difference. Twenty-seven per cent stated that company-owned restaurants were better managed. Twenty-five per cent of the firms identified location as the explaining factor. Six per cent of the respondents stated that age of the establishment or the number of restaurants in the area caused the difference in performance.

Chapter Summary

This chapter has examined the ownership of fast-food service establishments by thirty-three franchisors. It has shown that, although the fast-food service field had reached a state of maturity as of 1970, the firms in the study group were growing at an accelerated rate. For the thirty-three responding firms the analyses conducted in this chapter reject the hypotheses that the length of time engaged in business or the length of time engaged in franchising affect the ownership of establishments by the franchisor or the percentage of total revenues of the franchisor which are derived from company-owned establishments. Further, analysis has shown that there is no verifiable relationship between total revenues and franchisor ownership of restaurants among responding firms. It has been shown that company-owned establishments were usually company-owned from their inception and that the buy-back policies of these franchisors have not adversely affected the average sales volume of franchised restaurants.

CHAPTER IV

FRANCHISEE ATTITUDES TOWARD FRANCHISING

Although the length of time in operation and the amount of total revenues have not been shown to explain variations in the percentage of total establishments in franchise company chains that are owned by the franchisor, this percentage is rising. Several franchise company executives have stated a desire to operate all units on a company-owned basis.[1] Thus, the tendency to buy-back franchised outlets, although explained by exogenous forces or corporate preference, does exist.

Purchase by Force

If franchised systems are to become wholly-owned chains, the franchisees of such systems must be willing to sell their businesses at reasonable prices. There may exist among franchisors the power to cancel franchise contracts, to refuse to renew them, or to harass franchisees into selling[2] but there is no evidence that this power is being exercised on a wide scale. Further, if a broad-scale movement of this nature

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[1]Charles G. Burck, "Franchising's Troubled Dream World," Fortune, XXCI (March, 1970), 6.

[2]Oxenfeldt and Kelley, op. cit., p. 70.

were to precipitate, it is likely that regulatory authorities would act to bring franchisors under tighter controls.[3]

Monetary Inducement to Sell

That a franchisee would be willing to sell an unsuccessful business is a simple matter to rationalize. The opposite situation, however, is more difficult to explain. Obviously, the opportunity for substantial profit from the transaction would cause many such franchisees to sell. In fact, John Y. Brown, the president of Kentucky Fried Chicken Corporation, reported that many successful franchisees responded to his offers of an exchange of stock for their businesses. At the time, however, the securities of Kentucky Fried Chicken Corporation were rising in value to a price-to-earnings ratio of seventy. The basis for this situation was an earnings growth rate of over 40 per cent a year. Because no firm can maintain this rate of growth on an expanding base, the earnings multiple of Kentucky Fried Chicken stock has dropped to as low as fifteen in the past few years.[4] Other firms have had similar experiences.[5]

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[3] "FTC Planner Indicates Future Moves to IFA," NAFB Letter, National Association of Franchised Businessmen (February, 1971), p. 1.

[4] "Franchising: Too Much, Too Soon," Business Week, No. 2130 (June 27, 1970), pp. 54-55.

[5] "New Issue Parade at Fast Pace in '69: Stock's Action Sluggish," The Franchise Annual (Chicago, 1970), p. 11.

Thus, while a franchising firm may be able to increase its earnings per share by paying relatively high prices for franchised outlets under certain circumstances, it would be unsound to presume that disparities in the rates of return demanded by various investors will permit a perpetuation of this practice. Therefore, if franchisees are to be induced to sell their businesses at prices which are attractive to the franchisor, there must be a rationale above and beyond the interstitial adjustments of capital markets. Such a rationale may exist in the attitudinal changes which a franchisee may undergo over a period of time.

Inherent Forces of Change

Two hypotheses, which reflect the attitudinal changes of franchisees over a period of time, are to be tested in this chapter. First, over a period of time the franchisee becomes less dependent on the franchisor for assistance in the operation of his business. Royalties, however, continue at their previous rates. As a result, the franchisor is viewed, increasingly, as a parasite.

Second, the decreased dependency on the franchisor and a desire for change creates an increasing willingness to sell the franchised business. This hypothesis is supported by several lines of reasoning. Obviously, if the franchisee is not dependent on the franchisor for his effectiveness, he may initiate another business elsewhere and cease to pay royalties by selling the franchise. Further, the profit potential of a small fast-food service establishment is limited. As the franchisee achieves a degree of success, his aspiration level is heightened. Because he is often precluded from opening another outlet while holding the franchise, the sale of the franchise may be necessary if he is to satisfy his aspiration for expansion.[6] In addition, the desire for change may result from a dissatisfaction with the duties and responsibilities of business ownership.[7,8]

No attempt is made, herein, to statistically correlate the attitudes of franchisees with their financial success.[9] Rather, this chapter focuses on the more general issues concerning whether or not the franchise venture has met with the franchisee's expectations, the attitudes of franchisees toward royalties, and their willingness to sell the franchise which they hold. Obviously, profitability is an

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[6]Edwin H. Lewis and Robert S. Hancock, The Franchise System of Distribution (Minnesota, 1963), pp. 80-83.

[7]"What It Takes To Succeed In A Franchise Business," Changing Times, XXIV (May, 1970), 1-2.

[8]Oxenfeldt and Kelly, op. cit., also support both of these hypotheses.

[9]A study of 500 franchisees by the Conference Board Record revealed that, among fast-food franchisees, 32.3 per cent earned approximately what the franchisor had projected, 25.8 per cent earned more than the franchisor's projection, and 41.9 per cent earned less than the franchisor's original projection. NAFB Letter, National Association of Franchised Businessmen (September, 1970), p. 3.

important element in a venture of this nature but there may be other elements which are equally as important. Among these may be the amount of time which the business demands, the nature of the tasks which the franchisee may have to perform, the lack of mobility inherent in business ownership, the psychological pressures resulting from business uncertainty, the degree of perceived independence, and the actual amount of psychic reward derived from independence.[10]

Primary information to be used in the analysis of the hypotheses concerning franchisees is provided by case studies of the twenty-four franchisees listed in Exhibit I of Appendix F. The format of these case studies is presented in Exhibit II of Appendix F. Because some of the opinions solicited in the case studies might be injurious to the relationship of the franchisees and their parent companies, specific reference to a particular franchisee is avoided in this discussion except where permission to quote the franchisee was granted. It should be noted that the number of case studies is not sufficient to accept or reject hypotheses by way of statistical inference. Practicality imposes the restriction that these hypotheses be tested by judgment on the basis of the case studies and selected secondary sources.

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[10] Oxenfeldt and Kelly, op. cit., pp. 72-76.

The Franchisee

The literature of franchising is filled with descriptions of franchisees. Virtually every book written on the subject includes a discussion which characterizes the typical franchisee. The consensus reached by the writers in this area is that there is little, if anything, of a universal nature among franchisee's backgrounds, experience, education, or even age.[11] Some generalizations concerning the proper level of motivation, ability to work with people, ability to work under pressure, business experience, and the ideal age have been forwarded, but these are meant to serve as an ideal profile of typical franchisees.[12] Nonetheless, an assessment of the level of satisfaction which franchisees derive from their businesses must be cast in relation to the characteristics of the individuals involved. The acknowledgment of individual differences in employment preferences is basic to most studies of personnel.

Business Experience of Fast-Food Service Franchisees

It is one thing to say that franchisees in general come from varied backgrounds and of varied personal characteristics.

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[11]Robert Metz, Franchising: How To Select a Business of Your Own (New York, 1969), pp. 22-23.

[12]Robert Rosenberg and Madelon Bedell, Profits from Franchising (New York, 1969), pp. 52-54.

It is quite another thing to generalize that franchisees in a particular type of business have no similarities. True, most large franchise systems contain a variety of types of individuals, but the very nature of the selection procedures used by such firms should create a core of common traits possessed by all but a few exceptions. "There is no such thing in business as 'no special qualifications necessary.'"[13] It appears that, although there may be a franchise to suit practically every individual, a particular type of franchise may be suitable to only a certain type of individual. Franchisors occasionally scrutinize quite closely the amount and type of business experience an applicant has had, and some have prospective franchisees interviewed by trained psychologists.[14]

Logically, a study of fast-food service franchisees should reveal a pattern of individual characteristics which reflects the type of person necessary to operate in this capacity. Of the twenty-four franchisees studied, only seven had previously been involved in the field of food in any manner. Two had previously been employed by the franchisor. However, all but seven had previous business experience, and ten had degrees in business administration. Fast-food franchisors,

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[13]Lewis, op. cit., p. 83.

[14]Robert M. Dias and Stanley I. Gurnick, Franchising: The Investor's Complete Handbook (New York, 1969), pp. 32-33.

therefore, appear to place considerable weight on previous business experience but not necessarily in the food field.

Initial Capital of Franchisees

The franchisees were often reluctant to discuss their investments but the consensus of the group appeared to be that a primary factor leading franchisees to seek a franchise, as opposed to initiating a business without assistance, is the lack of capital which the franchisor is capable of arranging. Ordinarily, the franchisor contacts a local bank, provides information concerning the soundness of the proposed business, and agrees to guarantee the loan. For this service, the franchisee pays a fee to the franchisor. In most cases, this fee is greater than that charged by the Small Business Administration for a similar service.[15]

Age of Franchisees

It has been said that most people who enter franchising, do so shortly after the age of forty. It is at this age that most people assess their past and present economic and social status and their prospects for the future. At this point in one's life cycle, one realizes that, if he is to make a change in his life, he must act in the very near future.[16] Although

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[15]Statement by Denver Hollabaugh, Burger King Franchisee, Arlington, Texas, August 26, 1971.

[16]Rosenberg and Bedell, *op. cit.*, pp. 52-53.

the average age of the franchisees studied was forty-one, a wide range, twenty-one to sixty-one, existed.

Attitudes Toward Independence

With few exceptions, franchisees expressed the feeling that an independent business was for them the only means of achieving a satisfactory level of income. Further, there was a pronounced feeling among most franchisees that independence is a reward in itself. The intensity of the desire for independence was far greater among franchisees in business for less than one year. Some of the franchisees in business for less than one year were not receptive to field representatives of the parent company seeking to assist them with business problems. Beyond one year of operation, however, there was a progressive tendency for franchisees to take a rather passive attitude toward independence.

Conclusion Regarding Franchisee Characteristics

In the aggregate, the actual degree of uniformity among fast-food franchisees was found to be quite low. In addition to wide variations in age, education, and, to a lesser degree, past experience, the franchisees studied varied greatly in their degrees of extroversion, temperament, and levels of aspiration. If certain characteristics are needed to operate a fast-food service establishment, there appears to be little evidence that franchisors successfully pursue these characteristics in their procedures for selecting franchisees.

Attitudes of Franchisees Toward the Franchise Arrangement

A service franchise may consist of little more than the right to use a trademark, or it may comprise a complete business package. The franchisee's view of what he received, however, may strongly affect his attitude toward selling the franchised business and starting a new business of his own. It may, further, affect his attitude toward the franchisor from the standpoint of trust. Some franchisees received a complete business package from the outset, only to discover that the cost had been excessive or that the franchisor's judgement left something to be desired.

Preopening Assistance

Six of the twenty-four franchisees felt that the preopening assistance provided by the franchisor was necessary to their success. Eight franchisees felt that the assistance received was extensive and quite helpful but that it was not absolutely necessary. Seven felt that the assistance was minimal, unnecessary, and, in some instances, detrimental to their operations. Only three franchisees stated that the franchisor had not provided any preopening assistance.

Criteria for Franchise Selection

With only one-fourth of the franchisees finding the preopening assistance to be necessary, one must question why franchisees selected the franchise. Six franchisees stated that they were attracted to the franchisor by advertising. Three had based their decision on their observations of the success of the franchisor's outlets. Two franchisees relied upon the reputation of the franchisor. Seven of the franchisees were directed into the franchisor's organization by friends who were associated with the company. Only three of the twenty-four actually made a diligent search of available alternatives. The remaining franchisees decided on the basis of available locations and financial arrangements.

Attitudes Toward Royalty Payments

Nine of the franchisees felt that their royalty payments were not offset by the benefits of the franchise. Of these, five had been in operation less than one year. The remaining four had been in operation two, three, four, and five years respectively. There appears to be, therefore, a positive relationship between the length of time in business and the perceived dependency on the franchisor. This, of course, is contrary to what was anticipated in the hypotheses.

Willingness to Sell the Franchise

Thirteen of the franchisees studied expressed a willingness to sell their franchise at five times its annual profits.

One stated that he would sell at ten times earnings and two were indifferent toward selling. The remaining eight franchisees stated that they would be unwilling to sell their franchises at any price which might reasonably be offered. The average length of time in business for all franchisees studied was four years. The franchisees who were unwilling to sell their franchises had been in business an average of 6.8 years. This suggests that there is an inverse correlation between the length of time in business and the willingness to sell.

Overall Satisfaction with the Franchise Arrangement

Regarding their level of satisfaction with the fast-food service field, there were fifteen franchisees who were highly satisfied, four who were rather indifferent, and five who were dissatisfied with the fast-food service field. The average length of time in business among those who were highly satisfied was 4.7 years. Those in the low and moderate ranges had been in business 2.6 years and 2.75 years respectively. Again, there appears to be a heightening of enthusiasm for the business as the length of time in business increases.

Alternative Explanations of the Case Study Findings

The case studies reveal that the hypotheses concerning franchisees and their changing attitudes and aspiration levels are not valid. Further analysis of the franchisees' operations suggests several possible explanations for the rejection of these hypotheses.

First, although the activities imposed by business ownership at the inception of the business might become disinteresting after some period of time, the activities demanded of the franchisee may change substantially over time. A business in operation for less than one year demands a lot of time and effort of the owner if it is to succeed. Beyond this point, the owner's participation in the operation progressively lessens. It becomes more of an investment than an employment. As an investment, requiring only limited participation by the owner, the franchise has an attractive yield.

Second, there is a basis for asserting that the franchises awarded at an earlier point in time are better than those awarded more recently. Presumably, franchisors have progressively moved to marginal locations as saturation has been approached. This would suggest an inherent bias resulting from the method of data collection. A better approach might be to study a group of franchisees over an extended period of time. This, however, is not practical for the present study.

Third, some of the franchisees based their opinions primarily on economic considerations. The unsuccessful franchises may be sold or closed at an early point in time, resulting in a higher average level of success among the older franchised businesses.

As a verification of the internal consistency of the information provided by the franchisees studied, it is useful to cross-classify certain opinions which were expressed. Such an analysis reveals that four of the franchisees felt that royalty payments to the franchisor were justified, were highly satisfied with the fast-food service business, and were quite willing to sell their franchised businesses at five times earnings. This position is difficult to rationalize. If one assumes that a high level of satisfaction with the business implies a desire to remain in the business and that a perceived justification of royalties implies that the franchise enables the franchisee to operate more effectively than he could on his own, why then, are these individuals willing to sell their businesses at prices which would not represent a windfall profit?

The answers provided by these franchisees were quite enlightening. One had been highly successful but his level of aspiration had risen since he entered the business. As a franchise holder he can not operate a similar business not associated with the franchisor. Further, his expansion within the system was limited by the number of franchises available in his area. This franchisee felt that despite the fact that an independent operation would be less effective, because of its lack of a nationally known trademark, he could operate on a broader scale to his benefit. The second individual had a desire to live in another section of the country. Despite his satisfaction with the franchise arrangement, he can not move without selling. The remaining two franchisees, when asked how they rationalize this set of feelings did not see any contradiction in their thinking. They both stated that they would simply like "to move on to bigger and better things."

Chapter Summary

This analysis of twenty-four franchisees has not supported the hypotheses of increasing dissatisfaction and willingness to sell. Among the franchisees studied, franchisors would probably find that repurchase on desirable terms should take place during the early years of operation. Given a strategy of early repurchasing of franchised outlets, these case studies suggest that franchisees may be receptive to a reasonable purchase offer.

CHAPTER V

INTERFACES OF GOVERNMENT AND FRANCHISING

Throughout the past decade, franchising has received increasing attention in courts, legislative and regulatory bodies, and various agencies of government. This attention is attributable to potential benefits as well as hazards which franchising holds for the American economy. An examination of the legal and political aspects of franchising provides a framework for speculation regarding actions of government which may be taken in the future to enhance the contribution which franchising may produce for American society.

The potentials of franchising center around its ability to integrate the small, independent businessman into an economic environment which has developed a trend toward large-scale operations and a concentration of economic power. Economies of scale and the indivisibility of many tools which enhance efficiency may not favor the small business. At the same time, it is generally recognized that American society envisions equality of opportunity and the absence of barriers to entry in business as a basic precept of its political and economic philosophy. Franchises pool the purchases, promotion and managerial skills of small businessmen. By doing so, franchising enables small businessmen to participate in economies of larger-scaled business operation.

In addition to the overall potential of fostering the growth of small business, franchising has been viewed as a vehicle for expanding the participation of minority groups in the ownership of small businesses. At present, minority groups own a relatively small portion of the business firms in operation. This disparity is a source of discontent among minority groups and a possible source of various forms of social ills in American society.

The hazards of franchising exist primarily in three forms. First, the sale of franchises leads itself to fraud and misrepresentation. Second, franchise contracts may frequently become the subject of dispute. Third, the provisions of franchise agreements and the practices which evolve from them may violate antitrust policy.

Minority Groups in Franchising

Franchising has been viewed as an instrument whereby minority groups may enter business for themselves with a reasonable likelihood of success. This assertion is based upon its ability to cope with the two major barriers to such entry: lack of capital and lack of business experience. Noting this potential, the Task Force for Equal Opportunity in Business solicited data from 250 firms which stated that their franchises were offered on a nondiscriminatory basis.[1]

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[1] Harry Kursh, The Franchise Boom (Englewood Cliffs, 1969), pp. 149-151.

As a result of this effort, the Department of Commerce published, in 1965, a booklet entitled Franchise Company Data. In addition to listing the firms and revealing numerous facts concerning the nature of the operation, capital required, training provided, and other information, the publication outlines the various loan programs available through the Small Business Administration.[2]

In 1968 the functions of the Task Force for Equal Opportunity in Business were shifted to the newly created Affirmative Actions Program under the direction of Abraham Venable. Venable has stated that after distributing fifty-thousand copies of the Franchise Company Data booklet, he could not identify ten Negroes directed into franchising by the program.[3] As of 1970, a survey by the Small Business Administration revealed that minority groups operate only 1.3 per cent of all franchises. Further, the Small Business Administration has determined that franchises operated by minority franchisees have a greater percentage of failures.[4]

Several franchising firms have launched their own programs to bring minority groups into franchising. Al Lapin, past president of the International Franchise Association,

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[2] LeRoy Collins, Franchise Company Data (Washington, 1965), pp. vi-vii.

[3] Kursh, *op. cit.*, pp. 152-157.

[4] "SBA Minority Survey," NAFB Letter (September, 1970), p. 3.

feels that governmental programs have failed for two reasons. First, the volume of paperwork and details required became unreasonable and franchisors lost interest. Second, the programs have been poorly conceived from the outset. In most cases, the government has sought to develop business in the ghettos. Sound location studies reveal that these areas are incapable of supporting franchise operations.[5]

Fraud and Misrepresentation

A rate of expansion such as franchising has experienced in the past two decades frequently precipitates an air of optimism which enables the unethical to capitalize on the unwary. Although the records of the United States Post Office Department contain cases of franchise mail fraud fifty years ago, the pace of this activity has quickened in recent years. Over 600 such cases have been investigated during the past five years, and it is estimated that these cases alone involved over $27 million in losses to investors. Robert M. Dias, president of the National Association of Franchised Businessmen, estimates that the total loss to investors from franchise frauds during the period from 1964 to 1970 amounted to $160 million.[6]

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[5]Harry S. Meily and others, "Franchising--A Lending Frontier," The Journal of Commercial Bank Lending, LII (April, 1970), 19-20.

[6]"Senator Williams Issues Franchising Report," NAFB Letter, National Association of Franchised Businessmen, Washington, January, 1970, p. 1.

Along with the problem of fraud, which implies an intent to deceive, one must consider a variety of practices representing gradations of misrepresentation resulting from nonpunishable forms of sales "puffery." In recent years, numerous franchise businesses have been based primarily on the use of celebrity names and sports personalities which lacked sufficient managerial capability and operating experience. Consequently, these firms have suffered a high rate of failure.

Use of celebrity names is an inducement to potential investors because it is felt that a well-known person would not become involved in an unsound business. In most cases, however, the celebrity has little or no involvement in the business aside from the consideration received for the use of his name.[7] A bill introduced by Senator Harrison Williams would require disclosure of financial arrangements with celebrities [8] but, as yet, no affirmative action has been taken on the bill.[9]

State-Level Legislation Against Fraud and Misrepresentation

Dealing with overt fraud is not a matter of requiring new legislation. Strengthening enforcement of existing

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[7] Lubbock Avalanche Journal, May 5, 1971, p. 8A.

[8] Wall Street Journal, May 18, 1970, p. 2.

[9] "FTC Commissioner Cites Franchising Problems," Franchise Letter (November, 1971), p. 1.

statutes may stop fraudulent practices as they arise. In some states, however, legislatures have deemed it necessary to enact statutes which declare specific practices illegal, regardless of intent, in order to expedite the enforcement of fraud statutes. Wisconsin and Illinois, for example, have outlawed the use of pyramid or chain referral types of franchises.[10]

Two states have chosen to interpret franchise agreements as tantamount to securities and thereby subjected franchising firms to disclosure regulations. California, for example, has enacted a Franchise Investment Law to protect franchisees when they purchase a franchise. Specifically, the California Franchise Investment Law has five major features. First, any firm or person which offers "franchises for sale in California must submit a prospectus at least forty-eight hours prior to the finalization of the contract." Second, franchisors with fewer than twenty-five establishments must register their franchise offering with the state commissioner of corporations. Third, the law does not apply to wholesale relationships or to franchises which do not require a franchise fee. Fourth, franchisors are required to maintain certain records and are subjected to liabilities and penalties for failure to register or violation of prohibited practices. Fifth, advertisements

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[10]E. Patrick McGuire, "State Franchising Regulations," The Conference Board Record VII (October, 1970), 31.

and sales presentations must be filed three days in advance of use.[11]

Although Georgia is the only additional state that has held franchises subject to state securities laws, the legislatures of Massachusetts, New York, and Kentucky have considered bills which would bring franchising under such regulation. Further, Missouri, Texas, Washington, Iowa, and South Carolina have instituted investigations of franchising to formulate possible regulations.[12]

Federal Regulation of Fraud and Misrepresentation in Franchising

Regulation at the state level has several disadvantages. Obviously, this form of regulation results in some duplication of effort with regard to the formulation of laws and their enforcement. National franchisors may be burdened with the variety of standards and clerical procedures that may evolve. To some extent, state level regulation may represent a barrier to entry for smaller firms.

There have been three major moves in recent years to institute federal regulation of franchising. First, in 1967, Senator Philip Hart sponsored a bill to control franchise terminations. Second, Senator Harrison Williams held a series

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[11]Anthony R. Pierno, "Exclusive: California Franchise Investment Law," Franchise Journal (February, 1971), p. 16.

[12]McGuire, *op. cit.*, pp. 29-32.

of hearings in 1970 to formulate possible regulatory or full disclosure legislation. Third, in 1970 the Federal Trade Commission conducted an investigation of franchising for purposes of establishing guidelines. As yet, nothing has been finalized at the federal level.

Franchise legislation. Because the bill sponsored by Senator Hart dealt with franchise-contract termination and renewal,[13] it is discussed in the following section. The hearings held by Senator Williams, chairman of the Senate Small Business Committee's Urban and Rural Economic Development Subcommittee, "were designed to cover various aspects of franchising."[14] Testimonies included numerous celebrities whose names have been used by franchisors as well as other members of the franchise community. The report resulting from these hearings included: (1) recommendations for the compilation of statistics on franchising, (2) increased efforts to foster minority group participation in franchise ventures, (3) full disclosure of information by franchisors, and (4) increased powers for regulation by the Federal Trade Commission.[15]

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[13] "Franchise Legislation," Franchise Letter (October, 1971), p. 1.

[14] "Franchise Regulation Threat Casts Dark Shadow," The Franchise Annual (Chicago, 1970), p. 6.

[15] "Senate Small Business Committee," Franchise Journal (February, 1971), pp. 18-19.

A full disclosure bill resulting from Senator Williams' report, which would have required submission of financial and operating information to the Securities and Exchange Commission[16] was not submitted in time for approval by the Ninety-first Congress.[17] In addition to its disclosure provisions, the bill would grant injunctive power to the Securities and Exchange Commission to terminate the use of a misleading advertisement.[18] The bill, identified as the Franchise Full Disclosure Act of 1970 (S.3844),[19] is expected to be reintroduced in the Ninety-second Congress.[20,21]

Federal Trade Commission guidelines. The Federal Trade Commission investigation of franchising was a general study of franchise patterns and practices in the fields of fast-food, motels, business services, laundry, dry cleaning, and convenience foods. From its inception the study was intended to serve as the basis for a set of guidelines for franchise contracts and franchise advertising.[22] The Commission stated

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[16] Wall Street Journal, May 18, 1970, p. 2.

[17] "Franchise Legislation," op. cit., p. 1.

[18] Wall Street Journal, May 18, 1970, p. 2.

[19] "F. T. C. Commissioner Cites Franchising Problems," Franchise Letter (November, 1971), p. 1.

[20] "No Hurry About Franchise Laws in Washington, Franchise Letter (October, 1971), p. 1.

[21] A similar bill, the Franchise Disclosure Act of 1970 (H. R. 19022) has been introduced in the house by Congressman William S. Stuckey, Jr.

[22] "Federal Trade Commission Notes," NAFB Letter, (July, 1970), p. 7.

that its reasons for initiating the study were (1) complaints regarding misrepresentation of potential earnings, (2) investment requirements, (3) management services provided, (4) franchise territories, (5) unjust terminations of franchise agreements, and (6) numerous reports of practices in violation of antitrust laws enforced by the Commission.[23]

At the conclusion of its year-long study, the Federal Trade Commission announced that it "finds misrepresentation to be the most urgent problem requiring commission action."[24] Accordingly, the Commission proposed in November of 1971 a comprehensive set of disclosure guidelines requiring information concerning twenty-seven items. Included among these items are:

> The enfranchiser's business experience and financial history.
>
> Whether any of the franchise company's major stockholders, directors, or officers have ever been convicted of a crime involving fraud or have filed for bankruptcy.
>
> The number of current franchises that operated at a loss during the previous year.
>
> The total amount of fees that the franchise buyer must pay to the seller, expressed in dollars and as a percentage of gross sales.
>
> The conditions under which the franchise agreement may be terminated.
>
> If the franchise seller provides training, the number of hours of instruction given and a brief biography of the instructors.[25]

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[23] "Legal Notes," Franchise Journal (July, 1970), p. 1.

[24] Wall Street Journal, July 9, 1971, p. 30.

[25] Wall Street Journal, November 11, 1971, p. 8.

Further protection is proposed by way of a ten-day period during which a franchise buyer may cancel the contract and receive a full refund. The guidelines would prohibit franchisors from negotiating promissory notes which waive the franchisee's rights to legal action against the holder of the note. Where the name of a public figure is used in the franchise, the franchisor must reveal the nature and conditions of promotional assistance to be provided by the public figure.[26] The Federal Trade Commission announced that a public hearing on its proposals would be held in February, 1972.[27] At this writing, the proposals are still under consideration.

If the guidelines proposed by the Federal Trade Commission are adopted, it would appear that disclosure legislation is unnecessary. As a preventive measure the guidelines should preclude the necessity of duplicative measures at the state level. Further, in light of additional franchise regulation or additional enforcement of antitrust laws pertaining to franchise regulation, the Federal Trade Commission may represent a more logical franchise regulatory agency than the Securities and Exchange Commission.

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[26] Ibid.

[27] "New Rules Drafted on Franchises," Franchise Letter (December, 1971), p. 2.

Franchise Contracts

It is difficult to generalize as to the content of franchise contracts. There are wide variations between contracts of different companies and particularly between different types of franchised businesses. Most franchise contracts, however, identify the products, territory, classes of customers, prices, and duration covered by the contract. As a rule, the promotional obligations of both parties are specified. Franchisees are frequently subjected to sales quotas, limitations on their right to carry additional lines of goods, requirements to provide certain services, and conditions of performance for which the franchisor may terminate the agreement. Further, provisions for renewal are commonly included.[28]

Service franchise agreements usually spell out the franchise fees, royalties, and other considerations to be required of the franchisee[29] and either provide for or limit the franchisee's ability to transfer rights granted in the contract.[30] In service franchise contracts the agreement must cover standards for creating the product. Franchisors must

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[28]Theodore N. Beckman and William R. Davidson, Marketing (New York, 1967), pp. 396-398.

[29]Milton Woll, "Sources of Revenue to the Franchisor and Their Strategic Implication," Journal of Retailing, VII (Winter, 1968-69), 14-20.

[30]Robert M. Dias and Stanley I. Gurnick, Franchising: The Investor's Complete Handbook (New York, 1969), p. 88.

control the nature and quality of goods and services provided by franchisees to protect their trademarks.[31] Implementation of this requirement normally requires provision for training by the franchisor.

Appendix G presents the franchise contract used by Chicken Delight, Incorporated. With the exception of sales quotas, this contract contains each of the elements previously mentioned. This particular contract is used for illustration of several legal issues discussed in subsequent sections.

Contract Specificity

The Chicken Delight franchise agreement, as with many other such agreements, demonstrates a high degree of specificity. Contract specificity has been the subject of numerous disputes. Franchisees have complained that the details of such agreements cause inflexibility and are often detrimental to the franchisees' interests. When a franchisee is required to maintain business hours not justified by revenues generated or is otherwise restrained from making significant business decisions, he loses an important quality of an independent businessman.[32]

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[31] Sidney A. Diamond, "Federal Trade Commissioners Warn of Abuses in Franchising," Advertising Age, XL (July 21, 1969), 88.

[32] Jerome Shuman, "Franchising-Quo Vadis? The Future of Franchising and Trade Regulation," Franchise Legislation, Hearings before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, United States Senate, 90th Congress, 1st session, pursuant to S. Res. 26 on S2507 and S2321, U. S. Government Printing Office (Washington, 1968), p. 514.

Lawrence G. Meyer of the Federal Trade Commission has stated: "An examination of the all too typical franchise contract usually discloses restrictions quite unnecessary to the ongoing success and profitability of the franchise."[33] During the early 1960's, the Small Business Administration interpreted most franchise contracts as being too restrictive to qualify franchisees as independent and therefore ineligible for SBA assistance.[34]

Vendor-Vendee Relationship

Basic to the issue of contract inequities is the legal nature of vendor-vendee relations. A franchise relationship is generally considered as a vendor-vendee relationship rather than a relationship of principal and agent.[35] As such, the parties to the agreement are expected to seek their own best interest and the courts will not take upon itself the task of altering such an agreement if it is in keeping with public policy.[36]

Contract of Adhesion

When a contract is written by a dominant party and another party is given only the choice of accepting or

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[33] "FTC Policy Planners: possible directions on franchising," Franchise Journal (March, 1971), p. 29.

[34] Kursh, op. cit., pp. 62-64.

[35] Philip F. Zeidman, "The Franchise Agreement--Its Achilles Heel," Franchise Legislation, op. cit., p. 521.

[36] Charles M. Hewitt, Jr., Automobile Franchise Agreements (Homewood, 1956), p. 6.

rejecting the agreement, without being able to negotiate terms, the contract is considered to be a "contract of adhesion."[37] In a contract of adhesion "any ambiguities or uncertainties in the wording of the agreement will be construed against the draftsman."[38] Under these circumstances, it is necessary that franchisors be specific and precise in stating their desires and intentions in their contracts.

Fiduciary Relationship

Harold Brown, a Boston lawyer and author of Franchising, Trap for the Trusting, has argued that franchises constitute a fiduciary relationship. In a 1970 Canadian case, Jirna Limited vs. Mr. Donut of Canada Limited, the court ruled that franchises are not mere vendor-vendee relationships but constitute at least quasi-fiduciary relationships. Such a relationship is one of trust and one in which both parties are obliged to act in their mutual interest. As yet, U. S. courts have not accepted this position.[39]

Contract Termination

The Supreme Court, assessing the consitutionality of the Puerto Rican Dealer Contract Law which provides for

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[37] Ibid., pp. 216-217.

[38] Mark R. Greene, Risk and Insurance (Dallas, 1968), p. 217.

[39] "Franchising and the Fiduciary Relationships," NAFB Letter (August, 1970), pp. 3-4.

indefinite renewal of franchises unless "just cause" for termination can be shown, found that a U. S. Circuit Court of Appeals was correct in finding that the law "retroactively changed contracts in existence at the time it was passed, and thus was unconstitutional." The Supreme Court, however, reversed the decision of the appellate court on the grounds that a Puerto Rican court "should not be overruled on its construction of local law unless it could be said to be inescapably wrong."[40]

In 1967 the Senate Subcommittee on Antitrust and Monopoly held hearings on bills sponsored by Senator Philip Hart which were similar to the Puerto Rican Dealer Contract Law. The bills, S.2321 and S.2507, were intended to protect franchisees from arbitrary termination and refusals to renew franchise contracts.[41]

The bills considered as a franchise any continuing relationship of one year or greater duration which accounts for 25 per cent of the merchants gross receipts. In this regard the bills could have affected many vendor-vendee relationships which neither party construed as a franchise.[42]

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[40] "Fornaris Reversed Again," NAFB Letter (December, 1970), p. 1.

[41] Franchise Legislation, op. cit.

[42] John F. Byset, "Statement for the Chamber of Commerce of the United States," Franchise Legislation, Hearings before the Subcommittee on Antitrust and Trade Regulation of the Committee on the Judiciary, United States Senate, 90th Congress, 1st Session, pursuant to S.Res. 26 on S.2507 and S.2321, U. S. Government Printing Office, Washington, 1968, p. 526.

As a result of the hearings, Senator Hart introduced the Fairness in Franchising Act (S.1967) in January, 1970.[43] Essentially, the bill was a refined version of the previous bills. The Senate Antitrust Subcommittee killed the Fairness in Franchising Act in the Ninety-first Congress.[44]

Franchised automobile dealers have some degree of protection afforded by the 1956 Automobile Dealers Day in Court Act which operates to assure that automobile manufacturers act in good faith in manufacturer-dealer relations.[45] One must question why the same protection is not afforded to other franchisees.

In part, this disparity may be explained by the structural situations in various markets. New franchisees in many fields have a wider range of choice as to franchises than automobile dealers. The ability to accept or reject a renewal agreement is affected by this situation. If an automobile dealer chooses to reject the terms of a renewal agreement, he is likely to face the alternative of seeking a different field of endeavor. His vested interest in the business makes this alternative undesirable.[46] Where the range of choice is

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[43] Philip A. Hart, "Fairness in Franchising," Congressional Record, Proceedings and Debates of the 91st Congress, 2nd Session, Vol. 116, Washington, January 19, 1970.

[44] "Franchise Legislation," Franchise Letter (October, 1971), p. 1.

[45] Philip F. Zeidman, op. cit., p. 523.

[46] Hewitt, op. cit., p. 219.

greater, the consequences of rejecting the terms of a renewal contract are not as great.

Another possible reason for the disparity in legal treatment of automobile dealers and other franchisees is the lesser degree of real concern among franchisees in non-automobile fields for their own protection. A Massachusetts franchise bill, for example, was amended to cover only automobile dealers after only three of the more than three hundred who attended the hearings for the bill were from non-automotive fields.[47]

Franchise Contracts and Antitrust Law

There are four major antitrust issues commonly associated with franchise contracts. First, many such agreements represent tying contracts. Second, either within the written agreement or by oral agreement some franchisors have fixed resale prices. Third, exclusive dealing and full-line forcing may exist in the relationship. Fourth, territorial restrictions may be imposed. Examination of the Chicken Delight franchise agreement in Appendix G reveals that each of these, with the exception of price fixing, exists in the written contract.[48]

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[47]"Franchise Legislation in Massachusetts," NAFB Letter (February, 1971), p. 2.

[48]Paragraphs six and eight illustrate tying agreements and exclusive dealing. Paragraph two is an example of full-line forcing. Paragraph one restricts the franchisee's territory.

Tying Contracts

Tying contracts outlawed by the Clayton Act in 1914 "where the effect may be to substantially lessen competition or tend to create a monopoly" were widespread in franchise contracts prior to a class-action suit against Chicken Delight, Incorporated, in which franchisees were awarded treble damages for the difference between prices paid to Chicken Delight and competitive prices.[49] The ruling was followed by a number of similar suits between franchisors and franchisees.[50]

Franchisors have defended their tying arrangements on the grounds of maintaining secrecy concerning special preparations and protecting the goodwill of their trademarks by adherence to quality standards. In some instances this position is a valid defense.[51] If, however, the tied product may be supplied by others without impairing secrecy or quality, the arrangement is illegal.[52] Although an appeals court partially reversed the Chicken Delight decision by granting that the price difference constituted royalties in the Chicken Delight franchise agreement as compared to other franchise

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[49] "Chicken Delight Franchisees Win Suit," NAFB Letter (May, 1970), p. 4.

[50] Wall Street Journal, July 14, 1970, p. 14.

[51] Diamond, op. cit., p. 88.

[52] "Clarification of FTC Attitude on Exclusive Buying Clauses," NAFB Letter (April, 1970), pp. 4-5.

agreements, the ruling that such tying agreements are illegal was not altered.[53]

Price Fixing

Vertical price fixing in franchise arrangements is not a common practice but does exist where the degree of control desired is extensive. MacDonald's, for example, stipulates the prices to be charged by franchisees.[54] Price fixing is considered by federal courts to be illegal *per se*. That is to say, no test of the economic effects of price fixing is necessary to establish its illegality. The only general exception to this rule is vertical price fixing in a fair-trade state. Price fixing is illegal even under circumstances in which it can be shown that prices are fixed at reasonable levels, and the practice may be attacked under Section I of the Sherman Act or Section V of the Federal Trade Commission Act.[55]

The fact that price fixing has been established as a *per se* violation of antitrust laws would appear to preclude its inclusion in any franchise contract. A franchisor,

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[53]"Chicken Delight Reversal," *Franchise Letter* (November, 1971), pp. 2-3.

[54]Edwin H. Lewis and Robert S. Hancock, *The Franchise System of Distribution* (Washington, D. C., 1963), pp. 43-4.

[55]Marshall C. Howard, *Legal Aspects of Marketing* (New York, 1964), pp. 24-27. See also, *United States v. Trenton Potteries Co., et. al.*, 273 U. S. 392, 396 (1927).

however, may perceive advertising efficiencies, greater assurance that adequate services will be performed, or increased standardization among outlets from the imposition of a standard price.[56] Thus, among service franchisors, vertically imposed price constraints may deserve more flexible treatment because of favorable effects on interbrand competition.

Exclusive Dealing and Full Line Forcing

Exclusive dealing and full-line forcing have the effect of precluding competitors from selling to a dealer. These practices may be in violation of Section III of the Clayton Act as a type of tying contract, Section I of the Sherman Act as a contract in restraint of trade, or Section V of the Federal Trade Commission Act. Illegality of exclusive dealing rests upon whether it results in a substantial lessening of competition.[57] Full-line forcing, unless it is accompanied by restrictions which exclude competition, is not illegal.[58] The Chicken Delight decision involved exclusive dealing with regard to paper goods. Since the Chicken Delight decision, many franchisors have enabled their franchisees to purchase from alternative sources in order to avoid prosecution.[59]

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[56] Shuman, op. cit., p. 518.

[57] Howard, op. cit., pp. 95-101.

[58] Beckman and Davidson, op. cit., p. 409.

[59] Floyd Powell, District Director, Franchise Operations, Mister Donut, Lubbock, Texas, June 16, 1971.

Restricting Territories

Although the legality of the imposition of territorial constraints on dealers had been tested several times in federal courts, complicating issues had precluded a thorough evaluation of this practice until the 1967 decision against Arnold Schwinn and Company. In this decision, the Supreme Court found that "where a manufacturer sells products to its distributors subject to territorial restrictions upon resale, a _per se_ violation of the Sherman Act results." The Court rules that such restraints upon retailers also constitutes a _per se_ violation of the Sherman Act and that the term _franchise_ within the agreement does not alter its legality.[60] Leaving little doubt on this question, the effect of the Schwinn case should lead most franchisors to follow the practice of assuring franchisees that the parent company will not sell or operate another business of the same tradename within specified boundaries without limiting the franchisee's freedom to solicit business beyond these boundaries.

Buy-Back Policies and Antitrust Law

As yet, service franchisors have not encountered governmental action against the practice of buying previously franchised establishments. The observation that franchising

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[60]Donald N. Thompson, "Franchise Operations and the Law," in David J. Rachman, _Retail Management Strategy_ (Englewood Cliffs, 1970), pp. 82-83.

may be used to create, ultimately, a centrally-owned chain was cited in hearings before the Small Business Administration and the Fairness in Franchising hearings in 1967. Senator Harrison Williams referred to the buy-back policies of some franchisors during the course of franchise hearings in 1971.[61] The Federal Trade Commission has referred to the practice as "inherently unfair." Thus, legislators and regulatory bodies have been aware of this phenomenon for some time.

Position of the Small Business Administration on Repurchasing

In an address to the International Franchise Association, the text of which was entered in testimony before the Fairness in Franchising hearings conducted in 1967, Philip F. Zeidman, General Counsel for the Small Business Administration, stated:

> It seems at least academically possible for a franchisor to make use of the franchising approach to lay the foundations for a massive chain of stores and then proceed after profits have piled up, the wherewithal, the banking connections, and so on--for the franchisor to squeeze out the individual franchisees and transform himself, then into a centrally-owned chain.[62]

To Zeidman, this possibility, among other considerations, provides ample justification for the extension of the

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[61]"Senator Williams Issues Franchising Report," NAFB Letter (January, 1970), p. 1.

[62]Zeidman, op. cit., p. 522.

Automobile Dealers Day in Court Act to other industries.[63] Such an action would not preclude the transformation of franchises into wholly owned chains. Franchisees might still be induced to sell. The elimination of arbitrary cancellation and refusals to renew would, however, protect franchisees from the ill effects of the practice.

The issue of repurchasing franchises is also important from the standpoint of the assistance provided by the government. Federal Trade Commissioners have noted the inherent unfairness of using Small Business Administration funds to finance business where only less-successful businesses will be left in the possession of the small businessman.[64]

Legal Status of Repurchasing

An even broader issue surrounding the franchise and buy-back practice is the potential effect on the structure of the economy or of certain industries in the economy. Practiced on a wide scale, buying-back franchises could lead to high levels of concentration in industries which might otherwise remain as industries characterized by many small sellers. Public policy generally favors the latter. Section VII of the Clayton Act prohibits the acquisition of the assets of another corporation where "the effect of such

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[63] *Ibid*., pp. 523-524.

[64] "FTC Policy Planners Indicate Moves to IFA," *op*. *cit*., p. 29.

acquisition may be substantially to lessen competition, or tend to create a monopoly."[65] This provision, however, has been applied primarily to mergers between large corporations because of the substantial lessening of competition required.

In recent years a substantial number of major corporations have acquired the operations of franchisors.[66] If, by way of example, Burger Chef, which is owned by General Foods Corporation,[67] acquired all or a substantial proportion of its franchise restaurants it would appear that competitors might be precluded from a substantial portion of the market for the supplies required by such restaurants. Substantial lessening of competition, however, is a matter of judicial interpretation requiring analysis of individual circumstances.

This study has not substantiated the assertion that there are inherent tendencies for franchise systems to become wholly owned chains. Among the firms and individuals studied repurchasing of franchised outlets was found to occur randomly as a function of managerial preference and with the approval of franchisees. Therefore, preventative legislation or guidelines do not appear warranted. Although the percentage of the total number of outlets in franchise systems which are

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[65]Howard, op. cit., p. 162.

[66]Louis M. Bernstein, "Does Franchising Create a Secure Outlet for the Small Aspiring Entrepreneur," in David J. Rachman, op. cit., pp. 406-407.

[67]Ibid.

owned by franchisors was shown to have risen among the firms studied during the past decade, it remains to be seen whether this percentage will rise to a level which will warrant actions under the Clayton Act.

CHAPTER VI

SUMMARY AND CONCLUSIONS

The revolutionary expansion of franchising which occurred during the decade of the sixties focused considerable attention on a long-standing marketing arrangement. Resulting from extension of the franchise technique to the service fields, this revolution led to a new awareness of the potentials of franchising. In addition to its capabilities for enabling good, small-scale business concepts to gain broad market representation within a relatively short span of time, franchising has provided new hope for the small businessman to establish and maintain a profitable enterprise. In the wake of this seemingly ideal marriage of aspirations has followed a body of skepticism and scrutiny concerning the motives and outcomes of this phenomenon.

While surveying the patterns and potentials of modern-day franchising, this study has given particular attention to speculation as to the permanency of service franchising. Unlike other franchising forms, service franchising results in a unique state of cash flows which may suboptimize the franchisor's profits. Further, it attracts individuals into the private ownership of business who might not otherwise be self-employed. Within this context, there appear to be underlying forces leading this form of franchising to outgrow its function. If these forces exist and manifest themselves, successful service franchise systems will ultimately become wholly owned chains.

Speculation that a substantial portion of the franchised establishments in operation will ultimately be purchased by franchisors has far-reaching implications. If valid, it means that franchising may serve to foreclose more fields of business to the small entrepreneur. Control of the retail outlets in many fields would increase levels of concentration in industries supplying these retail outlets. Concentration of economic power has been associated with increased barriers to entry into a field of business and the capacity to raise prices and restrain production. Thus, this speculation deserves investigation and possibly the attention of antitrust authorities.

The forces leading to cessation of franchising in service fields were formalized into five hypotheses representing a sequence of events which would logically accompany the process of change if these forces are inherent in service franchising. Each of these hypotheses and the assessment of their validity among the fast-food service franchisors and franchisees studied are discussed below. These findings are based upon thirty-three questionnaire responses and twenty-four case studies. They apply only to the firms and individuals listed in Appendices D and F respectively.

Maturity in Service Franchising

According to the first hypothesis in the sequence, service franchising for a particular type of outlet eventually reaches a state of maturity in which the rate of growth of the number of establishments diminishes. At this point in time, franchise fees, which may have been a significant source of revenue in the beginning, are substantially reduced. The period of time required to attain this status is unknown, but one may logically deduce that the growth rate of a particular type of establishment cannot indefinitely exceed the rate of growth in population and the economy in general.

As of 1970 there was evidence that the food-service field had begun to compensate for excessive growth in previous years. A full accounting of the growth rate of fast-food service establishments in franchise systems is precluded by the lack of information from firms which have ceased operations entirely. Among the fast-food service franchisors analyzed in this study, however, the rate of growth between 1968 and 1970 was greater than the rate of growth in prior periods. Thus, among these firms, maturity is yet to come. A decrease in the total number of restaurants in operation between 1965 and 1970 suggests, however, that maturity in this field is eminent.

Ownership of Fast-Food Service Establishments

Owing to the fact that a major reason for franchising may be the desire to expand despite a lack of sufficient capital to do so on a company-owned basis, the second hypothesis speculates that over time or as the financial strength of the franchisor permits, the franchisor purchases the more successful existing franchises. This hypothesis suggests two possible reasons for the purchase of franchised establishments by the franchisor. First, a franchisor may have an original objective of operating as a wholly owned chain. In this context franchising is merely a temporary expediency necessitated by capital shortage. A second reason centers on the frustrations of interorganizational administration. Desiring to operate as a franchised system within which franchisees are expected to adhere to rigidly defined standards, often including directed purchases, the franchisor finds increasing difficulty over time in obtaining cooperation. As a result of this difficulty, the franchisor is led to purchase the franchised establishments.

Tests of this hypothesis were made by considering: (1) total revenues, length of time in business, and length of time franchising, as independent variables; and (2) the per cent of total establishments that are owned by franchisors, and the per cent of total franchisor revenues derived from franchisor-owned establishments, as dependent variables. Computation of the six possible coefficients of correlation revealed that none of the combinations demonstrated a significant level of association between these variables. Thus, the hypothesis that the repurchase of franchised establishments by franchisors is inherent in the nature of service franchising was not supported by the thirty-three firms studied.

Beyond the question of whether repurchasing is inherent in service franchising is whether the repurchase of franchised establishments exists to a degree worthy of concern. It is true that, as of 1970, 21 per cent of the total establishments in franchise systems studied were owned by franchisors. However, only 8 per cent of the establishments of such firms were franchised and later repurchased by the franchisor. This suggests that most of the fast-food service establishments owned by these franchisors were initiated and retained by the franchisor. The practice, on the part of these franchisors, of buying franchised establishments is, therefore, not widespread.

Performance of Parent-Company Owned Establishments Versus Franchised Establishments

The relative performance of company-owned establishments as opposed to franchised establishments and the direction of change in the performance of franchised and company-owned establishments over time reveals something of the franchisor's repurchase practices and his motives for making these purchases. If the franchised establishments are more successful than company-owned establishments, it follows that repurchasing serves as a means of replacing poor managers. This assertion is strengthened if franchised establishments demonstrate consistent improvement in average performance. On the other hand, if parent-company owned establishments outperform their franchised counterparts and franchised establishments demonstrate progressively lower performance, the implication would be that franchisors tend to purchase the more successful establishments.

Data from the study group indicated that parent-company owned establishments outperformed their franchised counterparts throughout the past decade and demonstrated a higher rate of growth in sales per establishment. Although franchised establishments demonstrated a rate of growth in sales volume which might be largely attributable to inflation, there was no indication that physical sales volume per establishment declined during the decade among the firms studied. This finding reinforces the findings in the previous section. That is to say, these franchisors were capable of identifying the better locations and keeping them as parent-company outlets rather than discovering the merits of a location after it had been franchised.

Franchisee Perceptions of the Franchise Arrangement

Among the reasons for selecting a franchise, as opposed to starting a small business without assistance, are the benefits derived from the professional advice in initiating the business and the training required to operate the business effectively. In exchange for these benefits the franchisee agrees to restraints, a franchise fee, and continuing royalties. Although the franchisee continues to benefit from the franchisor's trademark image and occasional advisory visits, the amount of assistance provided by the franchisor decreases substantially after the business is established. Furthermore, the franchisee's need for assistance decreases as he gains experience. Seemingly, the franchisee would resent the fact that royalty payments continue at their previous levels despite the reduced assistance.

Twenty-four case studies of franchisees revealed that their attitudes toward the franchisor and the payment of royalties became negative during the latter part of the first year of operation but that these attitudes progressively improved beyond the second year. Franchisees in business for more than two years felt that they could operate successfully without the assistance of the franchisor but that the value of the trademark justified the payment of royalties. The degree of perceived dependency on the franchisor and the level of satisfaction with the franchise arrangement were found to have a positive correlation with the length of time the franchisee had operated the business. The hypothesis that franchisees tend increasingly to view the franchisor as a parasite was not supported by the franchisees studied.

Franchisee Willingness to Sell the Franchise Back to the Franchisor

There are two reasons to suspect that franchisees will desire to sell their businesses. First, it has been noted that franchising encourages some individuals to become independent businessmen who might otherwise hesitate to do so. As a result, franchising may increase the likelihood that a person unsuited to the demands of business ownership will invest in such a venture. Logically, over time, these individuals may want to reverse their decision. Second, if one considers the training and assistance of the franchisor as a primary reason for the purchase of a franchise, it follows that, with experience, the franchisee finds himself paying royalties for services which he no longer needs. This should lead to an increasing awareness of the desirability of severing the relationship and opening another business in order to avoid royalty payment.

Twenty-four case studies of franchisees revealed that the desire to sell the franchise was greatest during the first two years in business. This suggests that the first reason is more valid than the latter. As noted in the previous section, the perceived dependency on the franchisor for assistance is overshadowed by the perceived value of the trademark image. Despite their expression of a favorable attitude toward the franchise arrangement and an increasing level of satisfaction over time, more than half the franchisees studied expressed a willingness to sell their business at five times their annual earnings. Apparently, this earnings multiple was sufficient to induce sale of the business among the franchisees studied. However, the hypothesis that the willingness of franchisees to sell their business increases over time was not supported by the franchisees studied.

Recommendations

The findings of this study suggest that specific measures to control repurchasing would be premature at this point in time. Repurchasing has yet to demonstrate magnitudes worthy of concern by antitrust authorities. Franchising is likely to result in an increase in the number of small businessmen. It holds promise for reduced barriers to business entry and lower rates of small business mortality.

There is, however, a need for some type of full disclosure requirements such as those proposed by the Federal Trade Commission. The volume of litigation concerning franchising and the records of fraud and misrepresentation suggest that franchising lends itself to abuse. Intelligent investment decisions cannot be made by those who are uninformed. At minimum, the details of a franchise offering should be accessable to the investor.

The "good faith in termination" bill proposed by Senator Hart, should be given further consideration. Absence of such legislation may enable franchisors to impose undue hardships upon franchisees. Further, a bill of this nature may have some merit as an assurance that franchise companies will employ fair methods in negotiating repurchases.

Suggestions for Future Research

Limitations described in this study suggest that research on a broader scale would provide a more conclusive basis for understanding the repurchase phenomenon. Specifically, a long-term study of a larger group of franchisees and a correlation analysis based upon a greater number of franchisors are needed. Further, a study of price-to-earnings ratios and repurchase practices may reveal financial motives for repurchasing.

Numerous books and pamphlets on small business initiation and franchise selection have been published. As yet, no one has fully synthesized these two areas. If one considers the various types of assistance available from suppliers and governmental agencies, many franchise benefits are negated. Such a study might be directed toward the determination of the true investment value of a franchise.

Franchisors and franchisees report numerous problems with personnel. As with other retail firms, low pay, the need for part-time employees, and seasonal variations present unusual demands. The industry could benefit from the experience of other retailers.

In conclusion, franchising is not a clearly defined area of marketing. The numerous forms of franchising discussed in this study indicate that much could be gained from an analytical study of franchising as an interval on the spectrum of channel control.

APPENDIX A

THE QUESTIONNAIRE AND ACCOMPANYING COVER LETTER

February 7, 1971

Dear Sir:

The accompanying questionnaire concerns the assertion by some analysts that successful franchise firms will ultimately become wholly-owned chains. I am evaluating this assertion as part of a dissertation for North Texas State University. Your cooperation in this effort will be of great benefit to me and will constitute a contribution toward a better understanding of the impact of franchising on the retail structure.

As you examine the questionnaire, you may ask yourself the following questions:

(1) Should this information be released? If you would prefer that this information be concealed in aggregate summaries, write "confidential" at the top of the questionnaire and I assure you that no part of this information shall be traceable to your firm.

(2) How accurate must the data be? I do not expect an appreciable amount of research in generating this information. If the information is not readily available, provide your estimate and place an "e" beside your answer.

In addition, I do intend to send a summary report to participants after I conclude my study. I hope that you will find this effort worthy of your time and I will truly appreciate the assistance you provide.

Sincerely,

Terry J. Tinney
Assistant Professor-
Marketing
Texas Tech University

Name and Position of Individual Completing Questionnaire:

____

Name of Firm: ____________________________________

Location: ______________________________________

Name of Franchise(s): ____________________________

Scope of Operation: ___National ___Regional ___Local

Year of Inception of Business: __________

Year in which Franchising Operations Began: __________

1. How many franchised establishments were affiliated with your firm as of the end of each of the following years?

   1960________ 1965________ 1968________ 1970________

2. How many establishments did your firm own as of the end of each of the following years?

   1960________ 1965________ 1968________ 1970________

3. What per cent of the establishments which your firm owned in 1970 were repurchased from franchisees? _____

4. What was the amount of your revenues from franchised businesses during each of the following years?

   1960________ 1965________ 1968________ 1970________

5. What was the amount of your revenues from owned establishments during each of the following years?

   1960________ 1965________ 1968________ 1970________

6. What was the average sales volume per franchised outlet in each of the following years?

   1960________ 1965________ 1968________ 1970________

7. What accounts for the difference between the average sales volume per franchised outlet and the average sales volume per owned outlet?
   _____ Better Location _____ Better Managed

   Other--Please Specify: ______________________________

APPENDIX B

FAST-FOOD SERVICE FRANCHISES LISTED

IN THE 1971 FRANCHISE ANNUAL

	Company	Location
1.	A & W International, Inc.	Santa Monica, Calif.
2.	Abner's International, Inc.	Ft. Lauderdale, Fla.
3.	Acuff (Roy) Cannonball Kitchens, Inc.	Nashville, Tenn.
4.	Alfie's Fish & Chips, Inc.	Houston, Texas
5.	Alfie's Steakhouse & English Pub	Houston, Texas
6.	All-Pro Chicken, Inc.	Pittsburgh, Pa.
7.	American Dairy Queen Corp.	Minneapolis, Minn.
8.	American Snacks, Inc.	Chelsea, Mass.
9.	Amiel's Enterprises, Inc.	Rochester, N. Y.
10.	A.Q. Chicken Houses, Inc.	Springdale, Ark.
11.	Arby's International, Inc.	Youngstown, Ohio
12.	Arnold's (Eddy) Tennessee Fried Chicken, Inc.	Nashville, Tenn.
13.	Arthur's King of Beef	Norfolk, Va.
14.	Ascot Traders, Ltd.	Cedar Rapids, Iowa
15.	Astrodine Food Systems, Inc.	New York, N. Y.
16.	Bambino's, Inc.	Beltsville, Md.
17.	Barbecue Inns Int'l, Inc.	Minneapolis, Minn.
18.	Barn & Silo Stores, Inc.	Chicago, Ill.
19.	Barnaby's Inc.	Chicago, Ill.
20.	Barnacle Bill's, Inc.	Irwin, Pa.
21.	Barnhill Franchise Corp.	Cuyahoga Falls, O.
22.	Baron Int'l, Inc.	Denver, Colo.
23.	Barrel of Beer, Inc.	Chicago, Ill.

	Company	Location
24.	Barrel O'Chicken	Dallas, Texas
25.	Baskin-Robbins 31 Flavor Stores, Inc.	Burbank, Calif.
26.	Baur International, Inc.	Oak Brook, Ill.
27.	Bea's andwich Shops, Inc.	Methune, Mass.
28.	Beef- Roo, Inc.	Rockford, Ill.
29.	Beef Inc.	Wilmington, Del.
30.	Benihana of Tokyo (GFA Industries, Inc.)	New York, N. Y.
31.	Bennett (Tony) Spaghetti House	Houston, Texas
32.	Big Boy Restaurants of America	Glendale, Calif.
33.	Big League Enterprises, Inc.	Wichita, Kan.
34.	Big Scoop Int'l, Inc.	Dallas, Texas
35.	Boone's (Pat) Favorite Foods of America Enterprises, Inc.	Nashville, Tenn.
36.	Bonanza International, Inc.	Dallas, Texas
37.	Branded Burgers of America, Inc.	Hartselle, Ala.
38.	Branding Iron Bar B-Q System, Inc.	Houston, Texas
39.	Bresler's 33 Flavor Ice Cream Shops	Chicago, Ill.
40.	Britain's Fish'N Chips	Nashville, Tenn.
41.	British Fish & Chips Ltd.	Denver, Colo.
42.	Broadway Joe's, Inc.	Miami, Fla.
43.	Brookdale Ice Cream Stores	Glendale, Calif.
44.	Brown & Portillo, Inc.	Oak Brook, Ill.
45.	Buckaroo Steak Ranches, Inc.	Arlington, Va.
46.	Buffalo Bill's Wild West Restaurants	Los Angeles, Calif.

	Company	Location
47.	Bun N'Burger Int'l, Inc.	New York, N. Y.
48.	Burger Castle Systems, Inc.	No. Miami, Fla.
49.	Burger Chef Systems, Inc.	Indianapolis, Ind.
50.	Burger King Restaurants, Inc.	Miami, Fla.
51.	Cable Car Burgers, Inc.	Oakland, Calif.
52.	Camelot Enterprises, Inc.	New York, N. Y.
53.	Captain Jim's Seafood Galley	Los Angeles, Calif.
54.	Carmine Foods, Inc.	Richmond, Va.
55.	Carousel Sundae Bar, Inc.	Springfield, Mo.
56.	Carrols Development Corp.	Syracuse, N. Y.
57.	Carvel Franchise Systems, Inc.	Yonkers, N. Y.
58.	Casey Jones Junction, Inc.	Wichita, Kans.
59.	Cassano Pizza King	Dayton, Ohio
60.	Catfish Joes, Inc.	Dallas, Texas
61.	Celebrity Systems, Inc.	New York, N. Y.
62.	Champburger, Inc.	Miami, Fla.
63.	Chef Italia, Inc.	Binghamton, N. Y.
64.	Chicken Chef Systems, Inc.	Jackson, Miss.
65.	Chicken Delight, Inc.	Des Plaines, Ill.
66.	Chicken Galore Food Service Int'l	Jackson, Miss.
67.	Chicken Holiday Take-Out Shops, Inc.	Edison, N. J.
68.	Chicken Hut System, Inc.	Fayetteville, Ark.
69.	Chicken Unlimited Enterprises, Inc.	Chicago, Ill.
70.	Church's Fried Chicken, Inc.	San Antonio, Tex.

	Company	Location
71.	Cock-a-Doodle of America, Inc.	Cedar Rapids, Iowa
72.	Commissary Corp.	Wooster, Ohio
73.	Convenience Foods of America, Inc.	Hendersonville, Tenn.
74.	Copper Penny Family Coffee Shops	Sherman Oaks, Calif.
75.	Corporate Marketing, Inc.	Ft. Lauderdale, Fla.
76.	Country Cupboard, Inc.	Dallas, Texas
77.	Country School Restaurants	Lyons, Ill.
78.	Covered Wagon Int'l, Inc.	Fairfax, Va.
79.	Culpepper's Plantation Enterprises Inc.	Kew Gardens, N. Y.
80.	Currie's Ice Cream Stores	Los Angeles, Calif.
81.	Dairy Sweet Co.	Ankeny, Iowa
82.	Debbie Lynn's Kitchens	Farmingdale, N. Y.
83.	Denny's Restaurants, Inc.	La Mirida, Calif.
84.	der Cheese n'Wurst	Arlington, Texas
85.	Der Wienerschnitzel International	Torrance, Calif.
86.	DiMaggio (Joe) Franchise Corp.	Los Angeles, Calif.
87.	Dinner Table, Inc.	Salt Lake City, Utah
88.	Dino's Gondolas, Inc.	Tampa, Fla.
89.	Diversi Marketing Plan	Claremont, Calif.
90.	Dixie Cream Flour Co.	St. Louis, Mo.
91.	Dixie Fried Chicken, Inc.	Santa Monica, Calif.
92.	Dixon's Chili Parlors, Inc.	Independence, Mo.
93.	Dizzy Dean's Restaurants, Inc.	Jackson, Miss.
94.	Dog 'n' Suds, Inc.	Champaign, Ill.

	Company	Location
95.	Dolly Madison Industries	Philadelphia, Pa.
96.	Donut Hole	Covina, Calif.
97.	Double-Dee Restaurants	Los Angeles, Calif.
98.	Drummer Boy, Inc.	Topeka, Kan.
99.	Dunkin' Donuts Inc.	Quincy, Mass.
100.	Dutch Pantry, Inc.	Harrisburg, Pa.
101.	Earl of Sandwich Enterprises	Chicago, Ill.
102.	El Chico Corp.	Dallas, Texas
103.	Eng Enterprises, Inc.	Atlanta, Ga.
104.	Executive Chef	Los Angeles, Calif.
105.	Farmer's Daughter, Inc.	Evansville, Ind.
106.	Farrell's Ice Cream Parlour Restaurants Int'l, Inc.	Portland, Ore.
107.	Fisherman's Wharf Fish & Chips Inc.	Hollywood, Calif.
108.	Food For Profit, Inc.	Los Angeles, Calif.
109.	Foodmaker, Inc.	San Diego, Calif.
110.	Foster Freeze	Whittier, Calif.
111.	Franchise Acquisitions, Inc.	No. Miami, Fla.
112.	Franchise Concepts, Inc.	New York, N. Y.
113.	Franchise Conglomerates Corp.	Los Vegas, Nev.
114.	Franchise Management Corp.	Rochester, N. Y.
115.	Franchise Organization, Inc.	Ronkonkoma, N. Y.
116.	Franchising Int'l, Inc.	Chicago Heights, Ill.
117.	Frank N'Stein Systems, Inc.	Columbia, S. C.
118.	Friar Fish's Seafood Specialty Shoppes	Torrance, Calif.

	Company	Location
119.	Frostop Corp.	New York, N. Y.
120.	GDA Franchise Corp.	Ft. Lauderdale, Fla.
121.	General Jackson's Fried Chicken Corp.	Columbus, Ga.
122.	Gold Platter, Inc.	Macon, Ga.
123.	Golden Bird	Los Angeles, Calif.
124.	Golden West Steaks, Inc.	Denver, Colo.
125.	Goodlight (Chas.) & Sons, Ltd.	Quincy, Mass.
126.	Gorton Corp.	Gloucester, Mass.
127.	Graziano's (Rocky) Pizza Rind	New York, N. Y.
128.	Great Lakes Franchise Systems, Inc.	Rosemont, Ill.
129.	G. S. Franchise Corp.	Richmond, Va.
130.	Hamburger Huts, Inc.	Chicago, Ill.
131.	Hannah's Old Time Pie Shoppes	Houston, Texas
132.	Hardee's Food Systems, Inc.	Rocky Mount, N. C.
133.	Harris (Phil) Corp.	Nashville, Tenn.
134.	Henry's Drive-In, Inc.	Chicago, Ill.
135.	Hilleary Franchise Systems, Inc.	St. Louis, Mo.
136.	Hirt's (Al) Sandwich Saloons, Inc.	Nashville, Tenn.
137.	Honey Fried Chicken Corp.	Rocky Mount, N. C.
138.	Howdy Beefburger, Inc.	Quincy, Mass.
139.	Hungry Penguin Fish & Chips	Birmingham, Mich.
140.	International French Cafes, Inc.	Mt. Prospect, Ill.
141.	International Industries, Inc.	No. Hollywood, Calif.
142.	Int'l King's Table, Inc.	Eugene, Ore.

	Company	Location
143.	Jack's Franchising Co., Inc.	Birmingham, Ala.
144.	Jackie's Int'l, Inc.	Miami, Fla.
145.	Jackson-Atlantic, Inc.	Atlanta, Ga.
146.	Jan-U-Wine Int'l, Inc.	Los Angeles, Calif.
147.	Japanese Steak House, Inc.	Miami Springs, Fla.
148.	Jerrico, Inc.	Lexington, Ky.
149.	Jiffy Franchises	Lexington, Ky.
150.	Jimbll's Div.	Runnemede, N. J.
151.	Johnny's American Inn, Inc.	Omaha, Neb.
152.	Jumpin' Bean Restaurants, Inc.	San Rafael, Calif.
153.	Karmelkorn Shoppes, Inc.	Norfolk, Neb.
154.	Kaserman's Old Fashion Ice Cream Parlors	Massillon, Ohio
155.	Kentucky Fried Chicken Corp.	Louisville, Ky.
156.	Kentucky Giant Magic Pit Barbecue, Inc.	Frankfort, Ky.
157.	Korn-Fed Katfish, Inc.	Houston, Texas
158.	Kwik-Kook, Inc.	Coatesville, Pa.
159.	Laurel & Hardy Restaurants, Inc.	Washington, D. C.
160.	Linky's	Savannah, Ga.
161.	Little Caesar Enterprises, Inc.	Southfield, Mich.
162.	Little King Int'l	Tigard, Ore.
163.	Little Red Hen, Inc.	Northbrook, Ill.
164.	London Ben Fish and Chips Shoppes	No. Miami, Fla.
165.	Long John Silver's	Lexington, Ky.
166.	Longchamps Restaurants	Ft. Lauderdale, Fla.

	Company	Location
167.	Lord Hardwicke, Ltd.	New York, N. Y.
168.	Lord Olds English Beef House	New York, N. Y.
169.	Lotts Prize Sandwich Shoppes	Lexington, Ky.
170.	Love's Enterprises, Inc.	Beverly Hills, Calif.
171.	Luigi's Franchise System, Inc.	San Francisco, Calif.
172.	Lum's, Inc.	Miami, Fla.
173.	Maid Rite Products, Inc.	Muscatine, Iowa
174.	Major Brand Food Corp.	East Paterson, N. J.
175.	Mama Tino's	Hollywood, Fla.
176.	Management Diversified, Inc.	Lansing, Mich.
177.	Mantle's (Mickey) Country Cookin', Inc.	Dallas, Texas
178.	Maryland Fried Chicken of America Inc.	Macon, Ga.
179.	May Leo's Chop Chop	Los Angeles, Calif.
180.	McDonald's Corp.	Chicago, Ill.
181.	McManus (John H.) Ice Cream Corp.	Quincy, Mass.
182.	Minute Man of America, Inc.	Little Rock, Ark.
183.	Mister Beefe Int'l, Inc.	Pittsburgh, Pa.
184.	Mr. Big Food Systems, Inc.	Chicago, Ill.
185.	Mister Donut of America, Inc.	Westwood, Mass.
186.	Mr. Fish & Chips	Newport Beach, Calif.
187.	Mr. Hambone Int'l, Ltd.	Danville, Va.
188.	Mr. Pizza, Inc.	Clifton, N. J.
189.	Mr. Quick, Inc.	Moline, Ill.

	Company	Location
190.	Mr. Sandwich U. S. A., Inc.	New York, N. Y.
191.	Mister Softee, Inc.	Runnemede, N. J.
192.	Mr. Steak, Inc.	Denver, Colo.
193.	Mr. Swiss of America, Inc.	Oklahoma City, Okla.
194.	Modern Franchise Sales Corp.	Miami, Fla.
195.	Mugs Up Root Beer Co.	Kansas City, Mo.
196.	Mutual Franchise Corp.	Needham Hts., Mass.
197.	Nathan's Famous, Inc.	Brooklyn, N. Y.
198.	Nat'l Carateria Systems, Inc.	Minneapolis, Minn.
199.	Nat'l Taco Co.	Eugene, Ore.
200.	Neba Int'l, Inc.	Hollywood, Fla.
201.	Niblick, Inc.	Greensboro, N. C.
202.	Nickerson Farms	Eldon, Mo.
203.	Nino's, Inc.	Milwaukee, Wis.
204.	O'Leary's Ice Cream Parlors, Inc.	Fort Worth, Texas
205.	Omni Hut Enterprises, Inc.	Nashville, Tenn.
206.	Orange Julius of America	Hollywood, Calif.
207.	Original House of Pies, Inc.	Los Angeles, Calif.
208.	Original Skinny Food Enterprises, Inc.	New York, N. Y.
209.	Our Heros, Inc.	New York, N. Y.
210.	Ozark Fried Chicken, Inc.	Dallas, Texas
211.	Pagoda Food Systems, Inc.	Greenville, S. C.
212.	Pancho's Mexican Buffet, Inc.	Fort Worth, Texas
213.	Pasquale Food Co.	Birmingham, Ala.

	Company	Location
214.	Paul Bunyan Restaurants	Hinsdale, Ill.
215.	Pepe's Taco, Inc.	Arlington, Texas
216.	Performance Systems, Inc.	Nashville, Tenn.
217.	Peterson's, Inc.	Wilmington, Dela.
218.	Pewter Pot Management Corp.	Burlington, Mass.
219.	Pickin' Chicken (Int'l), Ltd.	Toronto 540, Ont., Can.
220.	Pioneer Systems, Inc.	Los Angeles, Calif.
221.	Pizza Hut, Inc.	Wichita, Kans.
222.	Pizza Inn, Inc.	Arlington, Texas
223.	Pizza Papa, Inc.	St. Paul, Minn.
224.	Plantation Fried Chicken Corp.	New Orleans, La.
225.	Potpourri Int'l, Inc.	Pittsburgh, Pa.
226.	Poulet Buffet, Inc.	Chicago, Ill.
227.	Prexy's, Inc.	Greenwich, Conn.
228.	Prime Rib Inn	Glendale, Calif.
229.	Price of Whales	Fountain Valley, Calif.
230.	Purple Pickle, Inc.	Ft. Lauderdale, Fla.
231.	Quarterback Sports Federation, Inc.	Minneapolis, Minn.
232.	Ranch House of America, Inc.	Ft. Lauderdale, Fla.
233.	Red Barn System, Inc.	Ft. Lauderdale, Fla.
234.	Rhodes English Seafood Shops	San Francisco, Calif.
235.	Rickshaw Boy, Inc.	Denver, Colo.
236.	Rob's Beef, Inc.	Los Angeles, Calif.
237.	Rogers, Roy, Western Foods, Inc.	Washington, D. C.

	Company	Location
238.	Salt, H., esq.	Louisville, Ky.
239.	Sambo's Restaurants	Santa Barbara, Calif.
240.	Sam's Roast Beef Sandwich	La Mirada, Calif.
241.	Sandy's Franchise, Inc.	Kewanee, Ill.
242.	Satellite Systems, Inc.	Indianapolis, Ind.
243.	Saxons Sandwich Shoppes, Inc.	Kansas City, Mo.
244.	Scooper Dooper, Inc.	Pennsauken, N. J.
245.	Sea Host, Inc.	New York, N. Y.
246.	Senor Taco, Inc.	Modesto, Calif.
247.	Seven Kings, Inc.	Lexington, Ky.
248.	7-Knights Int'l. Inc.	Beatrice, Neb.
249.	Shakey's Incorporated	Burlingame, Calif.
250.	Shawn's Colonial Tavern	Tierra Verde, Fla.
251.	Sir George's Smorgasbord House, Inc.	Orange, Calif.
252.	Sizzler Family Steak Houses	Culver City, Calif.
253.	SMAKS, Inc.	Kansas City, Mo.
254.	Smorgasbord Management Co.	Tampa, Fla.
255.	Sno-Cap Enterprises, Inc.	St. Louis, Mo.
256.	Snuffy's, Inc.	Columbus, Ga.
257.	Spudnut Industries, Inc.	Salt Lake City, Utah
258.	Stage Delicatessen & Restaurant, Inc.	New York, N. Y.
259.	Stand 'N' Snack of America, Inc.	Jacksonville, Fla.
260.	Starr (Bart) Food Services, Inc.	Birmingham, Ala.
261.	States Marketing Corp.	New York, N. Y.

	Company	Location
262.	Stewart's Root Beer, Inc.	Mansfield, Ohio
263.	Sveden House Int'l	Minneapolis, Minn.
264.	Taco Bell	Torrance, Calif.
265.	Taco Kid, Inc.	Wichita, Kan.
266.	Taco King Nat'l Franchise Sales	Dallas, Texas
267.	Taco Rancho, Inc.	Orlando, Fla.
268.	Taco Tico, Inc.	Wichita, Kan.
269.	Tennessee Ernie Ford Food, Inc.	Nashville, Tenn.
270.	Tennessee Jed's Franchise Corp.	St. Louis, Mo.
271.	Tex Ritter's Chuck Wagon System Inc.	Nashville, Tenn.
272.	TFI Companies, Inc.	Chicago, Ill.
273.	Tijuana Taco, Inc.	Scottsdale, Ariz.
274.	Time-Out, Inc.	Omaha, Neb.
275.	Tippy's Taco House of America, Inc.	Dallas, Texas
276.	T. J.'s Taco Houses, Inc.	Gardena, Calif.
277.	Topper's Steakhouses, Inc.	Gardena, Calif.
278.	Topsy's Int'l, Inc.	Kansas City, Mo.
279.	Torch House Enterprises, Inc.	Alexandria, Va.
280.	Trans Nat'l Franchise Systems, Inc.	Springfield, Mo.
281.	Treacher's (Arthur) Fish & Chips, Inc.	Columbus, Ohio
282.	Trini's Restaurant's, Inc.	Dallas, Texas
283.	Trolley Systems	Phoenix, Ariz.
284.	Turkey Trot Corp.	Columbus, Ohio

	Company	Location
285.	Uncle John's Restaurants, Inc.	Orange, Calif.
286.	Village Inn Pancake House, Inc.	Denver, Colo.
287.	Village Inn Pizza Parlors, Inc.	Scottsdale, Ariz.
288.	Wagon Ho!	St. Petersburg, Fla.
289.	Waffle House, Inc.	Decatur, Ga.
290.	Wee Willie Franchise Systems, Inc.	Santa Ana, Calif.
291.	Western Pancake House, Inc.	Columbus, Ohio
292.	Western States Char-Steak House, Inc.	Chicago, Ill.
293.	Western Trails Deli-Ranch Development Corp.	St Louis, Mo.
294.	Wetson's Systems, Inc.	Valley Stream, N. Y.
295.	White Whale Restaurants, Inc.	Camp Hill, Pa.
296.	Williams (Hank, Jr.'s) Barbecue Pits, Inc.	Nashville, Tenn.
297.	Wimpy Int'l, Inc.	Los Angeles, Calif.
298.	Winchell Donut House, Inc.	South El Monte, Calif.
299.	Winky's Drive-In Restaurants, Inc.	Pittsburgh, Pa.
300.	World of Wieners	Westport, Conn.
301.	Wrather Corp.	Beverly Hills, Calif.
302.	Yankee Doodle House, Inc.	Berkeley, Ill.
303.	Ye Olde Country Squire	Akron, Ohio
304.	Yogi Bear's Honey Fried Chicken	Rocky Mount, N. C.
305.	Youngblood's Fine Foods, Inc.	Waco, Texas
306.	Yummer's Roast Beef Div.	San Francisco, Calif.
307.	Zuider Zee Fish & Puppies	Dallas, Texas
308.	Soup 'R Sandwich	Rock Island, Ill.

APPENDIX C

DELETIONS FROM THE LIST OF FRANCHISORS

Based upon the assumption that one may reasonably expect a business firm changing its address to leave a forwarding address, the following firms are presumed to be out of business because the questionnaire envelopes were returned, unopened, with the comment that no firm of the indicated name was located at the given address.

Captain Jim's Seafood Gallery

Carousel Sundae Bar, Inc.

Cock-A-Doodle of America

Convenience Foods of America

Chicken Chef Systems, Inc.

Curries Ice Cream Stores

Debbie Lynn's Kitchens

Dinner Table, Inc.

Dolly Madison Industries

Executive Chef

Fisherman's Wharf Fish and Chips

Food for Profit Inc.

May Leo's Chop Chop

Niblick, Inc.

Picken's Chicken Ltd.

Rob's Beef, Inc.

Red Barn System, Inc.

Senor Taco, Inc.

Stage Delicatessen and Restaurant

Taco Rancho, Inc.

The Original Skinny Food Enterprizes, Inc.

Turkey Trot Corp.

Wagon Ho!

Western Trails Deli-Ranch

Astrodine Food Systems

Seven Knights Inc.

Roy Acuff Cannonball Kitchens, Inc.

Pat Boone's Favorite Foods

Cable Car Burgers, Inc.

Youngbloods Fine Foods, Inc.

The following firms returned the questionnaire with an indication that they have never engaged in franchising.

Barrel O'Chicken

Champburger, Inc.

The following Firms were revealed to be out of business in the sources given.

Broadway Joe's Inc.

Mickey Mantle's Country Cookin' Inc.

Carole Martin, "Big Name in Sports No Guarantee of Success," Lubbock Avalanche Journal, May 5, 1971, p. 8-A.

Golden West Steaks, Inc.

NAFB Letter, National Association of Franchised Businessmen, September, 1970, p. 30.

The size of the universe under consideration was further reduced by the following indications of double counting in the 1971 Franchise Annual.

Franchise	Firm
Charles Goodlight and Sons, Ltd.	Dunkin' Donuts
Hannah's Old Time Pies	Alfie's Fish and Chips
Honey Fried Chicken	Hardee's Foods, Inc.
Howdy Beefburger	Dunkin' Donuts
Lotts Sandwiches	Jerrico, Inc.
Jimbll's Div.	Mister Softee
H. Salt Esquire	Kentucky Fried Chicken
Sam's Roast Beef Sandwich	Denny's Restaurants
Bart Starr Food Services, Inc.	Jack's Int'l.
Yogi Bear's Honey Fried Chicken	Hardee's Foods, Inc.
Alfie's Steakhouse and English Pub	Alfie's Fish and Chips
der Cheese and Wurst	Pizza Inn
Cappy's Fish 'n Chips	Franchise Conglomerates Corp.
Sveden House International	Smorgasbord Management Corp.
Rocky Graziano's Pizza Ring	Status Marketing Corp.

APPENDIX D

QUESTIONNAIRE RESPONDENTS

Company	Individual
Barnhill Franchise Corp.	R. W. Barnhill
Branded Burgers of America, Inc.	R. E. Johnston, Jr.
Carmine Foods, Inc.	J. E. Renard
Chicken Holiday Take-Out Shops, Inc.	L. M. Magnes
Chicken Unlimited Enterprizes, Inc.	S. O. Nadler
Chico's Pizza Franchises, Inc.	Irving Popick
Church's Fried Chicken, Inc.	Smith, Barney, and Co.
Denny's Restaurants, Inc.	V. O. Curtis
Dixie Industries	Not Given
Dog 'n' Suds, Inc.	H. R. Madsen
Dunkin' Donuts, Inc.	William Rosenburg
Dutch Pantry, Inc.	G. S. Seamark
El Chico Corp.	B. W. Patterson
Food Host U. S. A., Inc.	W. B. McCarthy
Hardee's Food Systems, Inc.	J. M. Harrington III
International Industries, Inc.	Robert Davis
Jerrico, Inc.	J. T. Moore
McDonald's Corp.	R. J. Boylan
Minute Man of America, Inc.	James Wakefield
Mister Donut of America, Inc.	F. A. Higgins
Mister Steak, Inc.	D. D. Thompson
Mister Swiss of America, Inc.	J. L. Pritner
Pancho's Mexican Buffet, Inc.	J. R. Payne
Pasquale Food Co.	D. V. Beale

Company	Individual
Pizza Hut, Inc.	F. S. Farha
Sambo's Restaurants	O. G. Johnston
Stand 'N Snack of America, Inc.	Denis McCarthy
Sveden House International	R. L. Barnes
Taco Bell	F. P. Cook, Jr.
Tippy's Taco House of America, Inc.	Avery Murray
Topsy's International, Inc.	W. L. Locklier
Wetson's Systems, Inc.	Harold Nobitz
Winchell Donut House, Inc.	V. O. Curtis

APPENDIX E

CALCULATION OF CORRELATION COEFFICIENTS AND TESTS OF SIGNIFICANCE

Exhibit I

Independent variable X = Number of years franchising

Dependent variable Y = Per cent of total establishments owned by franchisor

Pearson's Correlation Coefficient

$$r = \frac{\Sigma xy}{N\ \sigma_x\ \sigma_y} = \frac{-637}{(33)(5.04)(32.2)} = -.1189$$

where: r = coefficient of correlation

$x = X-X$

$y = Y-Y$

$\sigma_Y = \sqrt{\frac{y^2}{N}}$

$\sigma_X = \sqrt{\frac{x^2}{N}}$

N = the number of observations

Test of Significance

$$T = r\sqrt{N-1} = -.1189\sqrt{33-1} = .67 \text{ normal deviates}$$

where: T = the level of confidence expressed as normal deviates
r = the coefficient of correlation
N = the number of observations

Conclusion: No significant correlation is found to exist between X and Y.

Note: The statistical procedures used in this appendix are taken from:

Howard L. Balsley, Quantitative Research Methods for Business and Economics (New York, 1970), pp. 172 and 192.

Exhibit II

Independent variable = Number of years in business

Dependent variable = Per cent of total establishments owned by the franchisor

Pearson's Coefficient of Correlation

$$r = \frac{\Sigma xy}{N \sigma_x \sigma_y} = \frac{501}{(33)(6.9)(32.2)} = .0683$$

Test of Significance

$$T = r\sqrt{N-1} = .0683\sqrt{33-1} = .39$$

Conclusion: No significant correlation is found to exist between X and Y.

Exhibit III

Independent variable = Number of years in business before franchising

Dependent variable = Per cent of total establishments owned by the franchisor

Pearson's Coefficient of Correlation

$$r = \frac{\Sigma xy}{N \sigma_x \sigma_y} = \frac{148}{(33)(6.9)(32.2)} = .0202$$

Test of Significance

$$T = r\sqrt{N-1} = .0202\sqrt{33-1} = .11$$

Conclusion: No significant correlation is found to exist between X and Y.

Exhibit IV

Independent variable = Number of years franchising

Dependent variable = Per cent of total revenues derived from franchisor owned establishments

Pearson's Coefficient of Correlation

$$r = \frac{\Sigma xy}{N \sigma_x \sigma_y} = \frac{-927}{(33)(5.04)(36.3)} = -.1540$$

Test of Significance

$$T = r\sqrt{N-1} = -.1540\sqrt{33-1} = .87$$

Conclusion: No significant correlation is found to exist between X and Y.

Exhibit V

Independent variable = Number of years in business

Dependent variable = Per cent of total revenues derived from franchisor owned establishments

Pearson's Coefficient of Correlation

$$r = \frac{\Sigma xy}{N \sigma_x \sigma_y} = \frac{251}{(33)(6.9)(36.3)} = .0304$$

Test of Significance

$$T = r\sqrt{N-1} = .0304\sqrt{33-1} = .17$$

Conclusion: No significant correlation is found to exist between X and Y.

Exhibit VI

Independent variable = Number of years in business before franchising

Dependent variable = Per cent of total revenues derived from franchisor owned establishments

Pearson's Coefficient of Correlation

$$r = \frac{\Sigma xy}{N \sigma_x \sigma_y} = \frac{1954}{(33)(6.9)(36.3)} = .2360$$

Test of Significance

$T = r\sqrt{N-1} = .2360\sqrt{33-1} = 1.33$

Conclusion: Only a slight possibility of correlation between X and Y exists.

Exhibit VII

Independent variable = Total revenues

Dependent variable = Per cent of total establishments owned by the franchisor

Pearson's Coefficient of Correlation

$$r = \frac{\sum xy}{N\ \sigma_x\ \sigma_y} = \frac{257970}{(33)(35905.6)(32.2)} = .0692$$

Test of Significance

$T = r\sqrt{N-1} = .0692\sqrt{33-1} = .39$

Conclusion: No significant correlation is found to exist between X and Y.

Exhibit VIII

Independent variable = Total revenues

Dependent variable = Per cent of total revenues derived from franchisor owned establishments

Pearson's Coefficient of Correlation

$$r = \frac{\sum xy}{N\ \sigma_x\ \sigma_y} = \frac{1808430}{(33)(35905.6)(36.3)} = .0420$$

Test of Significance

$T = r\sqrt{N-1} = .0420\sqrt{33-1} = .24$

Conclusion: No significant correlation is found to exist between X and Y.

APPENDIX F

CASE STUDY PARTICIPANTS AND

CASE STUDY FORMAT

Exhibit I

Case Studies of Franchisees

Franchisees In Business Less Than One Year

Ken Hamilton, Dunkin' Donuts, 317 University, Lubbock, Texas, June 16, 1971.

Lawrence Rothenberg, Mister Swiss, Lubbock, Texas, June 21, 1971.

Allen Henn, Lum's, 1300 South Cooper, Arlington, Texas, August 26, 1971.

James Rozzell, Pizza Inn, 14440 Josey Lane, Farmers Branch, Texas, December 22, 1970.

Gordon F. Cullum, Chic-Ahoy, DeSoto, Texas, January 5, 1970.

Robert Downing, Mister Steak, 804 North Collins, Arlington, Texas, December 29, 1970.

Franchisees In Business From One to Three Years

Michael W. Robinson, Pizza Hut, Lubbock, Texas, June 15, 1971.

Melvin J. Distel, International House of Pancakes, Lubbock, Texas, June 20, 1971.

Thomas Hinson, Baskin-Robbins, Lubbock, Texas, June 17, 1971.

Michael Coffin, McDonald's, 2343 19th Street, Lubbock, Texas, December 2, 1971.

Kenneth O. Carter, El Chico, 4301 Brownfield Highway, Lubbock, Texas, October 6, 1971.

Dennis Thompson, Seven Knights Restaurant, 4409 19th, Lubbock, Texas, September 7, 1971.

Franchisees In Business From Three to Five Years

Dr. Leroy Garrett, Chick-A-Go-Go, 808 West University, Denton, Texas, January 6, 1971.

William Miller, Kentucky Fried Chicken, 215 North University, Lubbock, Texas, December 2, 1971.

Donald Bennett, Der Wienerschnitzel, Lubbock, Texas, December 5, 1971.

Cecil Parks, Orange Jullius, 10042 Marsh Lane, Dallas, Texas, November 26, 1971.

Dr. Herman B. Segrest, Baskin-Robbins, 356 University, Lubbock, Texas, December 1, 1971.

Denver Hollabough, Burger King, 1220 South Cooper, Arlington, Texas, August 26, 1971.

Franchisees In Business Over Five Years

W. M. Cromer, Poco Taco, 3503 50th, Lubbock, Texas, November 29, 1971.

James Martin, Dairy Queen, Lubbock, Texas, June 20, 1971.

William Gorey, Mister Donut, Lubbock, Texas, June 16, 1971.

M. R. Boldt, McDonald's, 1910 50th Street, Lubbock, Texas, December 3, 1971.

William Purdom, Kentucky Fried Chicken, 1208 50th Street, Lubbock, Texas, December 3, 1971.

J. L. Dunahoo, Dairy Mart, 4447 34th Street, Lubbock, Texas, December 6, 1971.

Exhibit II

Outline of Case Study Format

I. Preopening Considerations

   A. Selecting a franchise
      1. Reasons for deciding to purchase a franchise
      2. Methodology employed in selecting a franchise
   B. Perceived benefits derived from franchise during preopening phase

II. Operational Considerations

   A. Benefits derived from being part of a chain
   B. Services provided by the franchisor

III. Evaluation of the franchise arrangement

   A. Perceived dependency on franchisor
   B. Degree to which the benefits and services offset the cost of royalty fees and the restrictions imposed by the franchisor
   C. Level of satisfaction with the nature of the activities required by the franchise
   D. Desire to sever the franchise relationship
      1. Desirability of following alternatives
         a. Sever franchise arrangement and continue under another name
         b. Sell franchise and seek gainful employment in another field
         c. Sell franchise and open similar establishment elsewhere
      2. Attitude concerning fairness of repurchase clause in franchise agreement

APPENDIX G

THE CHICKEN DELIGHT FRANCHISE AGREEMENT

AGREEMENT

THIS AGREEMENT, made and entered into this.................day of ...., A. D. 196 ,

by and between CHICKEN DELIGHT, INC., an Illinois corporation, and ....

...., hereinafter sometimes collectively

referred to as first party, and ....,

of the City of ...., State of ...., hereinafter sometimes referred to as second party.

WHEREAS, there is a substantial and increasing public demand for hot, freshly prepared and uniform food products, carried out by the consumer or delivered to the consumer in a state for immediate consumption at times and places convenient to the consumer, and Chicken Delight, Inc. is the originator of special preparations, packaging, methods and systems of operation useful in the efficient preparation, sale and delivery of such food products; and

WHEREAS, "Chicken Delight" and other trademarks associated therewith are valuable properties for identifying to the public certain hot, freshly prepared food products, some of which are prepared with certain unique equipment, and all of which are packaged in and include certain distinctive products, and prepared, sold and delivered as prescribed by Chicken Delight, Inc.; and

WHEREAS, Chicken Delight, Inc. is a seller and supplier of certain equipment and supplies necessary and desirable in the conduct of the business hereinbelow described; and

WHEREAS, ...is an independent sales representative for the "Chicken Delight" franchise rights to the market hereinbelow described and has recommended the selection of second party to enjoy such rights in such market; and

WHEREAS, second party is desirous of engaging in the business of the preparation and sale of hot, freshly prepared packaged foods as hereinbelow described, and represents that he is willing to conduct such business so as to deliver to the public the products and services identified to the public by "Chicken Delight" and other trademarks associated therewith;

NOW, THEREFORE, in consideration of the covenants herein contained and of further valuable consideration, the parties hereto do hereby agree as follows:

1. Chicken Delight, Inc. hereby licenses to second party, during the term and upon the conditions hereinafter set forth, the right and franchise to use the names, symbols, method, and system of operation of "Chicken Delight," from a store situated at..

...., in the City of ....,

County of ...., and State of ...., and within the adjacent market

bounded by ....

Second party acknowledges that it is an essential element of the public understanding of the meaning of "Chicken Delight" that hot, freshly prepared and uniform foods from a "Chicken Delight" store will be delivered promptly and at the time designated by the customer; and second party represents and agrees that the aforesaid description of the franchised market constitutes the reasonable boundaries of an area within which such prompt and timely delivery may be accomplished and that he will make such prompt and timely delivery of such hot, freshly prepared food in all of said market. Second party acknowledges that heretofore he has not been engaged in the sale of carry-out food products. Chicken Delight, Inc. agrees to disclose to and instruct second party as to special preparations, packaging, methods and systems of operation in the sale of said packaged foods, which second party acknowledges constitute trade secrets, and he agrees not to disclose them to anyone except his "Chicken Delight" store employees, and not to use them except in his "Chicken Delight" business. Second party agrees that he will not divulge any business information, whether written or oral, received from first party or its authorized representative, or from any meetings of "Chicken Delight" store owners, nor use such information except in his "Chicken Delight" business, until such time as disclosure to the public may be required by the nature of the information, which information includes (but is not limited to) promotional material or plans, expansion plans, new products, marketing information, cost or other financial data, or development of cooking or packaging procedures. Second party agrees that he shall use only the name "Chicken Delight" and the trademarks associated therewith in the sale of said packaged foods and that his place of business for such sale shall be known only as "Chicken Delight." Second party agrees that no food shall be sold for consumption on his premises.

2. Said packaged foods shall consist of, and be limited to, the following, all of which shall be sold and delivered hot and freshly prepared except for cole slaw:

(a) Chicken dinner — one-half of what is known in the poultry trade as an average $2\frac{1}{4}$-$2\frac{1}{2}$ pound dressed and drawn Grade A frying chicken (weighing one pound fifteen ounces to two pounds one ounce without giblets and neck), cut into four pieces according to specifications of Chicken Delight, Inc. prepared, processed, and cooked in conformity with the method of Chicken Delight, Inc.; a generous portion of crinkle-cut French fried potatoes; a blueberry muffin; and a fully enclosed container of cranberry sauce or an approved substitute.

(b) Shrimp dinner — eight of what is known in the shrimp trade as 26/30 count raw shrimp, breaded to 15/20 count, Grade A U.S.D.I., obtained from the Gulf of Mexico, frozen but once, and prepared, processed and cooked in conformity with the method of Chicken Delight, Inc.; a generous portion of crinkle-cut French fried potatoes; a blueberry muffin; a fully enclosed container of cocktail sauce; and a package of mints.

(c) Fish dinner — eight ounces of what are known in the fish trade as fish fillets, prepared, processed and cooked in conformity with the method of Chicken Delight, Inc.; a generous portion of crinkle-cut French fried potatoes; a blueberry muffin; and a fully enclosed container of tartar sauce.

(d) Rib dinner — twelve ounce cooked weight portion of pork loin back ribs (and not spare ribs) which are described in the meat trade as a one and one-quarter pound to one and three-quarters pound size, prepared, processed, and cooked in conformity with the method of Chicken Delight, Inc.; a generous portion of crinkle-cut French fried potatoes; a blueberry muffin; and a fully enclosed container of barbecue sauce.

(e) Chicken snack (99'er) — same as chicken dinner, except that the chicken shall consist of a wing and a breast or a thigh and a drumstick.

(f) Shrimp snack (99'er) — same as shrimp dinner, except that there shall be but five shrimp and there shall be no muffin.

(g) Fish snack (99'er) — same as fish dinner, except that there shall be but four ounces of fish fillets and there shall be no muffin.

(h) Rib snack (99'er) — same as rib dinner, except that there shall be but eight ounces of ribs and there shall be no muffin.

(i) Bucket O'Chicken — bulk orders of chicken, shrimp, fish or ribs, as hereinabove described.

(j) Pizza pie — in 9", 12" and 16" sizes, prepared, processed and baked in conformity with the method of Chicken Delight, Inc.

(k) Cole slaw — prepared and processed in conformity with the method of Chicken Delight, Inc.

(l) Crinkle-cut French fried potatoes prepared, processed and cooked in conformity with the method of Chicken Delight, Inc.

(m) Blueberry muffin.

In the event that items other than those hereinabove specified are approved by Chicken Delight, Inc. for standard use in other "Chicken Delight" businesses, Chicken Delight, Inc. will grant second party permission to sell such other items upon the terms and conditions herein contained.

3. Second party is specifically granted the right and privilege to sell food or other products other than those herein specified, provided they are prepared at or sold from an entirely separate store, identified by a different trade name, and if delivered, delivered from a vehicle bearing no trademark of first party. Second party agrees not to use the "Chicken Delight" premises or trademarks for the sale of any products other than said "Chicken Delight" food products hereinabove described or in conjunction with or on the same premises with any other business or occupation.

4. The price to be charged to patrons by second party for any and all such products, whether or not specified herein, or any combination thereof, shall be determined in the sole discretion of second party.

5. Chicken, shrimp, fish, ribs, pizza, and potatoes shall be cooked in plain view of patrons, and wherever possible, in plain view of passers-by on the exterior of said place of business. Second party agrees to use only fresh, refrigerated chicken and not to use preserved chicken, such as canned, frozen, or cold storage chicken. Second party agrees that he will not pre-cook chicken, shrimp, fish or pizza in anticipation of orders not yet placed but will cook from a raw state as each order is placed. No frozen pizza crust, or frozen or pre-baked pizza pie shall be used. Such foods as may be frozen shall be frozen but once.

6. In order to enable second party to engage in the business of preparation, sale and delivery of hot, freshly prepared foods in accordance with the public understanding of "Chicken Delight" and associated trademarks, Chicken Delight, Inc. will furnish, and second party agrees to buy, certain unique and distinctive articles essential in the conduct of the business; and in addition such other articles, also essential in the conduct of such business, as second party has indicated a desire to purchase from Chicken Delight, Inc., all as indicated on the list attached hereto and made a part hereof. The purchase price of such articles is the sum of $............................, payable in cash in advance of shipment, of which it is acknowledged that the price of the cookers and fryers is the sum of $............................ Second party has determined not to buy from Chicken Delight, Inc. the articles which have been deleted from the printed form of list attached hereto. As such articles as have been deleted are, in the opinion of Chicken Delight, Inc., essential for the efficient conduct of the business described herein in accordance with the public understanding of "Chicken Delight" and associated trademarks, second party agrees to obtain at his expense and for use in his business, all such articles, meeting the reasonable standards of Chicken Delight, Inc., from any source desired.

7. Chicken Delight, Inc. represents and warrants that it has no financial arrangement with second party's suppliers, whether by rebate or otherwise in the purchase of chicken, shrimp, fish, ribs, potatoes, or shortening, and second party is at liberty to purchase such items from any source whatsoever provided, however, that such items meet the reasonable standards of Chicken Delight, Inc.

8. Second party recognizes the importance of furnishing products prepared in conformity with the method of Chicken Delight, Inc. in distinctive packaging, identified by "Chicken Delight" or other associated trademarks. Second party agrees to sell each said food product in an individual enclosed paper or plastic container bearing the standard identification and trademark of "Chicken Delight." Chicken Delight, Inc. agrees to sell or make available to second party, and second party agrees to buy solely from Chicken Delight, Inc., or such other person or corporation as may be designated by it, the requirements of second party for dinner kits (consisting of a dinner size container, spoon, napkin, and cranberry sauce or equivalent), snack kits (consisting of a snack size container, and package of mints), large buckets (being known in the trade as a ten-pound pail), medium buckets (being known in the trade as a five-pound pail), small buckets (being known in the trade as a two-pound pail), pizza kits (consisting of a carton and a corrugated liner), and other distinctive packaging, all from time to time authorized by Chicken Delight, Inc. and bearing one or more of its trademarks. The prices therefor will be .... cents for dinner kits, ... cents for snack kits, ... cents for large buckets, ... cents for medium buckets, ... cents for small buckets, ... cents for 9" pizza kits, ... cents for 12" pizza kits, and .... cents for 16" pizza kits, from the date hereof to ...., 196....., and from time to time thereafter will be no greater than ten (10) per cent more than the price in any previous six months' period. In the event of any increase in price, the new price shall not exceed the price stated herein by a percentage greater than the percentage increase in cost of Chicken Delight, Inc., and upon request Chicken Delight, Inc. will furnish second party with a statement from its independent certified public accountants that it does not. Purchases will be made in minimum quantities of five thousand (5,000) units and according to the requirements of second party for packaging. Second party agrees to buy from Chicken Delight, Inc. the special "Chicken Delight" batter preparation, the special "Chicken Delight" barbecue rib seasoning, and the "Chicken Delight" cole slaw cups, lids, French fry bags and carry out bags for reasonable prices, and that he will not use substitutes thereof in his "Chicken Delight" business.

9. Second party recognizes the importance of publicizing the "Chicken Delight" and other associated trademarks by all reasonable means. Chicken Delight, Inc. agrees to spend three (3) cents per kit or bucket for advertising and promoting "Chicken Delight" products.

10. All of the equipment and supplies of every nature sold and to be sold hereunder are quoted F.O.B. shipping point and for cash in advance of shipment.

11. Second party agrees that said business shall be conducted and operated only at a location within said market area approved by first and second parties, and that the construction or remodeling of his premises shall meet the reasonable standards of first party. Second party agrees that construction or remodeling of his premises will be commenced within thirty (30) days after the execution of this agreement, and that said construction or remodeling will be thereafter diligently pursued to completion and opening of said "Chicken Delight" business within a reasonable time. First party agrees to furnish an installation manual, including plans and specifications.

12. First party agrees to furnish an operational manual, and from time to time promotional and other recommendations. First party agrees to make personnel training facilities available to second party, and to furnish to second party at his place of business a trained supervisor for not less than five (5) days.

13. Second party agrees to purchase chicken, shrimp, fish, ribs, potatoes, muffins, and all other foods and materials only of a uniform and high quality. Chicken Delight, Inc. agrees to furnish upon request information regarding sources of food supplies. Second party agrees that all foods shall be prepared and cooked at a uniform and high quality. As to food products which require preparation in shortening, second party agrees to use only all-vegetable shortening.

15. Second party agrees to purchase or lease, and to use at all times, an adequate number of delivery vehicles and to plainly mark them and his place of business with the standard trademarks of Chicken Delight, Inc. Second party agrees to maintain a free and adequate delivery service within the entire market herein described, and to use delivery ovens which properly preserve heat until delivery to the consumer.

16. Second party agrees to allow first party, or its authorized representative, the privilege of complete inspection of his business, both inside and out. Second party agrees to open his books and records to the inspection of first party, provided, however, that second party shall have been given reasonable advance notice and that the inspection shall not interfere with the operation of second party's business. Second party agrees to furnish to Chicken Delight, Inc. a prescribed weekly report of each week's business no later than one week thereafter.

17. None of the first parties hereto promise to bring or defend any law suits arising over the imitation of any business, names, or symbols, except as first party, or any of them, may in the exercise of their own discretion choose to engage in.

18. Second party acknowledges the value of free delivery, uniformity and product control for quality, appearance, and high delivery standards, and further acknowledges observance of them by him as of great value to all other operators of "Chicken Delight" businesses.

19. This agreement shall be binding upon and inure to the benefit of the successors and assigns, or to the reorganization or purchasers of first party and the heirs, administrators, executors, and assigns of the second party, provided, however, that no assignment by second party shall be valid without the prior consent in writing by Chicken Delight, Inc. and the entry into a new and then standard "Chicken Delight" agreement between second party's assignee and Chicken Delight, Inc.

20. This agreement shall continue for a period of five (5) years from the date hereof, and shall be automatically renewed for three successive five-year terms, unless, at least six months before the expiration of any five-year term, second party gives to Chicken Delight, Inc. notice in writing of termination at the end of such term. Following the conclusion of the last such five-year term, this agreement shall continue from year to year, unless terminated by either party by giving sixty (60) days' notice in writing to the other. Second party recognizes that the good will in the "Chicken Delight" and associated trademarks, for which no franchise or other such fee has been required as a condition to entering this agreement, may continue to attach to any food carry-out business conducted at the same premises as a former "Chicken Delight" franchise. It is accordingly agreed that if second party determines to exercise his right of termination prior to the end of the last such five-year term, he will, at the time and as a condition of such exercise, offer to Chicken Delight, Inc. the option to acquire all or any part of the physical assets used in his business at such premises. The price for which such assets may be acquired by first party shall be the cost to the second party of the assets in question, less an allowance for depreciation of eighty-five (85) per cent.

21. In the event of a breach or threatened breach of the terms of this agreement by either party, the other party shall forthwith be entitled to an injunction restraining such other party from such breach without showing or proving any actual damage sustained. Any action for second party's breach of this agreement shall be separately maintainable by any of the first parties. It is specifically acknowledged that disclosure by second party of "Chicken Delight" special preparations, packaging, methods, systems of operation, or any business information referred to in paragraph 1 hereof, to anyone except his "Chicken Delight" store employees, or use thereof by second party except in his "Chicken Delight" business, shall constitute a material breach of this agreement and shall terminate this agreement. No termination of this agreement by first party, or of the right, title and interest of second party shall prejudice the accrued rights of first party or other rights created herein. In the event of the breach of this agreement or the termination of second party's "Chicken Delight" business for any reason, Chicken Delight, Inc. is hereby granted the right and option to purchase all cookers and fryers which were

recommended for use in said business by first party or sold by first party, whether now or hereafter purchased or owned by second party, and the price therefor shall be the price paid by second party less an allowance for depreciation of thirty (30) per cent during the first year hereunder, fifty-five (55) per cent during the second year, seventy-five (75) per cent during the third year, and eighty-five (85) per cent at all times thereafter.

22. In the event of the breach of this agreement by second party or the termination of second party's business for any reason prior to the expiration of the last five year term provided herein, second party (and its officers, directors and shareholders) agrees:

(a) Not to engage in the business of the sale of carry out or delivered packaged goods as described herein within said market area for a period of one year following such breach or termination, whether directly or indirectly, including but without being limited to the capacities of owner, partner, shareholder, director, officer or employee.

(b) To assign any real estate lease under which he has been operating his "Chicken Delight" business.

23. In the event of the breach of this agreement by second party or the termination of second party's "Chicken Delight" business for any reason at any time, including, but without being limited to the expiration of the last five year term provided herein, second party agrees:

(a) The license herein granted shall thereupon be terminated and second party shall immediately remove all evidence of the name and symbols of "Chicken Delight" and the other trademarks associated therewith.

(b) To relinquish the telephone numbers then assigned to his "Chicken Delight" business.

24. In the event of a sale of any existing "Chicken Delight" business, it is sometimes necessary for Chicken Delight, Inc. to perform various services in connection therewith, some of which may include the approval of the purchaser, approval of a new site, providing prospective purchasers, drawing new agreements, assisting in financing, furnishing promotional aids, and training the buyer. In the event of a sale of second party's "Chicken Delight" business, second party shall pay to Chicken Delight, Inc. a service charge of seven and one-half (7½) per cent of the sales price.

25. Neither party shall be responsible for any contingency unavoidable or beyond his or its control wherever arising, including, but without being limited to, strike, flood, riot, war, fire, rebellion, governmental limitation, and any such contingency shall excuse the inability or refusal or delay in filling or shipping orders; provided, however, nothing herein contained shall be interpreted as an excuse or defense for the failure to pay for goods.

26. The name of any corporation operating any "Chicken Delight" business may include the words "Chicken Delight" or any other trademark owned by or licensed to first party, but only with the written consent of first party. In the event of the termination of this agreement for any reason, the name of any such corporation shall be duly amended to delete such words.

27. If second party shall be adjudicated bankrupt, or shall make a general assignment for the benefit of creditors, or take benefit of any insolvent act, or if a receiver or trustee of the interest of the second party shall be appointed by a court of competent jurisdiction, or if after the opening of second party's "Chicken Delight" business it shall be closed for a period of ninety (90) days for any reason other than relocation or remodeling, or if second party shall default upon any financial obligation upon which Chicken Delight, Inc. has undertaken any secondary financial obligation, then in any such event first party, or either of them, shall have the right, without further notice, to terminate and end this agreement, as well as all of the right, title and interest of second party hereunder, but without prejudice to the accrued rights of first party or other rights to terminate not specified in this agreement.

28. This agreement and the addenda attached hereto contain the entire agreement of the parties and no representations, inducements, promises, or agreements, oral or otherwise, not embodied herein shall be of any force or effect. No failure of first party to exercise any power given it hereunder or to insist upon strict compliance by second party of any obligation hereunder, and no custom or practice of the parties at variance with the terms hereof shall constitute a waiver of first party's right to demand strict compliance with the terms hereof.

29. The invalidity or partial invalidity of any portion of this agreement shall not invalidate the remainder of this agreement.

Executed at Rock Island, Illinois, the day and year first above written.

CHICKEN DELIGHT, INC., an Illinois Corporation.

By .... (SEAL)
Its Authorized Agent

____ (SEAL)

____ (SEAL)
Second Party

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