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## **Franchising in Indonesia from Franchisee Perspective: A Case on Early Childhood Education Franchising in Indonesia**

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### **ABSTRACT**

The successful cooperation within the franchise system is largely determined by the quality of the relationship between the franchisor and the franchisee. The purpose of this study is to examine relationship between franchisor and franchisee from franchisee perspective in the early childhood franchising in Indonesia. In addition, this study was tested how the good relationships between two parties affect satisfaction and performance. Quantitative methods are used in this study with franchisee as the unit of analysis. This study used an online questionnaire because it was taken from the entire city in Indonesia. Data processing was performed using the WarpPLS 3.0 software which can be used for analysis of the structural equation model. Results of this study from 101 online questionnaires declare that apparently in the early childhood education franchise in Indonesia, franchisee will have a good performance if there was good relational quality between two parties backed by entrepreneurial orientation of franchisees. On the other hand, transactional qualities between the two parties do not directly influence the performance, just as antecedent to relational quality. The main practical implication is the entrepreneurial orientation that needs to be owned by a franchisee to be successful in running a franchise business, because entrepreneurial orientation from franchisee has positive effects to relational quality between franchisor and franchisee and also to franchisee performance. This study contributes to the relational quality and entrepreneurial orientation of franchisees that determines the success of the franchise system.

**Key words:** Relational quality, entrepreneur orientation, performance, franchising, Indonesia

### **INTRODUCTION**

Franchising is a form of business arrangement which has been claimed to offer a high possibility of business success. Franchising can be defined as a legal business arrangement in which the owner of a product, process or service (franchisor) licenses another party (franchisee) to use it in exchange for some sort of payment (Watson *et al.*, 2005). Franchising has become a popular business strategy in many industries around the world (Hoffman and Preble, 1993; Hoy and Stanworth, 2003; Kaufmann, 1999; Kaufmann and Dant, 1999). The franchise system is a business formula recognized for its steady growth in recent years, although, it is quite an old system.

The successful cooperation within the franchise system is largely determined by the quality of the relationship between the franchisor and the franchisee (Monroy and Alzola, 2005). Franchise relationship in product or business format, operate as a system of interdependent relationships, leading to relational exchange bounded by contractual agreement between both parties (Harmon and Griffiths, 2008). Relations between the two parties in a franchise system can generally be divided into two parts namely, the transactional and relational (Monroy and Alzola, 2005).

Relational quality is a relationship of cooperation between the franchisor and the franchisees that are not contained in the agreement (Monroy and Alzola, 2005) but the relationship is crucial relational long-term cooperation relationship as it involves factors such as relational norms of commitment, trust and communication between the two sides (Hunt and Morgan, 1996). The relationship between the franchisor and franchisee is dynamic and most of studies from franchisor perspective and the franchisee perspective has received little attention in the academic franchising (Grunhagen and Mittelstaedt, 2000). In fact, the success of franchise system depends on the success of franchisees, because the franchisee runs the business day-to-day and also has direct access to the consumer (Brookes and Altinay, 2011; Shane, 1996).

In general, the type of franchise development that is very good and is still increasing in Indonesia is food and beverages, education, minimarket and travel agencies (Riyadi, 2012). Education franchise in 2011 occupied the second position after food and beverage. However, the numbers of franchise education is still very small, only 137 brands compared with the amount of food and beverages franchising that reach 754 brands (AFI, 2011). It means it is a good challenge to develop educational franchising because more than 250 million Indonesians is a potential market. However, the failure of the franchise system in Indonesia is still high. Results of study conducted by IFBM (2011) with a total sample of 400 franchisees, there is 20% failure in the franchise in Indonesia and the main cause of business failure is relationship disharmony between franchisor and franchisee.

The success of franchising business does not depend only on a good relationship but also the entrepreneur orientation both of franchisor and franchisee. Research on entrepreneur orientation within franchising industry is still a debate because some researchers say that in the franchise system, the franchisee does not need to have entrepreneurial orientation, because franchisee just run the day-to-day business in accordance with the provisions set by the franchisor (Kaufmann, 1999; Williams, 1999). Some researchers said that a franchisee also determines the success of the franchise business because a franchisee can be categorized into two parts, the franchisee who just want to invest and franchisee who wants to have the entrepreneur orientation. So, the success of the franchise as a whole is also determined by the orientation of the entrepreneur of the franchisee, because franchisees implement daily activities directly determine the success of a franchise business (Clarkin and Rosa, 2005; Grunhagen and Mittelstaedt, 2005). Based on study that is still inconsistent, so the need to do this research is to determine whether entrepreneurial orientation affects franchisee satisfaction.

Social exchange theory can be used to explain the social aspect in relationship. An exchange perspective of franchising recognizes the important role that both the franchisor and franchisee assume in developing and maintaining sustainable relationships (Grace and Weaven, 2011). The basic assumption underlying the whole analysis in the social exchange theory is that individuals voluntarily enter and remain in relationships only as long as the relationship is quite satisfactory (Thibaut and Kelley, 1959). In the marketing concept, a partnership needs to consider the social aspect involving the commitment factor and also the confidence of both parties to achieve good cooperation relationship (Morgan and Hunt, 1994). The purpose of social exchange theory is the party involved in the collaboration that depend on each other in a beneficial way (Blau, 1964; Das and Teng, 2002; Miles, 2012). The benefits will be felt by all parties, if there is dependence between the parties involved (Lawler and Thye, 1999). Dependence would be felt if each party keeps with the norms of good cooperation such as commitment and trust in the other party (Holmes, 1981).

The relational quality describes the depth and organizational climate of the interfirm relationship, that develop long term relationship (Monroy and Alzola, 2005). Exchange theory emphasizes the process of interpersonal interaction that is based on the interests of participant for long term. Exchange relations are easily created and maintained when each party views transactions as beneficial (Chen, 2010). Pizanti and Lerner (2003) explained that the relationship within franchise systems using the exchange theory and found that franchisor-franchisee relationships deriving from exchange transactions are flexible and dynamic.

According to Bradach and Eccles (1998), contract are not fully expressing relations condition between franchisor and franchisee. Michael (2000) also said that the quality of the relations is very difficult and complex. The relational quality in a franchise system is a long-term relationship aimed at improving the transactional quality and maintains the effectiveness of the contract that has been made and agreed upon by both parties. In addition, the relationship is dynamic, so for long term cooperation, both parties must be confident and have good communication and commitment (Monroy and Alzola, 2005). In the franchise business, some researchers have used a relational quality to see its effect on satisfaction and performance. In this study, the dimension of the relationship quality consists of trust, commitment, communication and relationalism (Monroy and Alzola, 2005). Franchisor and franchisee also engage in an ongoing, long term relationship (Combs and Castrogiovanni, 1994). The relationship begins with the franchisor that is highly dependent on the local human, consumer information and financial capital to franchisees to access local market. In the meantime, the franchisee is motivated by the franchisor's knowledge and well-proven reputation to establish their business (Kaufmann and Stanworth, 1995).

Success in partnership strategy is inseparable from supervision and conduct of both parties. The franchise formula offers significant advantages both to the franchisor and the franchisee. The franchisor and franchisee also engage in an ongoing, long-term relationship. Franchisor is highly dependent on the local human, consumer information and financial capital of franchisees to access local markets. On the other hand, franchisee is motivated by the franchisor's knowledge and well-proven reputation to establish their business. The ongoing relationship between franchisor and franchisee likes the supervision of the organization, monitoring the behavior of others and the uncertainties, where the relationship can be explained by the agency theory that describes the relationship between the principal and agent relationship (Monroy and Alzola, 2005).

Performance is the work of someone either in terms of quantity and quality in an organization (Venkatraman and Ramanujam, 1986). Performance can be either individual or group work performance, where the description of the performance involves three essential components, namely the objectives, measures and assessment (Ford and Schellenberg, 1982). The goal of each organizational unit is a strategy to improve the performance, where the purpose is providing direction and how it should affect the expected behavior of any personnel organization (Venkatraman and Ramanujam, 1986). Furthermore, Morgan (2001) also stated that better partnership will increase their satisfaction, in which this statement supports earlier studies conducted by Morgan and Hunt (1994) and Reichheld (2001). Satisfaction felt by the franchisee is caused by the support provided by the franchisor to the franchisee's success of the business which became the foundation of the franchise to continue to be motivated and improve its performance in the long run (Roh and Yoon, 2009).

**H1:** Relational quality has a significant positive effect on franchisee performance.

Contemporary entrepreneurship research was initiated by Joseph Schumpeter, an economist (Maritz, 2005). Schumpeter (1934) described entrepreneurship as a process of “Creative destruction”, in which the entrepreneur continually destroys existing products or methods of production or replaces them with new ones. Schumpeter (1934) suggested that the main agents of economic growth are entrepreneurs who introduce new products, new methods of production and other innovations that stimulate economic activity (Maritz, 2005). In order to identify the concept of entrepreneurship as a strategy in the organization. Zahra and Covin (1993) reviewed the related literature and hypothesized that an entrepreneurial process is an important strategy-making mode that an organization may exhibit. It concluded that entrepreneurship is salient strategy making in the organization.

Entrepreneurial Orientation (EO) is the concept used to refer to the process and endeavors of organizations that engage in entrepreneurial behaviors and activities (Lumpkin and Dess, 2001). Business organizations that have high EO expose willingness to innovate, to take risk, to try out new and uncertain products and services and more proactive than competitor towards opportunities in the marketplaces (Covin and Slevin, 1991; Wiklund, 1999). The concept of entrepreneurship has become an area of intellectual and academic study since the late 19th century (Grunhagen and Mittelstaedt, 2005).

**H2:** Entrepreneur orientation has a significant positive effect on relational quality.

Entrepreneurial orientation is a strategy-making process as well as the style adopted by a company in entrepreneurial activities (Lumpkin and Dess, 1996, 2001). Miller (1983) considers that a company doing entrepreneurial orientation engaged in producing innovative products, in conditions of risk and as the first company to proactively innovate compared to its competitors. Lumpkin and Dess (1996) suggested that entrepreneurial orientation is not made up of three dimensions as used in the previous study which refers to the study of Miller (1983) but to have five dimensions, two additional dimensions used is the autonomy and aggressiveness in the face of competition, defined as follows:

- Proactive is the act of taking the initiative by anticipating and pursuing new opportunities and to participate in the activity
- Innovation is the tendency of companies to engage in and support new ideas, novelty, experimentation and creative processes that may result in new products, services, or technological processes
- Risk-taking is an act causing severe debt or creates resources that have a huge commitment to take advantage of opportunities in the marketplace for the benefit of high returns
- Competitive aggressiveness is the tendency of companies to directly challenge the competitor in order to win the competition in the market
- Autonomy is the independent action of individuals or teams to generate ideas or vision and bring it to completion

Entrepreneurial orientation is done to align strategic behavior by building competence of the franchisee (Zahra, 1993; Zahra and Covin, 1993, 1995). Meanwhile, from the perspective of franchisees, franchisee that has an entrepreneurial orientation will focus on developing a franchise business better than a franchisee that only invests. So the performance of the franchise is determined by the entrepreneurial orientation of franchisees (Grunhagen and Mittelstaedt, 2005).

The relationship between entrepreneurship orientation and performance is one of the most important subjects that draw attention of the researchers. In much of the studies in this field, firm performance is considered as a dependent variable and the entrepreneurship activities of the firms is considered as independent variable. Conceptually, there is a strong consensus among the researchers about the fact that the final result of the entrepreneurial activities is the improvement of the performance (Wiklund, 1999; Zahra and Covin, 1995; Zahra, 1993).

Katila *et al.* (2012) stated that an organization that has an entrepreneurial orientation will be developed better than organizations that do not have an entrepreneurial orientation. This statement approves previous research conducted by Lumpkin and Dess (1996) in their study which stated that entrepreneurial orientation affects performance in several alternative models, such as the effect of mediation models, model-free and model interaction. A similar statement expressed by Marino *et al.* (2002) and Coulthard (2007) who also stated that entrepreneurial orientation is one of the aspects that affect the performance of the company.

**H3:** Entrepreneur orientation has a significant positive effect on franchisee performance.

## **METHODOLOGY**

The methodology used in this study is quantitative method. The method of analysis used in this study is Structured Equation Modeling (SEM) to test the hypothesis that are related between variables used in the study. Data processing is done using program WarpPLS 3.0 (Kock, 2012). The unit of analysis in this study is the franchisees while the data used is a cross sectional. In order to obtain a sample frame of potential respondents to the survey, the database of the franchising from Asosiasi Franchising Indonesia (AFI) was used to locate the name of franchise groups. There are 137 brands of education franchising in Indonesia and there are 1730 franchisees. A list of questionnaires are sent online to 400 franchisees and 123 questionnaires are returned but only 101 of questionnaires can be processed, because 22 out of 123 questionnaires were ambiguous or incomplete. However, this study remains to be done because the requisite structural equation model is a sample of at least 100 (Hair *et al.*, 2011).

## **RESULTS AND DISCUSSION**

Of the 101 collected questionnaires, the data obtained that the number of female respondents comprised 61.39% of the sample with male representing 38.61%. The sample ranged in age from 20-60 years with the majority of the sample (37.62%) being aged between 30-39 years old. The educational background of franchisee shows that 48.51% franchisees are university graduates. In average, franchisee has joined the franchise business for 7-10 years (25.74%) with working time each week above 30 h. Description about the respondent shown in Table 1.

Measurement model is the first step that must be seen from the data processing with WarpPLS 3.0. Two criterias in analyzing the measurement model is convergent validity and discriminant validity its purpose is to show how well the fit measurement compared with the theory underlying the test design.

The convergent validity can be established by using the correlation analysis between the components of the constructs. The correlation coefficient values range indicates a moderate positive relationship between the dimensions of each variable. Convergent validity of scores obtained with

Table 1: Characteristics of survey respondents (n = 101)

| Classification                            | N  | Percentage |
|---|----|------------|
| <b>Gender</b>                             |    |            |
| Male                                      | 39 | 38.61      |
| Female                                    | 62 | 61.39      |
| <b>Age</b>                                |    |            |
| 20-29                                     | 6  | 5.94       |
| 30-39                                     | 38 | 37.62      |
| 40-49                                     | 33 | 32.67      |
| 50-60                                     | 24 | 23.76      |
| <b>Education</b>                          |    |            |
| High school                               | 11 | 10.89      |
| Diploma                                   | 29 | 28.71      |
| University                                | 49 | 48.51      |
| Graduate degree                           | 12 | 11.88      |
| <b>No. of years in franchise business</b> |    |            |
| <3  | 14 | 13.86      |
| 3-5                                       | 20 | 19.80      |
| 5-7                                       | 24 | 23.76      |
| 7-10                                      | 26 | 25.74      |
| >10                                       | 17 | 16.83      |
| <b>Working hour/week</b>                  |    |            |
| <10                                       | 14 | 13.86      |
| 11-20                                     | 24 | 23.76      |
| 21-30                                     | 11 | 10.89      |
| >30                                       | 52 | 51.49      |

two different instruments that measure the same concept shows a high correlation. An indicator measuring convergent validity is said to have a high value if the indicator is understood by respondents and are related to the latent variable that are measured (Kock, 2012). The result is significant if all the p-value number of all indicators are less than or equal to 0.05 (Hair *et al.*, 2011).

While the discriminant validity was analyzed by looking at the correlation between latent variables compared by the value of square roots of the Average Variance Extracted vlues (AVE's) are seen diagonally. Value of square roots should ideally be the greatest value when compared to the value of correlation with other variables which means that the indicator is only correlated with latent variables measured. Conversely, if the correlation value of the indicator of the other latent variables is greater, it means that indicators related to other latent variables, so that the measurement model of the research model is not valid (Kock, 2012). The results of the correlations among latent variables were expressed correlation between variables. The results of the correlation between variables are called the value of square roots of Average Variance Extracted (AVE's). The value of square roots of Average Variance Extracted (AVE's) should ideally be greater than the value of the correlation of other variables, thereby questions the indicator is very good and appropriate and not related to other variables.

Based on the calculation of all indicators, it all has p-value <0.05 which means that all the indicators used in this study is valid. The results of the calculations are shown in Table 2.

Reliability testing consists of the value of R-squared coefficient, composite reliability coefficient and cronbach's alpha coefficient. Coefficient-square only suggest a relationship between endogenous variables, so the exogenous variables do not have the R-square value. The R-square

Table 2: Validity measurement

| Indicator   | Weight | p-value | VIF   |
|---|--------|---------|-------|
| <b>Trust</b>  |        |         |       |
| Trust on the contract   | 0.393  | <0.001  | 1.080 |
| Trust on franchisor's information                                   | 0.498  | <0.001  | 1.211 |
| Trust in the ability of franchisor                                  | 0.486  | <0.001  | 1.196 |
| <b>Commitment</b>   |        |         |       |
| Commitment between two parties to successful business               | 0.308  | <0.001  | 1.272 |
| Commitment between two parties to promote good relations            | 0.319  | <0.001  | 1.353 |
| Commitment between two parties for a long term relationship         | 0.374  | <0.001  | 1.744 |
| Commitment between two parties to successful long-term relationship | 0.335  | <0.001  | 1.475 |
| <b>Relationalism</b>  |        |         |       |
| Both parties aiming for succesful business                          | 0.411  | <0.001  | 1.195 |
| Both parties work together for succesful business                   | 0.455  | <0.001  | 1.314 |
| Both parties attempt to solve the conflict amicably                 | 0.444  | <0.001  | 1.284 |
| <b>Communication</b>  |        |         |       |
| Communication with franchisor is frequent                           | 0.438  | <0.001  | 1.256 |
| Communication with franchisor is meaningful                         | 0.449  | <0.001  | 1.287 |
| Franchisor emphasises two-way communication                         | 0.425  | <0.001  | 1.221 |
| <b>Inovation</b>  |        |         |       |
| Marketing Inovation   | 0.402  | <0.001  | 1.142 |
| Creative Idea   | 0.452  | <0.001  | 1.245 |
| Invation to respond the market needs                                | 0.479  | <0.001  | 1.305 |
| <b>Proactive</b>  |        |         |       |
| Franchisee is able to take advantage                                | 0.395  | <0.001  | 1.572 |
| Franchisee is able to implement competitive strategy                | 0.414  | <0.001  | 1.768 |
| Franchisee is able to identify market demand                        | 0.392  | <0.001  | 1.552 |
| <b>Risk taking</b>  |        |         |       |
| Franchisee dare to try new strategy                                 | 0.431  | <0.001  | 1.696 |
| Franchisee dare to take new advantage                               | 0.457  | <0.001  | 1.876 |
| Franchisee dare to implement new idea                               | 0.352  | <0.001  | 1.224 |
| <b>Aggresiveness</b>  |        |         |       |
| Franchisee compete aggresively                                      | 0.33   | <0.001  | 1.373 |
| Franchisee aggresively observed competitor strategies               | 0.358  | <0.001  | 1.528 |
| Franchisee aggresively meet the market needed                       | 0.313  | <0.001  | 1.283 |
| Franchisee aggresively apply new strategy                           | 0.342  | <0.001  | 1.414 |
| <b>Performance</b>  |        |         |       |
| No. of students increase compared to last year                      | 0.237  | <0.001  | 2.025 |
| No. of outlet increase compared to last year                        | 0.166  | <0.001  | 1.232 |
| Assets increase compared to last year                               | 0.219  | <0.001  | 1.642 |
| Growth in market shared compared to last year                       | 0.219  | <0.001  | 1.613 |
| No. of employee increase compared to last year                      | 0.24   | <0.001  | 2.076 |
| No. of teacher increase compared to last year                       | 0.248  | <0.001  | 2.165 |

values indicate goodness of fit from each latent variable to the observed variables (Hair *et al.*, 2011). From the results of the R-square coefficient, can be seen that the effect of each variable is quite large if the value of R-Square is more than 0.5. While the composite value realibility coefficient and cronbach alpha coefficient shows the relationship between latent variables to measure the reliability of each dimension. Composite Reliability coefficient value must be equal to or greater than 0.7 (Kock, 2012). The results of the calculations can be seen in Table 3.



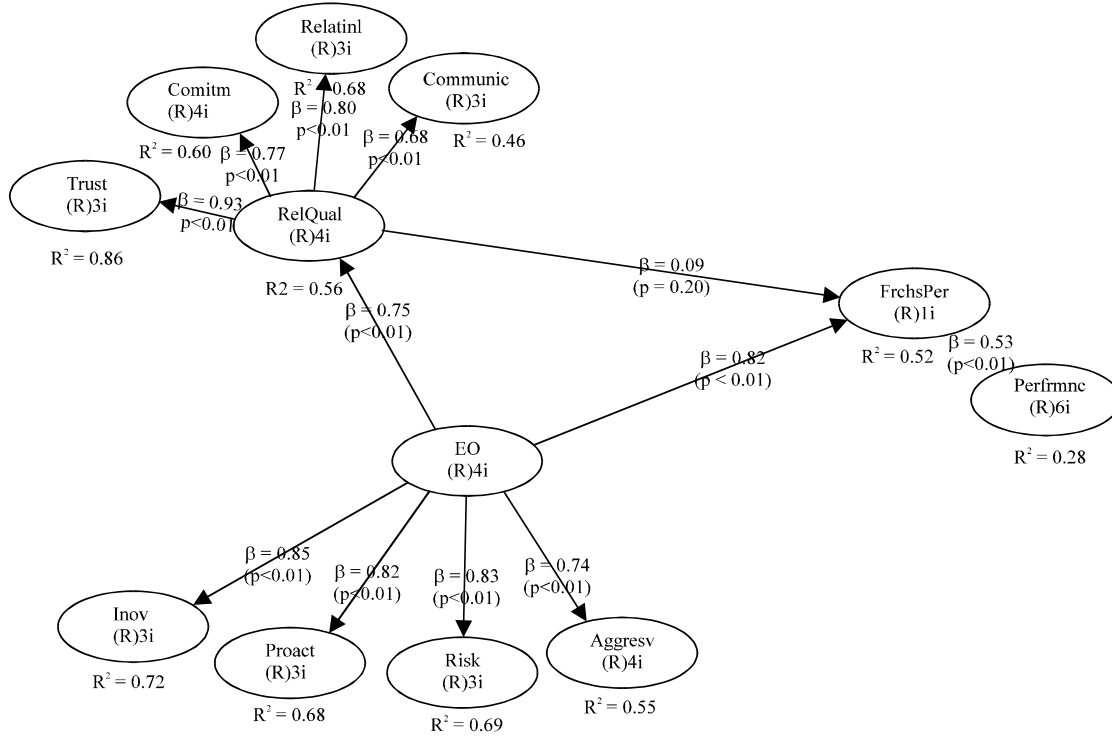


Fig. 1: Results of the research model

Table 3: Reliability test

| Indicators     | R <sup>2</sup> coeff | Comp. rel coeff | Cronbach's alpha coef | Average variance extracted |
|----------------|----------------------|-----------------|-----------------------|----------------------------|
| Trust          | 0.856                | 0.764           | 0.537                 | 0.522                      |
| Commitment     | 0.600                | 0.834           | 0.733                 | 0.558                      |
| Relationalism  | 0.643                | 0.806           | 0.639                 | 0.582                      |
| Communication  | 0.558                | 0.806           | 0.639                 | 0.581                      |
| Inovation      | 0.723                | 0.791           | 0.604                 | 0.560                      |
| Proactive      | 0.676                | 0.871           | 0.778                 | 0.693                      |
| Risk Taking    | 0.687                | 0.842           | 0.716                 | 0.643                      |
| Aggressiveness | 0.549                | 0.832           | 0.730                 | 0.553                      |
| Performance    | 0.285                | 0.881           | 0.837                 | 0.557                      |

Measurements show the model have a fit model if it meets the requirements of the 3 categories Average Path Coefficient (APC), Average R-Square (ARS) and Average Variance Inflation Factor (AVIF) as shown in Table 4. As for the number of p-values for APC and ARS in this study demonstrate the value of  $p < 0.001$  where the minimum requirement should be less than 0.05, so the structural model and the measurements in this study already have a good fit model. In addition, the third category is the value of AVIF is 2.972 where the terms of a model can be said to have a goodness of fit model if AVIF less than 5. So, the model already has a goodness of fit model and can proceed to the next test.

In detail, the relationship between variables and indicators of each variable can be seen in the results of the following research model.

The results of the research model shown in Fig. 1, the entrepreneurial orientation affects relational quality and franchisee performance. It means that entrepreneurial orientation is an

Table 4: Model fit indicates and p-value

| Models                                   | Value | p-value |
|--|-------|---------|
| Average Path Coefficient (APC)           | 0.718 | <0.001  |
| Average R-Square (ARS)                   | 0.595 | <0.01   |
| Average Variance Inflation Factor (AVIF) | 2.972 |         |

important thing to be owned by the franchisee in establishing good relations with the franchisor and franchisee in improving performance in doing business. But on the other hand, relational quality did not directly affect the franchisee performance. Thus in the context of educational franchising, especially in Indonesia, harmonizing relational quality between franchisor and franchisee is not a guarantee to provide good performance, it happens because the education franchise produces a service and it is different from other franchise systems.

## CONCLUSION

The primary contribution of this study is the insight offered regarding the effect of entrepreneur orientation to relational quality and franchisee performance. Clearly, the entrepreneurship orientation affects relational quality and also the performance. The results confirmed that a franchisee that has the entrepreneurial orientation will have better relationship with franchisor and for their performance, they have vision and goals of the business, not just merely invest. Based on the dimensions in relational quality, namely trust, commitment, relationalism and communications were distinct and conceptually clear while trust is the most powerful indicator of the relational quality. Indicator variables of entrepreneur orientation that has the most effect is innovation. This suggests that a franchisee needs to have the ability to innovate for business success.

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