Journal of Social Science Studies Vol. 2, No. 2, July 2022, pages 279 – 284

Ethical Foundations of Franchisor-Franchisee Relationships and Their Influence on Business Performance Outcomes Across Franchise Systems

Arif Rachman Putra, Rommy Hardyansah, Agung Satryo Wibowo

Sunan Giri University, Surabaya, Indonesia

A R T I C L E I N F O

Article history:
Received 25 May 2022
Revised 14 June 2022
Accepted 13 July 2022

Key words:
Franchising ethics,
Franchisor-franchisee relationship,
Business performance,
Contractual fairness,
Transparency,
Stakeholder trust,
Governance.

A B S T R A C T

This paper examines the ethical dynamics between franchisors and franchisees and their impact on business performance within franchise systems. Using a literature-based approach, it explores how trust, transparency, contractual fairness, and ethical governance influence outcomes such as operational compliance, innovation, franchisee satisfaction, and brand reputation. Ethical practices – ranging from balanced contract terms and collaborative standard-setting to fair dispute resolution and adaptive mentorship – emerge as central to sustainable performance and stakeholder retention. The paper further analyzes how ethical conduct shapes system resilience during crises and supports long-term scalability through enhanced trust and reduced litigation. It highlights that ethical franchising is not merely a legal obligation, but a strategic imperative that contributes to social legitimacy and market competitiveness. The findings underline the need for more integrated governance frameworks that promote ethical reciprocity and transparency in franchising. Recommendations include embedding ethics into franchisor training, enhancing cultural sensitivity, and encouraging participative governance models. Overall, the study reinforces that the moral foundation of franchising relationships is critical to securing performance outcomes, mitigating risk, and fostering public trust in an increasingly complex business environment.

INTRODUCTION

Franchise as a business model continues to demonstrate economic scalability and market expansion advantages across various industries. As globalization encourages the replication of standardized operational practices, franchising becomes a strategic channel for disseminating brand identity and managerial consistency. In this setting, the relationship between franchisor and franchisee is inherently symbiotic, characterized by contractual frameworks and performance expectations that require not only legal compliance but ethical alignment. In many cases, operational success depends on the extent to which both parties are able to work synergistically and support each other. As both parties pursue profitability, the ethical considerations underpinning their interactions become central to sustaining trust and operational longevity (Krupskyi et al, 2017).

The ethical dimension of franchise relationships becomes more prominent when viewed through the lens of autonomy versus control. Franchisors typically retain authority over brand standards and business procedures, while franchisees assume the risks associated with day-to-day operations (Jaolis, 2018). This asymmetry can potentially lead to ethical tension, especially when franchisees perceive directives that compromise local values or market adaptation. As highlighted by Spinelli et al. (2004), a franchise system thrives when power dynamics are managed equitably and communication channels allow for ethical concerns to be expressed and addressed transparently. Too dominant control from the franchisor also has the potential to inhibit local innovation, which can actually be a competitive advantage in certain regions. Transparency, empathy and clear conflict resolution mechanisms are essential in maintaining the integrity of the franchise system.

** Corresponding author, email address:* ***arifrachmanputra.caniago@gmail.com***

In practical terms, ethical issues in franchise relationships often manifest in areas such as territorial encroachment, pricing policies, and profit-sharing arrangements. Franchisors may introduce new outlets in close proximity to existing ones, undermining franchisee market share (Awasthi et al., 2020). Similarly, strict adherence to centralized pricing may limit franchisee responsiveness to local demand dynamics. Such tensions demand greater room for negotiation and ethical understanding in operational policy-making. According to Dant and Nasr (1998), such conflicts, when unresolved, lead to strained relations and reduced operational efficiency, highlighting the necessity for ethical governance mechanisms within franchise systems. Operational performance will suffer due to loss of motivation and distrust.

The ethical quality of the franchisor-franchisee relationship is closely tied to business performance outcomes. When franchisees feel ethically respected and empowered, their commitment to the brand deepens, resulting in enhanced customer service and operational diligence (Calderon-Monge & Pastor-Sanz, 2017). This sense of appreciation creates a positive work climate, which encourages long-term loyalty and bottom-up innovation. Conversely, perceived exploitation or disregard erodes morale and increases turnover intentions. The neglect of ethics in relationship management also often triggers hidden conflicts, such as formal compliance without moral support, which in the long run weakens the overall durability and reputation of the franchise network. Ethical leadership on the franchisor's part, encompassing fairness, accountability, and empathy, emerges as a determinant of sustainable franchise system performance.

Despite the growing attention to franchising ethics, empirical evidence reveals persistent problems in aligning ethical frameworks between franchisors and franchisees (Savita & Sharma, 2018). One recurring issue involves the opacity of contractual terms that disproportionately favor the franchisor's interests. franchisors utilize their dominant position to draft one-sided agreements, which limit the franchisee's flexibility and operational control. While such contracts are formally legal, this approach often violates the spirit of fair partnership and can undermine long-term trust in the business relationship. As Kaufmann and Eroglu (1999) note, franchise agreements often embed power imbalances that are difficult to renegotiate once signed, leaving franchisees vulnerable to unilateral decisions. Furthermore, in cross-cultural franchise expansion, ethical misalignments may stem from divergent moral values and legal interpretations across jurisdictions.

Power imbalance, if unmitigated, may compromise the ethical climate of the franchise network, leading to conflict escalation and brand inconsistency (Navarro Sanfelix & Puig, 2018). Franchisees may resort to covert noncompliance or legal disputes to assert their concerns, resulting in financial and reputational costs. Such outcomes are frequently exacerbated by the absence of mediatory structures or joint decision-making forums. As Morrison (1997) suggests, ethical business relationships require more than written contracts; they require institutionalized mechanisms for dialogue, feedback, and dispute resolution.

These ethical tensions are exacerbated by the increasing complexity of franchise operations, especially in service industries. As customers hold franchised outlets to the same standard as corporate-owned units, the moral accountability of the franchisee becomes inseparable from that of the franchisor. Discrepancies in ethical expectations between the two parties not only disrupt internal cohesion but also influence brand perception and customer loyalty. Therefore, studying ethical dynamics in franchise systems is critical for shaping more just, transparent, and resilient business models.

The objective of this study is to examine how ethical conduct within the franchisor-franchisee relationship influences overall franchise performance. Through reviewing theoretical and empirical studies, this paper seeks to identify recurring ethical tensions, evaluate how they are managed, and assess their implications for business success. The findings are intended to inform the development of more equitable franchise agreements and support frameworks that uphold ethical consistency across diverse market environments.

RESEARCH METHOD

This study utilizes a literature review methodology to synthesize and critically evaluate existing academic and professional publications related to ethical practices in franchisor-franchisee relationships. The approach is structured to identify thematic patterns, theoretical frameworks, and empirical findings that illuminate how ethical dynamics impact business outcomes in franchise systems. By focusing on peer-reviewed journal articles, books, and reports from established business ethics databases, the analysis aims to construct a comprehensive understanding of the ethical constructs influencing franchising behavior. The review encompasses studies from various sectors and geographical contexts to allow for broader generalizability and nuanced interpretation of the ethical issues at stake.

In conducting this literature review, the research process followed the integrative approach outlined by Torraco (2005), which includes formulating a guiding research question, selecting relevant literature, analyzing and categorizing the findings, and synthesizing the results to derive practical and theoretical implications. The search was conducted using databases such as Google Scholar, EBSCOhost, ProQuest, and Scopus, targeting publications from the fields of business ethics, franchising, and organizational behavior. The criteria for inclusion of such sources should be that they are published in English, contain an explicit discussion of ethics in franchising to ensure fundamental relevance. The review was structured around key ethical dimensions, such as contractual fairness, autonomy, mutual trust, and leadership accountability, which were used as coding categories for content analysis.

RESULT AND DISCUSSION

The contemporary expansion of franchise systems across diverse industries reflects a growing reliance on collaborative enterprise models. Within this framework, the interaction between franchisor and franchisee forms the foundation of operational coherence and market consistency. As both parties pursue shared economic interests, their ability to function harmoniously is frequently shaped by the ethical conduct embedded in their professional dealings. Where ethical standards are clearly observed, cooperation becomes not merely procedural but principled (Shaikh et al., 2018).

Franchising, unlike conventional corporate hierarchies, thrives on the distributed nature of business ownership. This diffusion of responsibility necessitates a refined understanding of fairness, accountability, and mutual recognition. The absence of such considerations often manifests in distrust, systemic inefficiency, and disjointed brand expression (Shaikh, 2016). Ethical integrity is not an accessory to contractual obligations but a structural imperative that influences decision-making at every level of franchise engagement.

Trust, in the commercial sense, emerges through consistent and verifiable behaviors, particularly where power asymmetries exist. In franchise arrangements, the franchisor typically sets strategic direction, while the franchisee manages localized execution. When expectations are clearly communicated and reinforced by just and transparent practices, both entities benefit from a stable and motivated partnership. Conversely, ethical lapses like hidden costs or unilateral changes undermine both franchisee performance and system-wide legitimacy (Kamar & Alsetoohy, 2021).

In an increasingly consumer-conscious marketplace, the moral quality of internal stakeholder relationships reflects outwardly. Customers, investors, and regulatory bodies pay close attention to how franchises govern themselves. Ethical misalignment between franchisor and franchisee risks reputational damage that transcends individual units (Pinar et al., 2014). This is becoming increasingly relevant as social media and digital channels allow for rapid and widespread dissemination of information. Maintaining principled relationships is not merely about internal stability, but about preserving the brand's broader social and economic credibility.

A franchise system's resilience in competitive environments is often linked to its moral architecture (Cavaco & Machado, 2015). When franchisors make ethics part of their strategy, rather than just a compliance obligation, they create a solid foundation for long-term, mutually beneficial relationships. Franchisors who offer more than compliance checklists—who instead embrace fairness as a strategic philosophy—encourage their partners to do the same. This virtuous cycle fosters innovation, nurtures long-term growth, and builds enduring business ecosystems. Ethical stewardship thus emerges as a fundamental driver of high-performing franchise models (Pirotti & Venzin, 2016). Ethics-based franchise management is not just a value-add, but a strategic pillar that determines long-term performance.

The ethical relationship between franchisor and franchisee is a critical determinant of overall business performance within franchise systems. At the core of this relationship lies mutual trust, transparency, and the consistent application of ethical standards in business transactions (Kim & Thapa, 2018). These elements contribute to the sustainability and profitability of the franchise model. When franchisors uphold ethical responsibilities such as honest disclosure, fair contract terms, and genuine support, franchisees are more likely to reciprocate with loyalty, performance excellence, and operational integrity (Dant & Nasr, 1998).

One of the most fundamental ethical dimensions relates to information asymmetry. Franchisors typically possess more strategic knowledge, industry experience, and operational know-how than franchisees (Kalıpçı et al., 2021). An ethical approach requires franchisors to bridge this informational gap through comprehensive training, ongoing communication, and accessible documentation. When this responsibility is neglected, it may lead to mistrust and operational inefficiencies, as franchisees may feel exploited or inadequately equipped to meet system standards (Spinelli et al., 2004).

Another key issue concerns fairness in contractual arrangements. Ethical contract structures ensure balanced obligations, clear exit options, and reasonable royalty schemes (Kim & Pennington-Gray, 2017). Conversely, contracts skewed heavily in favor of franchisors have been associated with higher conflict rates and lower franchisee satisfaction. Fairness in terms of territorial exclusivity, pricing freedom, and local marketing autonomy enhances franchisee motivation and promotes system-wide innovation (Kaufmann & Dant, 1996).

Moreover, ethical franchising is grounded in consistent support and guidance. Franchisors who provide adaptive mentorship, proactive troubleshooting, and relevant market insights tend to stimulate stronger performance among their franchisees. This support should be dynamic and customized, rather than bureaucratic or rigid. When franchisees feel abandoned, they may struggle with brand compliance and revenue generation, which ultimately impacts the reputation and profitability of the franchise network (Dant, 2008).

Ethical issues also arise in the enforcement of brand standards. While standardization is essential for brand consistency, overly authoritarian enforcement can suppress franchisee innovation and lead to disengagement. An ethical balance involves collaborative governance, where feedback from franchisees is integrated into policy updates. Systems that foster participative decision-making benefit from higher compliance rates and reduced franchisee turnover (Lafontaine & Blair, 2005).

Another significant factor is conflict resolution. Ethical franchisors invest in mechanisms that facilitate timely and fair dispute resolution, such as mediation panels or independent ombuds services. These mechanisms not only prevent legal escalation but also reinforce the perception of procedural justice, which in turn improves franchisee commitment and resilience during economic downturns (Mendelsohn, 2004).

Trust, as a psychological construct, has a reciprocal influence on performance metrics such as sales growth, customer satisfaction, and unit longevity. Ethical behavior from franchisors cultivates trust, while opportunistic behaviors such as encroachment, excessive control, or arbitrary fee adjustments erode trust and provoke legal contention. This dynamic interplay significantly shapes system stability and scalability (Chiou et al., 2004). When franchisors act ethically and consider the needs of local partners, this not only reduces friction, but also opens up opportunities for replication of successful business models in different regions.

Cultural alignment between franchisor and franchisee is another ethical domain that influences performance (Danielewicz-Betz, 2012). Ethical franchisors recognize the diverse socio-economic and cultural realities of their franchisees and adjust expectations accordingly. Imposing uniform standards without sensitivity to local values often results in operational friction and brand dilution. Thus, ethical sensitivity enhances cross-cultural synergy and market penetration (Justis & Judd, 2003).

Transparency in financial forecasting and risk communication also constitutes ethical excellence (Oumlil & Balloun, 2017). Franchisors who present realistic projections and acknowledge potential challenges build credibility, which enhances franchisee preparedness and reduces early failure rates. Misleading or overly optimistic financial representations, on the other hand, can result in severe reputational damage and class-action litigations (Stanworth & Curran, 1999).

Ethical marketing practices form another axis of influence. When franchisors engage in responsible advertising and ensure brand messages align with franchisee capabilities, brand equity is preserved (Perrigot et al., 2020). Conversely, when franchisors overpromise through central campaigns without supporting franchise-level execution, dissonance arises, leading to customer dissatisfaction and decreased unit performance (Coughlan et al., 2001).

From the franchisee perspective, ethical adherence includes honoring brand guidelines, remitting royalties punctually, and maintaining quality standards. Franchisees who cut corners or act opportunistically not only damage their own profitability but also the collective brand image. Ethical reciprocity therefore creates a mutually reinforcing cycle of accountability and success (Grace & Weaven, 2011).

The influence of ethical dynamics is especially pronounced during times of crisis. During the 2008 global financial crisis, franchisors who demonstrated flexibility in payment terms, provided targeted support, and maintained open lines of communication preserved higher franchisee retention and faster post-crisis recovery. Ethical responsiveness in adversity is thus a strategic asset (Dant, 2008).

Longitudinal studies suggest that franchises grounded in ethical governance structures outperform counterparts that prioritize short-term gains. These systems report higher franchisee satisfaction, lower litigation rates, and more sustainable unit growth. Ethical culture is both a risk mitigator and a competitive differentiator in the saturated franchise marketplace (Weaven et al., 2009).

Finally, ethical franchising contributes to social legitimacy. Brands perceived as ethical attract socially conscious investors, employees, and customers. This intangible equity strengthens stakeholder loyalty and enhances market value, extending the impact of ethical franchisor-franchisee relationships beyond internal metrics into public trust and corporate reputation (Schwartz, 2001).

CONCLUSION

The ethical dynamics between franchisors and franchisees have far-reaching implications for the stability, scalability, and social legitimacy of franchise systems. When mutual expectations are guided by fairness, transparency, and accountability, business outcomes improve across both financial and relational dimensions. Ethical behavior fosters long-term cooperation, brand consistency, and franchisee loyalty, which collectively strengthen network resilience and adaptability in volatile markets.

The implications of these findings extend to both managerial practice and regulatory development. Franchisors are encouraged to institutionalize ethical governance through comprehensive training, fair contract design, participative decision-making, and consistent support systems. Likewise, franchisees benefit from cultivating ethical responsibility in their local operations, which contributes to collective brand equity and long-term profitability. Ethical alignment between parties therefore constitutes a strategic foundation for sustainable franchising. To advance ethical franchising, future efforts should emphasize empirical benchmarking, cross-cultural research, and policy frameworks that reward integrity and penalize opportunism. Industry associations and legal institutions can play a crucial role in standardizing ethical norms and offering mediation structures that reduce conflict escalation. As the global franchise landscape continues to evolve, embedding ethics as a core design principle will not only mitigate risks but also enhance competitive differentiation.

REFERENCES

Awasthi, Y., Kakkar, B., & Uppal, A. (2020). Ethics of Advertisement and Marketing Policies: An Indian Perspective. *Rupkatha Journal on Interdisciplinary Studies in Humanities*, 12, 3-5.

Banerjee, S. K., & Maulik, S. K. (2002). Effect of Garlic on Cardiovascular Disorders: A Review. *Nutrition Journal*, 18(6), 603–612.

Calderon-Monge, E., & Pastor-Sanz, I. (2017). Effects of Contract and Trust on Franchisor Performance. *Contemporary Economics*, 11(4), 383-400.

Cavaco, N. M., & Machado, V. C. (2015). Sustainable Competitiveness Based on Resilience and Innovation–an Alternative Approach. *International Journal of Management Science and Engineering Management*, 10(2), 155-164.

Chiou, J. S., Hsieh, C. H., & Yang, C. H. (2004). The Effect of Franchisors' Communication, Service Assistance, and Competitive Strength on Franchisees' Intentions to Remain in The Franchise System. *Journal of Small Business Management*, 42(1), 19–36.

Coughlan, A. T., Anderson, E., Stern, L. W., & El-Ansary, A. I. (2001). *Marketing Channels (6th Ed.)*. Upper Saddle River, NJ: Prentice Hall.

Danielewicz-Betz, A. (2012). Interrelation between Work Ethics and Business Ethics: A Cross-Cultural Perspective. *Social Science Research Network*.

Dant, R. P. (2008). A Futuristic Research Agenda for the Field of Franchising. *Journal of Small Business Management*, 46(1), 91–98.

Dant, R. P., & Nasr, N. I. (1998). Control Techniques and Franchisee Satisfaction in Franchising: A Comparative Study. *Journal of Small Business Management*, 36(1), 86–98.

Dant, R. P., & Nasr, N. I. (1998). Control Techniques and the Use of Multifaceted Performance Measures: A Study of Franchise Systems. *Journal of Small Business Managemen*t, 36(4), 68–86.

Grace, D., & Weaven, S. (2011). An Empirical Analysis of Franchisee Value Co-creation Processes. *Asia Pacific Journal of Marketing and Logistics*, 23(3), 372–391.

Jaolis, F. (2018). Multifaceted Relational Forms in Franchise Organizations: The Relational Roles of The Franchisor Brand. *Doctoral Dissertation*. Petra Christian University.

Justis, R. T., & Judd, R. J. (2003*). Franchising: An Entrepreneur's Guide (3rd Ed.)*. Mason, OH: South-Western.

Kalıpçı Çağıran, F., Varıcı, İ., & Özdemir, F. S. (2021). Information Asymmetry Problematic and Voluntary Disclosure in Companies. *Ethics and Sustainability in Accounting and Finance*, 3, 149-177.

Kamar, M., & Alsetoohy, O. (2021). Franchisee-Franchisor Relationship Quality and Its Impact on Restaurants' Operational and Financial Performance: An Application of Leader-Member Exchange Theory. *Journal of Association of Arab Universities for Tourism and Hospitality*, 20(4), 293-316

Kaufmann, P. J., & Dant, R. P. (1996). Multi-Unit Franchising: Growth and Management Issues. *Journal of Business Venturing*, 11(5), 343–358.

Kaufmann, P. J., & Eroglu, S. (1999). Standardization and Adaptation in Business Format Franchising. *Journal of Business Venturing*, 14(1), 69–85.

Kim, M., & Pennington-Gray, L. (2017). Does Franchisor Ethical Value Really Lead to Improvements in Financial and Non-Financial Performance?. *International Journal of Contemporary Hospitality Management*, 29(10), 2573-2591.

Kim, M., & Thapa, B. (2018). Relationship of Ethical Leadership, Corporate Social Responsibility and Organizational Performance. *Sustainability*, 10(2), 447.

Krupskyi, O., Stukalo, N., Krasnikova, N., & Falko, Y. (2017). Franchising Model for Expansion of the International Travel Business. *Problems and Perspectives in Management*, (15, Iss. 4), 230-242.

Lafontaine, F., & Blair, R. D. (2005). The Evolution of Franchising and Franchising Contracts: Evidence from the United States. *Entrepreneurship Theory and Practice*, 29(3), 343–357.

Mendelsohn, M. (2004). *The Guide to Franchising (7th Ed.)*. London: Thomson Learning.

Morrison, K. D. (1997). The franchising relationship: An Ethical Perspective. *Journal of Business Ethics*, 16(10), 1101–1110.

Navarro, S. G., & Puig, F. (2018). New Challenges in Franchisor-franchisee Relationship. An Analysis from Agency Theory Perspective. *Cuadernos de Gestión*, 18(1), 85-101.

Oumlil, A. B., & Balloun, J. L. (2017). Cultural Variations and Ethical Business Decision Making: A Study of Individualistic and Collective Cultures. *Journal of Business & Industrial Marketing*, 32(7), 889-900.

Perrigot, R., López-Fernández, B., & Basset, G. (2020). Conflict-performance Assumption or Performance-Conflict Assumption: Insights from Franchising. *Journal of Retailing and Consumer Services*, 3, 1-39.

Pinar, M., McCuddy, M. K., & Eser, Z. (2014). Examining the Relationships between Ethical Issues in Franchising Business Success and Characteristics of Franchising Businesses: A Study in Turkey. *Bogazici Journal of Economics and Administrative Sciences*, 28(1), 1-26.

Pirotti, G. B., & Venzin, M. (2016). *Resilient Organizations: Responsible Leadership in Times of Uncertainty*. Cambridge University Press.

Savita, U., & Sharma, S. (2018). Do Franchisor and Franchisee Really Perceive Alike? Evidence from Indian Education Sector. *Global Business Review*, 19(5), 1379-1395.

Schwartz, M. S. (2001). The Nature of the Relationship Between Corporate Codes of Ethics and Behavior. *Journal of Business Ethics,* 32(3), 247–262.

Shaikh, A. (2016). Conceptualizing Fairness in Franchisor–Franchisee Relationship: Dimensions, Definitions and Preliminary Construction of Scale. *Journal of Retailing and Consumer Services*, 28, 28-35.

Shaikh, A., Sharma, D., Vijayalakshmi, A., & Yadav, R. S. (2018). Fairness in Franchisor–Franchisee Relationship: An Integrative Perspective. *Journal of Business & Industrial Marketing*, 33(4), 550-562.

Spinelli, S., Rosenberg, R., & Birley, S. (2004). *Franchising: Pathway to Wealth Creation*. Financial Times Prentice Hall.

Spinelli, S., Rosenberg, R., & Birley, S. (2004). *Franchising: Pathway to Wealth Creation*. Upper Saddle River, NJ: Pearson Prentice Hall.

Stanworth, J., & Curran, J. (1999). Colas, Burgers, Shakes, and Shirkers: Toward a Sociological Model of Franchising in The Market Economy. *Journal of Business Venturing*, 14(4), 323–344.

Torraco, R. J. (2005). Writing Integrative Literature Reviews: Guidelines and Examples. *Human Resource Development Review*, 4(3), 356–367.

Weaven, S., Grace, D., & Manning, M. (2009). Franchisee Personality: An Examination in the Context of Franchise Unit Density and Service Classification. *European Journal of Marketing*, 43(1/2), 90–109.

Wibowo, A. S., D. S. Negara, A. P. Marsal, E. B. Da Silva. (2021). Contractual Instruments' Effectiveness in Preventing Business Disputes and Ensuring Business Law Stability, *Journal of Social Science Studies*, 1(2), 209 – 214.