LIVE OR LET DIE: AN EXAMINATION OF FRANCHISEE DISCONTINUITY RATES ACROSS STATES AND METROPOLITAN STATISTICAL AREAS

Robert E. Stassen
University of Arkansas
Department of Marketing & Logistics
302 Walton College of Business
Fayetteville, AR 72701
+1 479 575-6155 (Phone)
+1 479 575-8407 (Fax)
bstassen@walton.uark.edu

Marko Grünhagen
Eastern Illinois University
School of Business
4002 Lumpkin Hall
Charleston, IL  61920
+1 217 581-6906 (Phone)
+1 217 581-7244 (Fax)
mgrunhagen@eiu.edu

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Abstract

To date, little has been reported with respect to franchise unit failure within franchise systems, even for the most successful franchise systems, where these rates should be the lowest. While the assessment of franchise unit “failure” is difficult given extant data sources, a related measure is unit “discontinuity” for which data actually is reported in the Uniform Franchise Offer Circular required in thirteen of the fifty states in the U.S.

This is the first study to examine these discontinuity rates for U.S. franchisee locations for two of the largest and best established franchise systems, McDonald’s and Subway, using mailing list data (Franda) for 2008 and UFOC filings for both franchise systems. The study links these discontinuity rates to the characteristics of the franchise system and to the competitive conditions in their geography. It also compares them to the “charge-off” rates for failed franchisees reported by the U.S. Small Business Administration, calculated as the dollar amounts provided by the SBA’s guarantees in settling with the lending bank divided by the total in loans made to that system’s franchisees. Using multiple regression analysis across U.S. states and metropolitan statistical areas, the study’s results show that the proportion of single-unit franchisees is significantly associated with failures rates for both systems, but controlling for this, substantial differences related to system size and the effect of coverage are discovered. Specifically, compared to McDonald’s, Subway shows higher discontinuity rates associated with increased market coverage as well as increased growth rates. The discontinuity rates reported in the UFOCs differ significantly from and are well above the “charge-off” rates from SBA guaranteed loans. Implications of the findings for research and practice are discussed.

KEYWORDS: exits, discontinuity, failure, McDonald’s, Subway