Teaching Objectives

The primary objectives of this case are to:

- To understand the theoretical underpinnings of franchisor-franchisee relationship.
- To realize the impact of decisions made by a franchise corporation on its franchisees.
- To enumerate the importance of brand image in franchising.
- To comprehend the interlinking of franchise agreements to franchisor performance.
- To learn the impact of economy on franchising business.

Theoretical Underpinning

There are two theories which are commonly applied to franchising. The 'agency theory' states that the rationale behind the wide spread of franchising is the relationship between two parties, one being the franchisor and other being the agent (franchisee). On the other hand 'resource scarcity theory' postulates that expanding firms use franchising to secure capital (from the franchisees) in a mutually cost-effective way. It views franchising as a mechanism to ease financial and managerial constraints on the growth of a business, whereas agency theory views franchising as a mechanism for improving the alignment between firm and unit level incentives. These theories can be used in the introduction of the case followed by further discussion.

According to one study (Ketchen, Jr, Combs, & Upson, (2006) of food service chains revealed four distinct groups relating to strategic use or avoidance of franchising. They are manager-scarce franchisors, money-scarce franchisors, franchising minimizers, and seasoned veterans. The manager-scarce and money-scarce franchisors use franchising to gain access to resources in an economical fashion, whereas franchising minimizers avoid franchising to avoid potential tangles of franchise-related agency, primarily due to their strong brand names. The seasoned veterans had been in business the longest and are not driven by agency concerns or scarcity of resources. Assessing these four groups it will be hard to place Cold Stone franchise in any of these categories, thereby indicating that the problems stem primarily from franchisor-franchisee relationship.

This case study can be used to discuss the following franchising topics:

1. Advantages of Franchising
    a. Potential for profits based on established concept
    b. Independent business ownership
    c. Advertising and promotion campaigns
2. Disadvantages of Franchising
    a. Failing to understand the importance of the Franchise Disclosure Document
        i. Dispute Resolution
        ii. Operating Territory
    b. Advertising and promotion practices
    c. Required suppliers
    d. Cost of overhead and operations
3. Legal Issues Concerning Franchise Concerns
    a. Franchisor Rights
    b. Franchisees Rights
    c. How litigation can affect the brand and image
4. Economic Considerations
    a. Flexibility of brand during a down economy
    b. Franchisee assistance offered during down economy

Teaching Approach

This case study targets undergraduate business students and can be used to facilitate discussions of the objectives listed above. The case is a good example of a "trendy" franchise. Cold Stone was, by many accounts, a hot franchise in the late 1990s and early 2000s. Customers were abounding, and new stores were popping up all over, some nearly on top of each other. When the economy imploded in 2008/2009, consumers took stock of their discretionary spending and Cold Stone no longer enjoyed the volume of customers it once had. At the same time, many franchisees were struggling to make a profit and insisted that rather than helping them, Cold Stone made it difficult, if not impossible, for them to survive and blamed them entirely for their failures as franchisees.

Advantages of Franchising:

Potential franchisees saw the benefits of owning a popular and well-known brand such as Cold Stone and the potential for big profits. Discuss the advantages of franchise ownership, specifically business ownership by using an established concept and advertising benefits. Advantages of franchising to franchisees include (a) buying an established concept; (b) acquiring tools for success; (c) securing managerial and technical help; (d) utilizing standardization and quality control; (e) minimum business risk; (f) requiring less operating capital; (g) possible easy access to credit; (h) comparative assessment of performance; (i) benefits from research and development; (j) access to professional advertising and promotion; and (k) other unique opportunities. Advantages of franchising to franchisors include (a) rapid business expansion; (b) more buying power; (c) operational convenience; (d) contribution by franchisees; and (e) motivation and expansion of the franchise system (for details refer Khan, 2014, pp. 70-71).

Disadvantages of Franchising:

On the flip side, franchisees who don't fully understand all of the clauses and provisions in the FDD may find themselves in a precarious situation should disagreements or disputes occur between franchisor and franchisee. The case discusses disputes between franchisor and franchisee regarding mandatory suppliers and subsequent rebates received by Cold Stone. The rebates were to be added to the Flexible Marketing Program to benefit marketing and promotional activities for the franchisees, but the franchisees claim this didn't occur. Discuss the amount of transparency that is appropriate for the franchisor to make information available to franchisees as it pertains to this program, intended to benefit franchisees. Also, discuss the importance of franchisees reviewing the cost of overhead operations in addition to other franchise start-up costs prior to entering into a franchise agreement. In short the disadvantages of franchising to franchisees include (a) unfulfilled expectations; (b) lack of freedom; (c) undesirable advertisement and promotion practices; (d) unexpected costs of services; (e) overdependence on franchisors; (f) monotony and lack of challenges; (g) termination and renewal; and (h) other operational problems. On the other hand the disadvantages of franchising to franchisors include (a) lack of freedom; (b) franchisee's financial situation; (c) franchisee recruitment and selection; (d) franchisee retention; and (e) communication with franchisees. (for details refer Khan, 2014 pp. 70-71).

Legal Issues:

The case highlights franchisee concerns and their collective opinions about their treatment by the franchisor. The franchisees came together and attempted to take on Cold Stone as a united front. In doing so, they ignored the arbitration clause in their franchise agreements. Was it so unexpected that Cold Stone would request a stay so as not to render the terms of their franchise agreement meaningless? What are the rights of franchisor and franchisee in this case? Discuss the impacts of the litigation on the franchise. Does the potential exist for the brand and image to suffer? What is the potential impact to future potential franchisees? Is it in the best interest of Cold Stone to fight their franchisees in court, or attempt to settle in a less public setting?

Economic Considerations:

Although the franchisee concerns began long before the 2008/2009 economic downturn, is it reasonable to associate a tough economy with a franchise that offers a product geared toward discretionary spending? Are specialty franchises like Cold Stone at a greater risk than low-cost fast food franchises such as McDonald's or Wendy's during a tough economy? What could Cold Stone have done to protect their franchises and be more flexible during economic downturn? Should Cold Stone have offered assistance, for example financial or new products at lower price points, to assist its franchises during a slow economy? Should Cold Stone have offer assistance to its franchises if they struggle outside of a difficult economic period?