

Modelling the complex choices of a business purchase

Owen Wright, Griffith University, o.wright@griffith.edu.au
Hume Winzar, Macquarie University, Hume.Winzar@efs.mq.edu.au

Abstract

In this paper, a choice modelling approach is used to consider attributes of a pre-purchase behaviour when purchasing a business (franchise outlet). Choice modelling methods are

consistent with consumer theory, and focus on an attribute-based determination of value.

However, choice modelling can place a severe cognitive burden upon respondents and induce satisficing rather than maximising behavioural patterns. In this framework, a choice model utilising best-worst scaling is evaluated to ascertain the benefits for potential purchasers and vendors. Findings indicate limited capacity for potential investors to rationalise the choices presented.

Keywords: choice modelling, consumer behaviour, franchising

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Introduction

Consumers in real markets make decisions among competing alternatives. Consumer behavioural research is fixated by prediction of how consumers react to changes in available choice sets. Some survey methods ask consumers to make choices from "experimental choice sets" enable researchers to learn about consumer preferences for products and attributes that do not yet exist in real markets. Choice sets are termed "experimental" because aspects of their composition are under the control of the researcher. The objective is to simulate real choice situations to determine how consumers will react when faced with particular choice situations. In this study, best-worst scaling is utilised to model the choice process in the context of business purchase (purchasing a franchised business unit); respondents ability to provide information and answer questions concerning choice sets is then evaluated, followed by validation of the estimated model (Carson et.al, 1994).

Framework for choice modelling

A central tenet of a business sale is disclosure by owners (franchisors) of their business and financial operations, to encourage mutually beneficial outcomes for both themselves and franchisees (Lim & Frazer, 2002). Recourse for potential franchisees to be fully informed in the purchase of a franchise is through a mandatory disclosure document as legislated through the Franchising Code of Conduct (1998). In this research, we wanted to learn from potential franchisees how choices were made when considering a franchise opportunity. The disclosure document adds to prospective franchisees positive decision-making process. Hence, we wanted to learn if potential franchisees personal experiences drove their evaluative criteria and, how they judged the material given to them. Specifically, which features of the disclosure document were of value and ultimately could the disclosure document (all or part) be useful to make decisions in the franchise sales process to prospective franchisees? The generic disclosure document is composed of four areas. They are, (i) the specifics of the franchise territory being sold; (ii) detailed franchisor experience and history; (iii) system information – details of existing and terminated franchises in the last three years, trade mark, patent, design/ copy right, marketing and co-operative funds, establishment costs and other payments/ financing arrangements; and finally (iv) legal requirements, including money required prior to signing the franchise agreement, summary of conditions of the agreement that deal with all obligations, summary of the conditions of the agreement, details of the goods and services the franchisee may acquire or provide, and any obligations to sign related agreements including leases, hire purchase, security, confidentiality, restrictions to business, provision for acknowledging receipt of the disclosure document. Attributes were developed from these dominant themes gathered from the disclosure document and tested in a choice model developed using a best-worst scaling system described in the next section. The results were to give us insight into the value placed on features developed from the disclosure document. Very rarely do we see a franchise that is ideal – a low-priced, high profit, established business model, managed by experienced

franchise principals, with high levels of integrity, and many very happy existing franchisees. While there are such business opportunities on offer, the central focus of this study is how do potential franchisees decide when confronted with opportunities that are less than ideal? That is, what tradeoffs are they willing to make when facing a franchise purchase decision?

Method & Instrumentation

A survey was structured using the decompositional technique of conjoint analysis. Conjoint analysis was chosen as the analytic tool as it allows a subset of possible combinations of a product (or system) features to be used to determine the relative importance of each feature in the purchasing process. This method is based on the premise that the relative values of attributes considered jointly can be better measured than when considered in isolation. When asked to perform choice decisions many consumers are unable to accurately determine the relative importance that they place on product attributes. For example, when asked which attributes are the more important ones, the response may be that they all are important. Furthermore, individual attributes in isolation are perceived differently than in the combinations found in a product. (Louviere, 1988) It is difficult for a survey respondent to take a list of attributes and mentally construct the preferred combinations of them. A low price is important, for example, but quality is also very important, so how do people make the tradeoff? The task is easier if the respondent is presented with combinations of attributes that can be visualized as different offerings.

In focus groups respondents were asked to identify attributes of franchise systems they considered important in the purchasing decision process. Identification of significant attributes in the disclosure document was considered an important first stage (Douglas, 2003; Goulding, 2002; Locke, 2001). These attributes were then condensed into a list of choices via the survey. Respondents were then asked to choose from a list of combinations of system attributes in a best-worst scenario. This method is efficient in the sense that the survey does not need to be conducted using every possible combination of attributes. The pattern of stimuli are mapped against the pattern of responses so that the responses are decomposed to extract estimates of the relative value of each to the attributes and attribute levels. The technique is explained in detail in Zikmund *et.al.* (2007). From these results we can derive parameter estimates for a formula for each respondent which enables prediction of the desirability of the combinations can be made from those that were not tested. Suggested attributes and levels used in this study are presented in Table 1.

Table 1: Testable attributes and Attribute levels

<i>Testable Attributes</i>	<i>Levels</i>
Territory	Exclusive or non-exclusive
Site selection	Policy or no policy
Franchisor (and team) experience (including current litigation)	High level of experience - Low level of experience
Current franchise status (including liquidity and size)	Mature - Infant
Franchise outlet price	\$40, \$80, \$160, \$320

Four variables at two levels, plus one variable at four levels, would require 64 different profiles for evaluation, but these can be reduced to just eight profiles in a Fractional Factorial design (FFD) like the following. The given FFD experimental design permits each attribute level to be traded off against each other level, providing sufficient information to calculate main-effects-only attractiveness measures for each attribute. The FFD translates into the following business franchise model descriptions set out in Table 2.

Table 2: Business franchise model descriptions

1:	<i>non-Exclusive territory, No site-selection policy, <5 yrs average team experience, Franchise operating 10+ years, \$320K</i>
2:	<i>Exclusive territory, No site-selection policy, <5 yrs average team experience, Franchise operating <5 years, \$80K</i>
3:	<i>non-Exclusive territory, Well-defined site-selection policy, <5 yrs average team experience, Franchise operating <5 years, \$160K</i>
4:	<i>Exclusive territory, Well-defined site-selection policy, <5 yrs average team experience, Franchise operating 10+ years, \$40K</i>
5:	<i>non-Exclusive territory, No site-selection policy, 10+ yrs average team experience, Franchise operating 10+ years, \$40K</i>
6:	<i>Exclusive territory, No site-selection policy, 10+ yrs average team experience, Franchise operating <5 years, \$160K</i>
7:	<i>non-Exclusive territory, Well-defined site-selection policy, 10+ yrs average team experience, Franchise operating <5 years, \$80K</i>
8:	<i>Exclusive territory, Well-defined site-selection policy, 10+ yrs average team experience, Franchise operating 10+ years, \$320K</i>

Respondents applied a score to each profile. A number of different methods are available for extracting a score from respondents, from simple 1-10 rating scales, to complex choice-based methods. (Karniouchina, Moore, van der Rhee, & Verma, 2009).. We elected to use a new approach suggested by Louviere and colleagues known as Best-Worst scaling (Finn & Louviere, 1992; Auger, Devinney & Louviere, 2007; Flynn, Louviere, Peters, & Coast, 2007). Best-Worst scaling makes very few assumptions about the nature of human decision making, is consistent with current theory on information processing and evaluation, overcomes many problems of idiosyncratic evaluation styles within each person or cultural group, and is a relatively natural and straightforward task for most respondents. Six such evaluation tasks were required of each respondent. From the evaluation stage, we had from each respondent an attractiveness score for each of the eight profiles ranging from -3 to +3. These were regressed against the pattern of stimuli (the fractional factorial design), using dummy-variable regression, to gain estimates of the relative value of each franchise profile attribute and attribute level. Such data were gathered for each person in our sample. A sample of the best-worst evaluation is set out in Table 3.

Table 3 - Example Best-Worst evaluation used in this study

Consider the four different franchise opportunities below. Please indicate which one is most attractive to you and which one is least attractive to you. Except for the differences shown below the franchise opportunities are the same.		
Most attractive		Least attractive
	non-Exclusive territory No site-selection policy <5 yrs average team experience Franchise operating 10+ years \$320K	
	non-Exclusive territory No site-selection policy 10+ yrs average team experience Franchise operating 10+ years \$40K	
	Exclusive territory No site-selection policy <5 yrs average team experience Franchise operating <5 years \$80K	
	Exclusive territory No site-selection policy 10+ yrs average team experience Franchise operating <5 years \$160K	

Sample

Interviews were conducted at a national franchising exposition. Respondents were recruited by a pair of trained research assistants, and vetted for their level of interest in buying into a franchise. Like those in the preliminary qualitative interviews, most were married couples looking for a change of career, or to go into business for themselves. For our purposes, a married couple counted as a single respondent making a purchase decision. One hundred respondents qualified for the study and agreed to complete the questionnaire, yielding 83 useable questionnaires. The majority of those who did not complete the questionnaire abandoned it because it was too complicated.

Conjoint results and discussion

The focus of this study was to find the relative importance of different components of the disclosure document amongst potential franchisees and implicit was the ability of respondents to process that information and subsequently make sound assessments. One issue was immediately apparent that many respondents were unable to process the information independently of salesmanship that, by its nature, must accompany a franchise agreement. Here we found that a significant number were unable to complete the task. Of the 100 people qualified and who agreed to participate, 17 failed to complete the questionnaire, most stating that the questionnaire was too complicated. 18 made random (nonsense) evaluations, as evidenced by extremely low Adjusted-R-squared values in their regression output. A further 19 were removed because their coefficients for price were estimated to be positive, implying that they preferred to pay a higher price for a franchise – clearly an irrational evaluation. This left 46 respondents for analysis. Figure 1 summarises the distribution of coefficients for those remaining respondents. The X-axis is the coefficient for the regression equations for each respondent. They range from -2 to +2.5. A positive coefficient implies a preference for that franchise feature, and a negative coefficient implies a preference for not having that feature – the larger the value the stronger the preference. We can see that about 22% of respondents seemed to prefer a franchise that did not offer exclusive territory, 20% preferred a franchise that did not offer help with site selection, and 26% preferred to work with franchise management with relatively less experience. These would seem to be not sensible evaluations. Arguments could be made for or against the value of a mature franchise, but a majority of respondents clearly preferred an established franchise.

Clearly, a small number of potential franchisees make rational evaluations when presented with clear choices. However, there remains a large number, who appear unable to make evaluations of opportunities in their best interests. Price was low in preference. Rational decision makers indicated choices away from price preferring other attributes relative to budget. Therefore, of the 100 respondents we interviewed, just 24 made completely rational evaluations of the franchise opportunities presented to them. This should be a concern for policy makers.

Figure 1: Summary of Coefficients for Franchise Attributes



Future research

No previous investigation of the mapping of pre-purchase decision-making when purchasing a franchise is evident in the Australian franchise literature. Factors contributing to franchising channel conflict and discontinuance have been highlighted within the marketing and management literature including information asymmetry between channel members, misinformation resulting from inadequately conducted due diligence, with goal divergence resulting from changing expectations and comparison levels between channel members (Dant, 1995). The full disclosure by system owners (franchisors) of their business and financial operations (broadly consistent with a prospectus for an initial public offering), is a central theme of the Code to encourage mutually beneficial outcomes for both parties in the franchise contract. While the onus of transparency lies with the franchisor, continued high levels of conflict within the franchising sector suggest that a significant number of franchise relationships still suffer from goal divergence between principals and their agents (Dant, 1995; Frazer et al., 2008). This research has begun to highlight flaws in that process. Goal divergent conflict can be symptomatic of perceptual incongruity, domain dissensus, *ex-ante* communication failure or personal ideological differences between channel members *ex-post* (including values, beliefs and ambitions) (Bowersox & Cooper, 1992; Lusch & Ross, 1985). These symptoms are attributable to insufficient formation of the channel relationship *ex-ante* and represent failures in the recruitment and selection modelling which has received cursory attention within the franchising domain. Thus, the aim of this research was to develop a preliminary model of pre-purchase behaviour in the decision to purchase a franchise. Future modelling must be industry specific in order to rationalise decision-making effectively in context.

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