

Understanding Human Resource Practices and Outcomes in Franchise Businesses

by Tashlin Lakhani

Franchise businesses are an essential and growing part of the U.S. economy, accounting for nearly 800,000 establishments, 9 million jobs, and \$800 billion in output annually. The importance of franchising is particularly evident in hospitality. Hotel and restaurant companies often use franchising to expand faster than would be possible through company ownership alone. Today, food and hospitality account for 65% of employment in franchise businesses.

However, we know very little about human resource management in franchises. This is noteworthy because a large body of empirical research has shown that investments in human resource (HR) practices such as employee selection, training, compensation, internal promotions, and employee discretion improve organizational performance including outcomes such as employee turnover, sales, and customer satisfaction.

At the same time, franchisors face legal constraints when it comes to human resource management. In recent years, changing legislation and debates over joint employer status have raised questions about what franchisors can and should do when it comes to the employees in their franchised locations.

PART ONE: FRANCHISEE-OWNED VERSUS COMPANY-OWNED HOTELS

Using a unique survey of HR practices and outcomes in a U.S. based limited-service hotel chain, this study illustrates a compelling argument for franchisors to provide franchisees with more guidance on how to structure their human resource systems to achieve optimal performance. The analysis suggests that franchisees' inexperience and strong profit motives lead them to underinvest in human resource practices compared to company-owned operations. Recognizing the constraints imposed by joint employer status, franchisors may be able to provide optional HR tools and best practices for franchisees that draw from their knowledge and experience in the operations they directly own and manage.

This study compares the HR investments of 178 franchisee-owned hotels and 305 company-owned hotels. Three sets of 'high performance' HR practices – practices that have been linked to improved organizational performance – are examined:

- *Skill-enhancing HR practices* that reflect investments in creating a high-skilled workforce: formal selection methods, costs to recruit, screen, and train new employees, initial training, and time to proficiency.
- *Motivation-enhancing HR practices* that reflect investments in enhancing employee motivation and commitment to the organization: competitive pay, benefits, job security, and internal promotion opportunities.
- *Opportunity-enhancing HR practices* that reflect investments in a high involvement work design that allow employees to use their skills in ways that benefit the organization: information sharing, meetings to discuss work-related issues, and employee discretion over their jobs.

Controlling for a range of establishment and labor market characteristics – including hotel size, hotel age, hotel location, RevPAR, local unemployment rate, local

median wage, local union density, local market hotel growth, and local market sales per hotel – I find that franchisee-owned hotels make significantly lower investments in all three sets of HR practices compared to company-owned hotels. On average, franchisee-owned hotels are less likely to use formal assessment methods in selecting workers, spend substantially less to recruit, screen, and train new workers (\$578 less per new hire), are associated with 10% lower annual salary, offer 2.58 fewer benefits (out of 6), have fewer full-time workers, and invest less in a high involvement work design – with 10% less information sharing and lower employee discretion than company-owned hotels.

Franchisee-owned hotels make significantly lower investments in all three sets of HR practices compared to company-owned hotels.

The only area where we do not observe significant differences is initial training and time to proficiency, which includes both formal and informal or on-the-job training. Franchisors typically provide formal training over areas such as brand standards and service skills, which should lead to similar levels of overall training across franchised and company hotels. Moreover, because training has generally been viewed as necessary for maintaining uniformity across operations, franchisors may feel more comfortable providing training and training-related materials to franchisees and their employees without risking joint employer status.

PART TWO: OWNERSHIP TYPES & SIZE

In the second part of the study, I use data on franchisee ownership types and franchisee size to examine whether differences in HR practices remain. First, I compare active franchisees who own and operate their hotels to passive franchisees who hire a salaried manager or third-party management company to manage the hotel on their behalf. I find that both active and passive franchisee-owned hotels invest significantly less in HR practices than company-owned hotels. Second, I compare single-unit franchisees to

multi-unit franchisees of varying sizes. I find that both single-unit and multi-unit franchisees invest significantly less in HR practices than company-owned hotels.

The results of this study provide strong support that franchisee decisions over HR investments are being driven, in part, by profit motives. Because franchisors decentralize human resource management to franchisees and because HR practices entail higher costs with little immediate payoff, franchisees appear to reduce investments in these practices. By contrast, company-owned hotels invest more in HR practices that have been linked to higher organizational performance in the long-run.

IMPLICATIONS

These findings suggest that franchisees may benefit from greater assistance with their human resource practices. If franchisors distance themselves from employment matters, franchisees are likely to have little guidance as to how HR systems should be structured to achieve optimal performance. In the absence of this guidance, franchisees' inexperience and lack of knowledge regarding the benefits of certain HR practices may lead them to focus on cutting labor costs and in turn, product and service quality.

Recognizing the importance of HR practices, some companies are beginning to offer their franchisees non-mandatory tools and suggestions for effective human resource management. For example, a leading lifestyle hospitality company in the U.S. recently launched an owner's catalogue with à la carte tools and best practices that can help franchisees better manage their employees. Explaining the value of the owner's catalogue, the Chief Culture Officer noted that "tools and services for areas such as recruitment and ongoing training will help bring greater clarity and consistency across managed and franchised operations."

Importantly, franchisees also appear receptive to these tools. Referring to franchisor involvement in HR matters, the Director of Human Resources for a franchisee-owned hotel in a leading hotel brand said "[If we had more communication from corporate], it would be wonderful, it would be fantastic. It would give me so much peace of mind all the time." Similarly, discussions with restaurant operators revealed a positive response to recent COVID-19 HR best practices shared by brands, noting that it was helpful to know what company operations were doing to function effectively.

By working together and providing franchisees with guidance on HR practices, franchisees can be "in business for themselves, but not by themselves."

Accordingly, in today's environment characterized by uncertainty regarding whether and how franchisors can assist franchisees with human resource management, this study indicates that companies should not distance themselves completely from franchisees and their employees. Without the expertise of franchisors, franchisees may be left guessing on how to successfully manage their employees. By working together and providing franchisees with guidance on HR practices, franchisees can be – as the famous saying goes – "in business for themselves, but not by themselves." Companies that do so are likely to find that this guidance pays off by creating a more stable workforce that is motivated to provide superior customer service and maintain brand standards. ■

PUBLICATION INFORMATION

Lakhani, Tashlin. "How and Why Does Franchise Ownership Affect Human Resource Practices? Evidence from the US Hotel Industry." *ILR Review*, (December 2020). <https://doi.org/10.1177/0019793920972661>.

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Cornell Hospitality Report

Vol. 21, No. 9 (October 2021)

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Cornell Hospitality Reports are produced for the benefit of the hospitality and service industries by the Center for Hospitality Research at Cornell University.

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