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Is Channel Conflict Bad for Business? A Competency-Based Theory and Empirical Evidence

Authors:

Kamran Eshghi, Sourav Ray, Vishal Kashyap

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A Competency-Based Theory and Empirical Evidence

Kamran Eshghi
Associate Professor of Marketing
Faculty of Management
Laurentian University
Email: keshghi@laurentian.ca

Sourav Ray *

Professor and Lang Chair in Marketing
Dept. of Marketing and Consumer Studies
Lang School of Business and Economics
University of Guelph
Email: s_ray@uoguelph.ca

Vishal Kashyap
Professor of Marketing
Department of Marketing
University of Graz
Email: ishal.kashyap@uni-graz.at

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* Corresponding author

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ABSTRACT

The impact of conflict between marketing channel partners is often traced to the transaction costs of dealing with the feuds and linked negatively to business performance. However, is such channel conflict really bad for business? We contend that it is not so and that conflict's net impact on business performance is nuanced. Channel conflicts are opportunities to learn which trigger myriad bilateral remedial adaptations, benefiting the partnerships. This tension between the deadweight loss of transaction costs and the advantage of learning means that the net impact of conflict will depend on the firms' competencies to benefit from learning and to keep the transaction costs from escalating. We incorporate these in our theory and test the propositions using data from a panel of 513 franchise firms over six years (2010-2015). Our data comprises information on litigation, franchise contract terms, and revenue extracted from Franchise Disclosure Documents (FDD), Entrepreneur Magazine, and Franchise Times rankings. We find that the negative impact of conflict is only true above a threshold level of conflict. At lower levels, conflict is associated with improved business performance – thus, an inverted U-shaped conflict-performance relationship. Consistent with the propositions, firm competencies reflected in the age and size of the firm, moderate the conflict-performance curve, shifting the apex to the right and flattening/steepening the slopes predictably. Our results are robust to different model specifications, measures of performance, and endogeneity considerations. For managers, the results indicate how certain competencies are critical to designing resilient marketing channels.

Keywords: Channel conflict, Firm performance, Learning, Transaction Costs, Firm Competency, Inverted U-shaped relationship

INTRODUCTION

Business related conflicts between marketing channel members, what we call channel conflicts, are very common (Dwyer et al., 1987; Samaha et al., 2011) and their potential to have disastrous consequences, is well recognized. Consider the following examples. After a year-long dispute with Unilever over pricing, Kaufland, a German retailer, ended their long-term relationship with several Unilever brands in 2018 (Askew, 2019). Following similar disputes over pricing, Costco delisted Coca-Cola beverages in 2009 (James, 2009). These conflicts may encompass disputes beyond just pricing, e.g., working conditions, fraud, disintermediation, encroachment, inventory demands, profit-sharing schemes, and even fair dealing concerns. For example, First of Five Inc. which operated a Harvey's and Swiss Chalet restaurant disputed the franchisor, Recipe Unlimited Corp.'s allegations of defaults and argued the subsequent non-renewal of the franchise agreement as unfair (Campbell Litigation 2024). While these can result in soured relations and termination of relationships, as in the above examples, several end up in costly litigations, which can leave a long shadow into the future (Winsor et al., 2019). Ewen (2014) discusses several such litigations involving franchisors and franchisees – Steak 'n' Shake Enterprises vs. Globex (conflict over price setting), Naik vs. 7-Eleven (conflict over wages), and Legacy Academy vs. Mamilove (conflict over misrepresentation).

Not surprisingly, practitioner sensitivities are overwhelmingly tuned to avoid conflict, as evident in the following quote by a distribution channel manager: *"Alternative distribution requires an enormous amount of distribution management, and channel conflict ... must be avoided at all costs"* (National Underwriter Life & Health/Financial Services Edition, 1997). Most research evidence suggests these sensitivities around the dark sides of channel conflict, where it affects business performance negatively, are justified (Bradford et al., 2004; Palmatier et al., 2006; Samaha et al., 2011; Eshghi & Ray, 2021).

However, is channel conflict really bad for business? While the question may seem overly loaded, even among practitioners, there is some acknowledgment that channel conflict may have a bright side. Consider the comment by an industry insider: *"Channel conflict should be a good word for brand manufacturers.... They should see it as an opportunity."* – Jean-Gabriel Henry, senior analyst in the business-to-business marketing practice, Jupiter Research (San Jose Mercury News, 2001). Indeed, there are suggestions that conflict can stimulate creativity, lead to reappraisal of policies, refine resource allocation, and enhance innovation (Assael, 1969; Menon, Bharadwaj, & Howell, 1996; Nordin, 2006; Rosenbloom, 1973; Rosson & Ford, 1980; Vaaland & Hakansson, 2003). Addressing the possibilities of such bright sides of channel conflict, Rosenbloom (1973) proposed that the conflict-performance relationship follows an inverted U-shaped curve – performance is low when conflict is at very low or high levels, and it is at its highest level when conflict is at the moderate level. Brown (1980) adds to this complexity by proposing that the inverted U-shaped relationship is preceded by an upright U-shaped relationship. Unfortunately, speculations notwithstanding, there are few rigorous empirical studies devoted to these issues (*cf.* Assael, 1969; Brown et al., 1983). Many earlier studies have limitations in research design, methodology, and measurement, such as data, sampling, and common method bias, that may have restricted the conclusions drawn. So, it is not clear if the lack of robust evidence of the bright line propositions is evidence enough against the possible bright side of channel conflict. We fear, the narrative of channel conflict's dark sides may skew

our view of its impact, in turn, hampering our ability to bring proper evidence-based guidance to channel managers for effective deployment of conflict management resources

This skew in our perspectives is a critical issue in current times. As our channel ecosystem gets populated by new technologies, such as customer relationship management (CRM), Internet of Things (IoT) etc., channel partners approach their channel relations with new competencies and capabilities. While there is a prevailing sense that these emerging competencies will garner greater efficiency and effectiveness in channel operations, the evidence is growing that such promises may be overstated (Shekari & Ray, 2024). Given the generally sparse empirical evidence, it is thus, extremely important that we examine the propositions of the legacy literature in the context of contemporary data.

To address this gap, in this study, we reopen the debate and investigate the potential inverted U-shaped relationship between channel conflict and performance. We leverage the idea that conflict imposes adaptive forces on the parties that pull in different directions. We draw on organizational learning (March, 1991) and transaction cost economics (Williamson, 1985, 1991) to highlight these contrasting forces and the trade-offs they impose. Our theoretical propositions are built on the idea that the firm's abilities to harness the adaptive forces to its benefit are determined by its competencies to benefit (a) by learning from conflict, and (b) by managing the transaction costs of conflict.

We conduct our empirical study in the context of franchising, where franchisor-franchisee conflict is common and likely to offer sufficient variation to test our theoretical propositions (Lafontaine, 2014). The organizational conflict literature discusses different stages of conflict, all the way from latent conditions and perceptions of conflict to overt behavioral outcomes, or manifest conflict (Pondy, 1967). Each stage triggers responses, some of which could be emotive (feelings of anger, frustration etc.), while others are behavioral (changing processes, personnel, contracts etc.). To exclude conflicts that may not impose a measurable burden of such behavioral adaptation on the parties, we specifically focus on litigation. As a proxy for manifest conflict, litigation imposes significant costs of adaptation on the parties involved and offers an appropriate context to capture the associated trade-offs. Our data comes from Franchise Disclosure Documents (FDDs), which are mandatory annual filings by franchisors in one of the "registration law" states in the United States, as well as from annual company reports and Franchise Times rankings. The data comprises franchise characteristics, litigation, and performance, for a panel of 513 franchises over five years (2011-2015). Our data and design facilitate estimating the causal impact of conflict with greater confidence and avoid common method bias, a limitation of earlier studies.

Our key result shows strong evidence that channel conflict is not always bad for business. Indeed, conflict at moderate levels can spur improvements in business performance before it can start having deleterious effects. We also show that this non-linear relationship is moderated by factors that frame the firm's competencies to benefit from learning, and to manage the transaction costs imposed by the conflict on the franchise. We leverage firm age and size to track the net effect of these competencies. These factors not only shift the apex of the inverted U conflict-performance curve but also change its slope by flattening and steepening it predictably.

While our primary contributions can be seen to belong to the marketing channel literature, our results apply to a broader set of inter-firm business relationships. Our theory and the empirical evidence of a significant inverted U-shaped relation between channel conflict and firm performance, contribute to the sparse literature on the positive aspects of channel conflict. This is significant, for conceptual suggestions notwithstanding, the literature is thin on the evidentiary bases of such claims. Additionally, in studying how litigation impacts performance outcomes in the context of franchise channels, we broaden the consideration of coordinated adaptation in a marketing channel (Type II and III adaptation, Williamson, 1991), thereby highlighting the trade-offs firms face in designing longer term adaptive capabilities versus more immediate efforts to manage disputes. Our data and methods also contribute to a growing body of literature that has been addressing some long run limitations in the paradigmatic channel conflict literature (Antia, Zheng, Frazier, 2013; Hermans et al., 2024; Li & Wan, 2023; Van Crombrugge et al., 2025; Van der Maelen et al., 2017; Wang et al., 2020). Our results can be generalized to any business exchange where both learning and transaction costs impose opposing forces on outcomes. With new digital technologies (e.g., sensors, blockchains), contractual arrangements (e.g., smart contracts), and business models (e.g., the gig economy, two-sided platforms) in the ecosystem, the nature and consequences of channel conflict are evolving in unpredictable ways. We hope our results will rekindle interests in this important domain.

In the rest of the paper, we first provide a brief review of the literature on channel conflict and its relationship to business performance. Then we offer our theory leading to testable propositions. We follow by describing our data, method and model to test the hypotheses. We then discuss the results and implications, concluding with future research and limitations.

LITERATURE REVIEW

Bright and Dark Sides of Conflict

Channel conflict refers to a situation where a channel member's actions (behaviors) negatively impact the goal attainment of the other channel members negatively (Etgar, 1979). The bright sides, or functionality, as opposed to the dark sides, or dysfunctionality, of conflict is still an important question that is not appropriately addressed in the literature. Explanations differ on when conflict could be functional or dysfunctional. Some scholars state that the quality of channel interactions will be enhanced due to conflict (Bower, 1965; Duetsch, 1971; Litterer, 1966). Others suggest conflict stimulates channel members to improve their performance (Assael, 1969; Menon et al., 1996; Rosenbloom, 1973). Yet others claim channel conflict can inspire innovation, lead to better decision-making, and improve value co-creation, by identifying and resolving the glitches in the channel (Moorman et al., 1992).

On the other hand, another group of scholars point out the dark sides, which can dominate and make conflict dysfunctional. When conflict and cooperation are seen as opposite poles of a continuum, channel conflict leads to less cooperation among channel members leading to lower performance (Alderson, 1965). Channel conflict may also result in a waste of resources and an increase in transaction costs. Finally, channel conflict makes channel members put more effort or duplicate their effort to do their regular activities (Rosenbloom, 1973).

Point of Ambiguity

The empirical studies in this domain show mixed results. Nordin (2006, p.118) states that “conflict had both good and bad sides, and some conflict should be eliminated while others should not be.” Some studies report a positive correlation between conflict and performance (Assael, 1969; Walker, 1970) while other studies report a negative one (Brown, 1980; Leckie et al., 2017; Lusch, 1976; Pearson, 1973). Yet others could not find any support for the impact of conflict on performance (Brown, 1977; Kelly & Peters, 1977). To resolve the inconsistency, Rosenbloom (1973) asserts that channel conflict can lead to improved performance based on a threshold effect. In other words, increasing conflict leads to higher performance up to a specific point (threshold). However, after reaching that point (threshold), performance begins to fall with an increase in the level of conflict. Thus, conflict can be functional or dysfunctional based on this threshold level. Brown (1980) added to this complexity by asserting that the inverted U-shaped relationship is preceded by an upright U-shaped relationship. However, aggregate results gravitate toward the dark side, or the negative relationship between conflict and performance as the results of a recent meta-analysis show (Eshghi & Ray, 2021). It is also noteworthy to mention that most of the studies on the bright side of conflict draw on theoretical explanations and are conceptual papers rather than being based on empirical analyses (Tang et al., 2017). In brief, there is no consensus on the impact of channel conflict on channel performance. These inconsistencies could be attributed to research design, measurement, or deployed methodologies.

Research Design. Most previous research has been conducted in a cross-sectional manner, which prevents understanding the causal relationship between channel conflict and performance (Lusch, 1976). Conflict is not a static phenomenon, and we require longitudinal data to examine its impact on channel outcomes, such as satisfaction and performance (Brown et al., 1991). To accurately assess the impact of conflict on performance, it is necessary to measure performance at least one period after the conflict has occurred. Therefore, it is difficult to observe the effect of conflict on channel performance in a single period. We should also bear in mind that sometimes low performance may lead to conflict (reverse causality) (Anderson & Narus, 1984).

Measurement. Scholars have employed various types of measurements to assess conflict and performance in previous studies. Most previous studies relied on cross-sectional surveys that capture the perceived, manifest, or affective conflict from managers’ point of view by measuring the frequency, intensity, or importance of conflictual issues. Moreover, conflict is a highly sensitive issue in the channel, and not all channel members are interested in responding to questions about it using surveys or interviews (social desirability). In the same vein, different subjective and objective measures of performance such as return on asset, asset turnover, sales, sales growth, profits, satisfaction, effectiveness, and efficiency have been used in the previous studies (Anderson & Narus, 1984; Duarte & Davies, 2003). Many of these performance types are measured perceptually (subjectively) using surveys. The financial performance measure could be more accurate with archived data rather than subjective perceptual measures (Kang et al., 2018). The correlation between channel conflict and performance would be closer to the true effect when channel performance is measured objectively. However, channel conflict and performance are measured using subjective data in previous empirical studies. This consistency of measurement of conflict and performance may inflate the observed effect of conflict on performance due to common method bias (Kang et al., 2018). Thus, we cannot make sure that

the observed effect of conflict on performance in the previous studies is not the artifact of measurement and common method bias.

Methodology. There are two limitations in much of the earlier literature that have explored the non-linear inverted U-shaped impact of conflict. (Lind & Mehlum, 2010). With rare exceptions (*cf.* Wang et al. 2020), most did not estimate and report the extremum point as being in the data range. As pointed out in Haans et al. (2016), this could lead to conclusions of U-shaped relations that may not be borne out by the data. Earlier studies also largely did not address the potential endogeneity of channel conflict treating it as an exogenous variable (e.g., Duarte & Davies, 2003; Lusch, 1976), which potentially biases the conclusions.

The limitations argued above, along with the inconsistencies in the results, imply that the conflict-performance relation is still highly debated. Compounded by a general lack of contemporary research in the domain, it remains a largely open question. This gap is concerning given the proliferation of new technology and business models that are emerging in our channel ecosystem. In the following sections, we first offer a firm competency-based theory, where we argue that firms' competencies with managing learning and transaction costs explain some of the heterogeneity in the conflict-performance relationship. We then follow up with an empirical test using archival data from the franchise channels context.

THEORY

Transaction Costs versus Organizational Learning

That conflicts can weigh down efficiency is intuitive. Channel conflicts can have both attitudinal and operational consequences. It is well recognized that these could lead to antagonism, tension, and loss of trust among channel members (Hunt 1995; Lusch 1976). The relational breakdowns these portend, in turn, lead to sharper bargaining over residual rents, renegotiations of existing agreements, greater monitoring of partner activities, and more assertive enforcement of agreed behavior, all part of the so-called maladaptation costs as per the transaction costs literature (Rindfleisch & Heide, 1997; Shekari & Ray, 2024; Williamson, 1985). These can lead to rewriting contractual provisions, e.g., in franchise contexts, which are costly exercises in themselves (Cochet & Garg, 2008). Not surprisingly, this resource hogging nature of channel conflicts negatively impacts firms' performances (Eshghi & Ray, 2021).

On the other hand, organizations are learning entities and experiences such as conflict which deplete efficiency and effectiveness, also offer opportunities to appropriately adjust the organizational routines and practices to achieve improved outcomes (Cyert & March, 1963; Lieberman, 1984; Lukas et al., 1996; Ingram & Baum, 1997; Mayer & Argyres, 2004). These improvements hinge on the firms' abilities to engage in and learn from exploration and exploitation activities (Holmqvist, 2004; March, 1991; Levinthal & March, 1993; Sorenson & Sorensen, 2001). In the context of marketing channels, exploration would refer to processes by which channel members can create variety in experience through experimentation and interaction with other channel members and the external environment (cite?). Exploitation refers to the incremental improvement of existing routines to enhance operational efficiency (cite?). Together, these allow the channel members to identify, respond to, and adapt to any lacunae in contractual provisions, misallocation of organizational resources, information gaps, or

misaligned transactional and relational arrangements that could have led to the conflict. A growing body of literature has studied how such learning can, in fact, positively impact channel performances. Some of these suggest that this learning leads to more efficient and effective operational routines in the channel (Ariño & de la Torre, 1998; Hoang & Rothaermel, 2010); others point to forward looking changes in contracts and channel design (Cochet & Garg, 2008; Mayer & Argyres, 2004). Yet others suggest the benefits accrue from the firms' abilities to learn from such conflicts and engineer better relations with other partners (Pangarkar, 2009; Powell et al., 1996; Sorenson & Sorensen, 2001). So, there is strong evidence of the benefits of learning from channel conflict.

Clearly, there are adaptive forces that accompany channel conflict that impact business performance differently. On one side, transaction costs negatively impact business performance, and on the other side, learning from conflict could have a positive impact. We now attempt to capture these trade-offs in a simple model to illustrate the nature of the net impact of conflict on business performance and develop the research propositions.

A firm competency-based model of channel conflict's impact on firm performance

We model the firm's performance, y (≥ 0), as comprising a secular profit, r (≥ 0), and the consequences of channel conflict, x (≥ 0).¹ The consequences of channel conflict, x , derive from (i) the benefits from learning, L , that the firm undergoes because of the conflict, and (ii) the transaction costs, T , that is a direct consequence of managing the conflict. We model the firm as being endowed with some characteristics, a and b , that allow it to leverage learning or manage transaction costs, respectively. Let a be *the firm's competence in benefiting by learning from conflict*, and b , *the firm's competence in managing conflict*. These competencies are not readily adjustable in the near term by the firm, having been developed over a long time. So:²

$$y = r + L(x;a) - T(x;b) \quad (1)$$

To specify the characteristics of the functions $L(x;a)$ and $T(x;b)$, consider first that there is always some learning from conflict that benefits the firm. So,

$$\partial L / \partial x > 0. \quad (A1)$$

The marginal learning from conflict yields decreasing returns.³

$$\partial^2 L / \partial x^2 < 0. \quad (A2)$$

With a as the firm's competence in benefiting by learning from conflict:

$$\partial L / \partial a > 0. \quad (A3)$$

¹ In our model, for exposition purposes we consider x to be exogenous. However, we control for its endogeneity in our empirical models.

² Learning accumulates over time. However, for ease of exposition, we consider the benefits of learning in net present value terms and abstract out the positive impact of learning to a single period. Similarly, while transaction costs reduce firm outcomes over time, we abstract out to a single period for our exposition purposes.

³ The firm's resources have limits, and more of the same types of conflict limits the benefits of learning.

The learning benefits do not grow without bounds with a . So, with decreasing returns:

$$\partial^2 L / \partial a^2 < 0. \quad (A4)$$

However, firms with higher competence, a , get greater learning benefits from conflict, i.e.,

$$\partial^2 L / \partial a \partial x > 0. \quad (A5)$$

$T(x;b)$ has slightly different characteristics. There is always some transaction costs associated with conflict, referred to as the maladaptation costs earlier. So,

$$\partial T / \partial x > 0. \quad (A6)$$

At higher levels of conflict, the increasing complexity of managing conflict compounds the potential productivity losses that accrue, and channel members face increasing opportunity costs. So, the marginal costs increase at higher levels of conflict. i.e.,

$$\partial^2 T / \partial x^2 > 0. \quad (A7)$$

Conflict management competence, b , reduces the transaction costs of managing conflict, i.e.,

$$\partial T / \partial b < 0. \quad (A8)$$

The firm's ability to reduce the transaction costs of conflict is bound, i.e., it cannot reduce these costs to zero. So, the firm benefits from b at a decreasing rate, i.e.,

$$\partial^2 T / \partial b^2 > 0. \quad (A9)$$

Firms with higher conflict management competence, b , benefit from a reduced rate at which the transaction costs increase with x .

$$\partial^2 T / \partial b \partial x < 0. \quad (A10)$$

Now, consider the firm performance function $y(x;a,b) = r + L(x;a) - T(x;b)$. With $r \geq 0$, being a constant, the shape of the function is determined by L and T . So, how does y behave with respect to x , for any given levels of a and b ? The following result follows from the assumptions of the model above:

$$dy/dx = \begin{cases} > 0, & \text{for } x < x^* \\ < 0, & \text{for } x > x^* \end{cases} \quad (2)$$

where x^* is the value of x where the function $y(x)$ is the maximum for any given a and b .

Equation (2) suggests that firm performance y has an inverted U-shape relation with conflict x and translates to the following proposition:

P1: Firm outcomes are increasing in conflict at lower levels of conflict but decreasing with conflict at higher levels of conflict.

To understand the intuition behind this proposition, consider the first order condition of $y(x; a, b)$. For an extremum x^* , it must satisfy:

$$\text{FOC}(x)^*: dy/dx = \partial L/\partial x - \partial T/\partial x = 0. \quad (3)$$

Now, let us consider the second order condition: $d^2y/dx^2 = \partial^2 L/\partial x^2 - \partial^2 T/\partial x^2$. Notice from our assumption (A2 and A7), the first term on the right-hand side is negative while the second term is positive. So, $d^2y/dx^2 < 0$. The negative result implies x^* is the value of x where the function, y , is the maximum, y^* at a given a, b . Hence, for any $x_1 < x^*$, $y(x_1) < y^*$ and for any $x_2 > x^*$, $y(x_2) < y^*$. Hence, the result in equation (2): $dy/dx > 0$ for $x_1 < x^*$ and $dy/dx < 0$ for $x_2 > x^*$.

Since $dy/dx = \partial L/\partial x - \partial T/\partial x$, $dy/dx > 0$ means $\partial L/\partial x - \partial T/\partial x > 0$ for $x_1 < x^*$. That is, learning dominates the transaction costs at lower levels of x . Correspondingly, $\partial L/\partial x - \partial T/\partial x < 0$ for $x_2 > x^*$; i.e., learning is dominated by the transaction costs at higher levels of x .

Two further results follow from the model (see the Appendix for explanations):

$$\partial x^*/\partial a > 0. \quad (4)$$

$$\partial x^*/\partial b > 0. \quad (5)$$

Equation (4) suggests that as a increases, y reaches its maximum at higher values of x . Intuitively, this suggests that firms with higher competence in benefiting by learning from conflict, a , can sustain a higher range of conflict before the benefits of learning get dominated by the transaction costs. This leads to the following proposition:

P2: Greater the firm's competence in benefiting by learning from conflict, greater the range of conflict it can endure and benefit from before the negative effects of conflict dominate.

Equation (5) suggests that as b increases, y reaches its maximum at higher values of x . Intuitively, this suggests that firms with higher *conflict management competence*, b , can sustain a higher range of conflicts before the negative impact of transaction costs starts dominating. This leads to the following proposition:

P3: Greater the firm's conflict management competence, greater the range of conflict it can endure and benefit from before the negative effects of conflict dominate.

Propositions P1-P3 suggest that performance y has an inverted U-shaped relation to x , with the apex x^* taking higher values for higher values of a and b . But how does the shape of y depend on a and b ? To understand this, consider how the slope $\partial y/\partial x$ change with a and b . Consider the sign of $\partial/\partial a [\partial y/\partial x]$. This is $\partial^2 L/\partial a \partial x$, which is > 0 based on (A5). So, the slope of y becomes *steeper* with a . Correspondingly consider the sign of $\partial/\partial b [\partial y/\partial x]$. This is $-\partial^2 T/\partial b \partial x$, which is also > 0 based on (A10). So, the slope of y becomes *steeper* with b .

P4: Greater the firm's competence in benefiting by learning from conflict, greater the marginal impact of conflict on firm performance.

P5: Greater the firm's conflict management competence, greater the marginal impact of conflict on firm performance.

To summarize, in the above descriptive model, we illustrate how channel conflict imposes a trade-off between learning and transaction costs to determine an inverted U-shaped performance–conflict relation. The benefits of learning dominate the transaction costs of conflict at lower levels of conflict, and in turn, are dominated at higher levels. We further illustrate that firm capabilities in terms of its competence in benefiting from learning, and competence in managing conflict, allow the firm to garner the benefits of conflict over a greater range of conflict. Lastly, we also illustrate how these capabilities portend a steeper performance–conflict relation.

Hypotheses

Our first testable hypothesis follows directly from P1:

H1: Firm performance exhibits an inverted U-shaped relationship to channel conflict.

Deriving testable hypotheses relevant to propositions P2-P5 calls for a more nuanced approach and will require us to find proxies for **a**, *the firm's competence in benefiting by learning from conflict*, and **b**, *the firm's conflict management competence*, which would be moderators of the hypothesized conflict–performance relation. There are several challenges here. First, unlike the assumptions in our expository model, these competencies may not be independent of each other. In other words, firm level characteristics could be common proxies that affect both competencies. While that does not impact the generalizability of the insights, it means our empirical results may need to be contextually justified. Second, our secondary data approach offers limited ability to construct finely grained measures of **a** and **b**.

To this end, firm age and size have been recognized as important factors for a firm's learning and conflict management efficiencies (Hoisl et al., 2017; Simon, 1991; Sinkula, 1994; Sorenson & Stuart, 2000), and have also been shown as crucial factors for channel performance (Brush & Chaganti, 1999; Majumdar, 1997). So, we consider the moderating roles of firm age and firm size as proxies for the firm's competencies. Our basic premise is that the net benefits operate differently for younger versus older firms, and for smaller versus larger firms.

Firm Age

In a general sense, channel members cannot immediately acquire, process, and leverage the information from conflicts. It takes time to evaluate and record new knowledge in organizational memory (Argyris & Schon, 1978). Subsequently, firms that are able to understand the conflicts more accurately from this information, including the contingencies they portend, have a greater ability to garner the benefits of learning from conflict. Firms with more experience should be better equipped for this task (Johnson et al., 2004; Solis-Rodriguez & Gonzalez-Diaz, 2012). Part of this ability to generate benefits also derives from the different processes firms deploy to deal with the information from conflicts. For younger firms, there is a greater likelihood that conflicts present new, previously unknown information, which must then first be distributed

across the firm as part of its knowledge repertoire (Sinkula, 1994). Additionally, for older firms, there is a greater likelihood that conflicts present previously known information, which can then be more easily processed to generate greater adaptive benefits, compared to younger firms, who may have to engage in more, and uncertain, experimentation. These would suggest that while firms, regardless of age, learn from conflict (Cohen & Levinthal, 1990; Hoisl et al., 2017), older firms would have greater competence to benefit from learning. This pertains to P2.

However, transaction (maladaptation) costs with rising conflicts deplete the benefits of learning. In general, the logic of learning curves suggests that older firms will be more efficient in doing many channel activities, including managing channel conflicts, compared to younger firms (Ingram & Baum, 1997). Some of these costs can be pegged to wrong selection issues (Sadeghi et al., 2022), where misfit partners are not able to deliver on the agreed terms, requiring greater oversight, training, monitoring, etc. These costs would likely be lower for older firms whose experience would lead to better selection of their channel partners, compared to younger firms. Another type of conflict could be rooted in more moral hazard of partners, whereby partners would act opportunistically. Older firms are more likely to have identified effective and efficient processes to deal with such opportunism, and thus, incur lower transaction costs. However, the net transactional efficiencies are not a given for older firms.

Yet other transaction costs could result from what Williamson (1985) called the “fundamental transformation” of a business transaction over time. As explained by Wilson (1995), repeated transactions build up non-redeployable assets over time as the channel partners look for transactional economies in scale and scope. These relationship specific assets amplify the hazards of opportunism associated with conflict, leading to higher transaction costs in terms of dispute resolutions and monitoring. The older firms naturally generate greater levels of such hazards than younger firms, who are thus, relatively less constrained by the associated transaction costs. At the same time, older firms may also be more likely to develop greater (and more appropriate) safeguards over time for these hazards, while for younger firms, without the benefit of experience, the hazards of these increasing specific assets pile up fast. In sum, it is unclear whether firm age can cleanly predict conflict management competence, as in P3.

The main upshot of the arguments above is that while older firms can be seen as being able to garner greater benefits from learning, compared to younger firms, it is not clear if they necessarily benefit from being able to better reduce the transactions costs of conflict. This leads to the following competing hypotheses, which follow from P2 and P3:

H2a: Firm age moderates the inverted U-shaped relationship between channel conflict and performance in such a way that the older the firm, the higher the level of conflict, where the inflection point of the inverted U-shaped curve occurs (Learning dominated).

H2b: Firm age moderates the inverted U-shaped relationship between channel conflict and performance in such a way that the older the firm, the lower the level of conflict, where the inflection point of the inverted U-shaped curve occurs (Transaction Costs dominated).

The age of the firm also affects both the rate of learning as well as the ability to keep transaction costs manageable. Older firms are more likely to have the required accumulation of knowledge and experience as well as the embedded procedures to learn faster and manage

conflict at lower transaction costs; so, they can focus on exploitation over exploration (March 1991). This results in a higher marginal net benefit compared to younger firms, which are not only unable to leverage learning from similar levels of conflict but also struggle to control their transaction costs with the same efficiency, as they lack strong exploitation capabilities. However, at higher levels of conflict, older firms face far greater transactional challenges due to the complexity of much greater levels of specific assets build-up from the fundamental transformation referred to earlier. This results in progressively greater depletion of the benefits of learning with increasing conflicts, relative to younger firms. These two effects result in a steeper slope of the conflict-performance curve for older firms compared to the younger firms. So, following P4 and P5:

H3: Firm age steepens the inverted U-shaped relationship between channel conflict and performance, i.e., the older the firm, the steeper the performance increases at lower levels of conflict, and the steeper the performance decline at higher levels of conflict.

Firm Size

Larger franchise firms tend to have a larger network of franchise outlets. The most immediate impact of such size is efficiency from scale economy. Larger firms benefit from more efficient systems and procedures for storing, processing, and sharing information (Moorman & Miner, 1998). Larger firms also have more (scale and variety) access to outside knowledge because of more interactions with other entities (Hoisl et al., 2017). These generate greater benefits of learning from conflict. But it is not just about scale but also *how* larger firms learn. Firm size is positively correlated with both exploitation (Rotharmel & Deeds, 2004) and exploration (Beckman et al., 2004). Johnson et al. (2004) suggest that firms categorize inter-firm relationship information as part of their *interactional knowledge stores*. These consist of knowledge from interactions with its channel members, including channel conflict, and acquired by firms through exploration. Thus, larger firms have a higher level of interactional knowledge due to more interactions within their channels, and the knowledge acquired in one relationship can be effectively transferred to other interactions relevant to conflict management in the channel. Nevertheless, greater size also comes with greater bureaucracy and inertia. Their greater rigidity would hobble the larger firms' abilities to benefit from learning to the same extent as the more nimble, smaller firms. So, the inherent competence of larger firms, to benefit from learning is not a given.

That said, the internal administration costs that result from greater hierarchy of larger firms increase the transaction costs significantly over smaller firms. At higher levels of conflict, these costs eventually dominate the benefits of learning.

In sum, whether the learning benefits can be sustained by larger firms over a greater range of conflicts before the weight of transaction costs dominates (P2 and P3) is an empirical issue. So:

H4a: Firm size moderates the inverted U-shaped relationship between channel conflict and performance in such a way that the larger the firm, the higher the level of conflict where the inflection point of the inverted U-shaped curve occurs (Learning dominated).

H4b: Firm size moderates the inverted U-shaped relationship between channel conflict and performance in such a way that the larger the firm, the lower the level of conflict where the inflection point of the inverted U-shaped curve occurs (Transaction Costs dominated).

The rate at which firms reap the benefits of learning and incur bureaucratic costs is different for large and small firms. While smaller firms are able to reap the benefits of learning without the weight of bureaucratic costs at lower levels of conflict, these benefits get very quickly depleted at higher levels of conflict as their lack of scale economies implies their bureaucratic costs acquire greater salience. This contrasts with larger firms, whose advantages in scale economies and associated learning abilities are closely tracked by their higher bureaucratic costs at all levels of conflict. This thereby mutes the net rate at which they gain from learning at lower levels or suffer from transaction costs at higher levels. This suggests that firm size flattens the inverted U-shaped relationship between conflict and performance, and smaller firms will have a steeper curve compared to larger firms, as in P4 and P5. So:

H5: Firm size flattens the inverted U-shaped relationship between channel conflict and performance, i.e., the smaller the firm, the steeper the performance increases at lower levels of conflict, and the steeper the performance declines at higher levels of conflict.

EMPIRICAL METHOD

Empirical Context and Data

We conduct our empirical study in the business-format franchise channels for several reasons. First, long-term inter-firm relationships are typical for such franchises, and all channel members have a vested interest in avoiding channel conflict, given the fixed transaction specific costs incurred to both select, as well as join the network. So, both learning and transaction costs are important considerations. Second, relevant data on channel conflict, performance, and other contract-related variables are publicly available for franchises, especially in North America. Third, conflict is an endemic characteristic of franchise relationships (Lafontaine, 2014), which would likely give us the variation to test our hypotheses. Last but not least, the broad public interest in franchising means that data is available from multiple independent sources, which allows researchers to test the robustness and generalizability of the research conclusions.

Our unit of analysis being the firm, we collect data about each franchisor's conflict and performance. To obtain data on litigated (manifest) conflict, we collect the Franchise Disclosure Documents (FDD) from 2011 to 2015 for a sample of 513 franchise firms, using their electronic filings in one of the "registration law" states in the United States. Registration law requires all franchisors to register their FDDs to the state's authorities. We extract the litigated conflict and other contract terms from 23 required items that must be included in FDD. Each FDD includes the previous ten years' information on litigated conflict (item 3). We recorded the number of litigations the firm has been engaged in from 2011 to 2015. We only choose litigated conflicts related to the franchise relationship (such as trademark infringements, default in payments, quality and responsibility shirking, etc.), and ignore other litigations such as those related to customer or supplier conflicts; this controls for different governance contexts. All FDDs are also accompanied by income statements and balance sheets of the franchisors. We get performance-related data (overall revenue and revenue from franchise operations) from both the FDD

appendices and Franchise Times rankings.⁴ We use the Franchise Times ranking data as a robustness check for the first source. We use The Entrepreneur's franchise ranking list for some general franchise data, such as the number of company-owned outlets and initial investment.

Measurement

The list of all variables, their measurement, and sources are provided in Table 1. We also report the correlation and descriptive statistics in Table A1 in Web Appendix.

Dependent variable

We use the revenue (dollar amount) of the franchisor, extracted from income statements, as our main measure of performance. We also extracted the part of the revenue that is attributed only to franchise operations: royalty fee, franchise fee, and the sum of royalty fee and franchise fee. We used sales levels from Franchise Times' ranking and other mentioned sales measures to check the robustness of the measures.

Main independent variables

Conflict is measured as the number of litigations experienced by the franchisor⁵. Firm age is measured as the number of years the firm has operated since its establishment in the specific business sector. Firm size is measured as the number of outlets in the franchise in that year.

Other variables (control)

A list of all the control variables, their measures, and sources are in Table 1. We control for industry sectors and year effects using dummy variables.

<Insert Table 1>

Estimation Strategy

Inverted U-shape estimation

The inverted U is estimated by regressing the dependent variable y (performance) on the independent variable x (conflict) and its squared term, x^2 .

$$y = \beta_0 + \beta_1 x + \beta_2 x^2 + \varepsilon \quad (6)$$

A significant positive β_1 and a negative and significant β_2 are necessary but not sufficient to infer an inverted U. It is important to also check the slopes at both ends to make sure both slopes are significantly positive (at the low end) and negative (at the high end). As well, the confidence

⁴ While we have conflict data going back to 2001, and Franchise Times rankings going back to 2004, we did not have information on revenue prior to 2011, so we end up using data from 2011 to 2015 only.

⁵ The initiator of litigation could be franchisor and franchisee. We do not separate them out because most claims by a franchisor or franchisee are followed by counter claim by the other party (Michael, 2000).

interval around the turning point (threshold) must also be within the data range (Haans et al., 2016; Lind & Mehlum, 2010).

Moderation of the inverted U-shape

To test for the moderating impact of Z of the inverted U shape, we estimate:

$$y = \beta_0 + \beta_1 x + \beta_2 x^2 + \beta_3 xZ + \beta_4 x^2 Z + \beta_5 Z + \varepsilon \quad (7)$$

The inflection point of the inverted U-shaped curve occurs at $x^* = -\frac{\beta_1 + \beta_3 Z}{2(\beta_2 + \beta_4 Z)}$. To see how the inflection point changes as Z changes, we consider: $\frac{\delta x^*}{\delta Z} = \frac{\beta_1 \beta_4 - \beta_2 \beta_3}{2(\beta_2 + \beta_4 Z)^2}$. As the denominator is strictly greater than zero, the direction of the shift depends on the sign of the numerator. If $(\beta_1 \beta_4 - \beta_2 \beta_3)$ is positive, as Z increases, the inflection point will shift to the right (learning dominated); if negative, the inflection point will shift to the left (transaction costs dominated).

The moderating effect of Z on the steepening of the curve is determined by the second derivative of y : $\frac{\partial^2 y}{\partial x^2} = 2\beta_2 + 2\beta_4 Z$. The magnitude $|\frac{\partial^2 y}{\partial x^2}|$ determines the steepness of the curve. With $\beta_2 < 0$ for an inverted U, steepening occurs if $\beta_4 < 0$ and flattening if $\beta_4 > 0$.

Endogeneity

As mentioned earlier in the theory section, the occurrence of conflict (litigation) is unlikely to be a random, exogenous incident. The number of conflicts (litigation) could be a function of many unobserved factors (e.g., mismatched channel partners, bad managerial practices) that could also impact firm performance; in which case channel conflict would be endogenous, violating the assumptions of a standard regression model (uncorrelated errors, $\text{Cov}(x, \varepsilon) = 0$) and thus, result in biased estimates. To account for such endogeneity, we consider both conflict and its squared term as endogenous variables (Angrist & Pischke, 2009; Wooldridge, 2002).

First, we run the Wu-Hausman test to check if we can reject the null hypothesis of conflict (and its squared term) being exogenous (Hausman, 1978; Wu, 1974). The results ($F(2,1342) = 96.143, p < 0.000$) reject the null, suggesting endogeneity.

Next, we use the 3SLS (3-stage least squares) procedure. For this, we estimate the endogenous variables with several other variables and estimate the equations simultaneously with the main model. The variables we choose to estimate conflict and its squared term, map to franchise specific, business environment specific and relationship specific factors, and are: years of franchising, number of franchise units, number of trademarks, relationship law state, growth of franchise over the last three years, and contractual provisions of mediation and arbitration. To address potential endogeneity in the relationship between conflict and performance, we instrument conflict using the number of franchise units, the number of trademarks, and the system growth rate. These instruments are grounded in established franchising research. First, larger franchise systems tend to face greater coordination and control challenges, increasing the likelihood of conflict (Lafontaine & Shaw, 1999; Shane, 1996). Second, a broader trademark portfolio often reflects more complex brand assets and product lines, which can spark disputes

over brand usage and consistency (Michael, 2002). Third, rapid growth can strain operational capacity and misalign franchisor–franchisee expectations, further elevating conflict risk (Lafontaine & Slade, 2007). Prior work suggests that the primary influence of these variables on outcomes operates through their effect on conflict. So, these variables are unlikely to exert a direct effect on performance, and while they may correlate with performance, it is only through their impact on conflict, satisfying the exclusion restriction in our 3SLS framework.⁶ We discuss these further in the Web Appendix – Section A2. We follow Papies et al. (2017) and Wooldridge (2002) to address the endogeneity of the squared term of conflict by regressing the squared term on these variables and their squared terms (see Equation 10). We also test the strength of instruments using the method proposed by Angrist and Pischke (2009), which accommodates more than one endogenous variable. The F-statistic (7.68) is greater than the critical value of 3.64, and we can reject the null hypothesis that the instruments are weak ($p = .1$).

Econometric models: Three-Stage Least Squares (3SLS)

We estimate three equations simultaneously. To estimate the effect of conflict on performance (H1), we regress performance on conflict and its squared term, controlling for the number of total outlets (size), advertising intensity, franchise initial investment, firm experience (age), and year and industry fixed effects (equation 8). Both conflict and its squared term are also regressed on the instruments and their squared terms as indicated (equations 9, 10).

$$Perf_{it} = \beta_{30} + \beta_{31} \cdot Conf_{i,t-1} + \beta_{32} \cdot Conf_sq_{i,t-1} + \beta_{33} \cdot Ltotal_{i,t} + \beta_{34} \cdot Lavest_{i,t} + \beta_{35} \cdot Adv_{i,t} + \beta_{36} \cdot Cexpr_{i,t} + \sum_{j=2012}^{2015} \tau_j + \sum_{c=1}^{25} sector_c + \omega_{3i} \quad (8)$$

$$Conf_{it} = \beta_{10} + \beta_{11} Ltrad_{i,t-1} + \beta_{12} Fexp_{i,t} + \beta_{13} Lfran_{i,t-1} + \beta_{14} Rel_st_{i,t-1} + \beta_{15} Arbit_{i,t-1} + \beta_{16} Mediat_{i,t-1} + \beta_{17} Grth3 + \omega_{1i} \quad (9)$$

$$Conf_Sq_{it} = \beta_{20} + \beta_{21} Ltrad_{i,t-1} + \beta_{22} Ltrad_sq_{i,t-1} + \beta_{23} Fexp_{i,t} + \beta_{24} Fexp_sq_{i,t} + \beta_{25} Lfran_{i,t-1} + \beta_{26} Lfran_sq_{i,t-1} + \beta_{27} Rel_st_{i,t-1} + \beta_{28} Arbit_{i,t-1} + \beta_{29} Mediat_{i,t-1} + \beta_{210} Grth3 + \omega_{2i} \quad (10)$$

Our model estimations for the moderation effects (H2-H5) are more involved. We have two moderating variables (firm age and size) with two different types of moderation (shift of threshold and steepening of inverted U). We investigate the effects of each moderator separately. Since interaction of the moderator with endogenous variables make the interaction terms endogenous as well, we follow the method recommended by Papies et al. (2017) and Wooldridge (2002) by including additional equations in our simultaneous estimations, regressing the interaction term of conflict and moderator on the instruments and their interactions with moderators. We mean-centered the moderator and main independent variable that is used in the interaction to mitigate the effect of multi-collinearity.

⁶ It is hard to pin down fully valid instrumental variables in secondary archived data such as ours. However, as we argue later, we test the robustness of our results in multiple ways – different dependent variables, different sampling, different estimation techniques, as well as models without accounting for instruments. Our results are robust.

To test H2 and H4, we check the sign and significance of the relevant numerator of the following term: $\frac{\delta X^*}{\delta Z} = \frac{\beta_1\beta_4 - \beta_2\beta_3}{2(\beta_2 + \beta_4 Z)^2}$. To test H3 and H5, we check the sign and significance of the relevant β_4 term (interaction of the squared term of conflict with the moderator) as discussed following equation 7.

Results for H1 (Inverted U)

Table 2 shows the results of 3SLS for all three regression equations with overall revenue from the income statement as the dependent variable. Conflict has a positive and significant effect ($\beta_{31} = .276$; $p = .000$), and conflict squared has a negative and significant ($\beta_{32} = -.007$; $p = .000$) effect on performance. These results provide the necessary conditions for the hypothesized inverted U-shaped relationship in H1. The number of total outlets, investment level, firm experience, and advertising intensity have positive and significant impacts on performance. The effects of the number of franchise outlets, relationship law state, and three-year growth, on conflict are positive and significant. It means that firms with a greater number of franchise outlets and a higher growth rate are more likely to experience conflict. The squared term of number of franchise outlets has a negative and significant effect on the squared term of incidence of conflict while number of franchise outlets, relationship law state, and three-year growth have positive and significant effects on the squared term of conflict.

We re-estimate the model using sales from Franchise Times' ranking as the dependent variable (see Table 3). The results are consistent – conflict and conflict-squared still have significant positive ($\beta_{31} = .152$; $p = .000$) and negative ($\beta_{32} = -.004$; $p = .000$) effect on performance, respectively.

<Insert Table 2 and Table 3>

To test the sufficient conditions for the inverted U-shape, we follow Lind and Mehlum (2010). We calculate the extremum point using the written Stata command – *utest*– by Lind and Mehlum (2010). The calculated value is 19.26. We test the slope of the curve before and after the extreme point. The slope for the first part of the curve is positive and significant (slope = .276, $t = 5.879$, $p = .00001$). The slope of the second part of the curve is negative and significant (slope = -11.749, $t = -4.193$; $p = .000$). Finally, for an overall test of the presence of inverted U-shape, we estimate a t-value of 4.19 ($p = .00001$), which indicates that we can reject the null of non-inverted U-shape relationship between channel conflict and performance. The Fieller interval for the extremum point is [15.078; 27.838], which is within the data range.⁷

Robustness of Results

Other forms of non-linear relationship. We added the cubic term of conflict to our equations. If the addition of the squared term of conflict increased (R^2) significantly, we might have an S-curve relationship instead of an inverted U-shaped relationship. Upon the addition of the cubic term, the sign and significance of conflict and conflict-squared terms did not change (Web Appendix A, Table A2). Adding the cubic term of conflict to the performance equation

⁷ Fieller (1954) confidence interval for extremum point accounts for finite sample bias and departure from normality.

increased (R^2) by less than .01 percent, and this increase is not significant ($p = .27$). The addition of conflict and its squared term increases (R^2) significantly ($p = .000$). We also graphed the relationship between conflict and performance within the data range to make sure that we have a true inverted U-shaped relationship (see Figure 1a).

<Insert Figure 1>

Estimation without endogeneity correction. We repeat the analyses without considering the endogeneity of conflict and conflict squared. The coefficient of conflict is positive and significant, and the coefficient of conflict squared is negative and significant (Table A3, Web Appendix A). The additional tests of the inverted U-shaped also support our main analysis. We conclude that our results are not an artifact of our specification for conflict and conflict-squared terms (endogeneity).

Alternative measures of performance. We use other measures of performance to estimate the effect of conflict on performance in separate 3SLS systems: (1) revenue from royalty fees, (2) revenue from franchise fees, and (3) revenue from the sum of royalty and franchise fees (refer to A1 section in Web Appendix A). The results are consistent with the main analysis.

Winsorizing. We winsorize the data at (1% and 99%) to make sure that the outliers do not drive our results, specifically the inverted U-shaped relationship between channel conflict and performance. The results are consistent with the main analysis (Table A4, Web Appendix A).

Alternative estimation method. We also used Conditional Mixed Process (CMP) to estimate the effect of conflict on performance. The advantage of CMP is that it works with unbalanced panel data and estimates each equation with its available data (Roodman, 2011). The results are consistent with the main analysis (Table A5, Web Appendix A).

We recognize the difficulty of finding appropriate instruments in available secondary data for a specific performance measure. However, such presumed misspecification would likely vary across other performance measures. So, one way to check for the robustness of the results would be to use the same instruments for several performance measures. Consistency in the core findings across models would strengthen our confidence in their validity. So, we conduct extensive robustness checks using alternative dependent variables (e.g., revenues from royalty fees and franchise fees). Furthermore, we account for possible sensitivity to data handling (e.g., winsorizing) and estimation method (e.g., CMP). Observing stable results across these specifications provides additional assurance that our conclusions are not an artifact of model-specific assumptions or data treatments.

Results for H2-H5 (Moderation of Inverted U)

To test the moderation effect of the shift in the inflection point (H_2 and H_4), we check the sign and significance of the relevant term ($\beta_1\beta_4 - \beta_2\beta_3$). We extracted the coefficients from the main regression analysis and used the *nlcom* command in *Stata* to test whether the numerator is significantly different from zero. A significant positive value shows a right shift is occurring (Learning dominated effect) while a significant negative sign shows a left shift is occurring (Transaction Costs dominated effect).

For firm age as a moderator, the numerator is negative and marginally significant ($-.0001, p = .095$). This suggests some statistical support (albeit marginal) for the transaction costs dominated effect (H2b). To further test whether $\frac{\delta X^*}{\delta Z}$ is significant, we estimate the expression $\frac{\beta_1\beta_4 - \beta_2\beta_3}{2(\beta_2 + \beta_4Z)^2}$ at different values of Z , specifically at the 25th and 75th percentile values of firm age. We do not find the expression to be statistically significant at the 25th percentile ($p = .691$), but again, negative and weakly significant ($p = .1$) at the 75th percentile (see Web Appendix A, Table A6, panel a). So, there is weak evidence that older firms are more likely to see the benefits of learning depleted by the transaction costs of operational complexity (likely driven by the hazards accompanying processes such as the “fundamental transformation of transactions” alluded to earlier) at lower levels of conflict.

For firm size as a moderator, the numerator is not significant ($-3.19 \times 10^{-7}, p = .219$); hence, the role of firm size in the threshold is indeterminate in our aggregate estimations. To test further, we test whether $\frac{\delta X^*}{\delta Z}$ is significant at 25th and 75th percentile values of firm size. Both estimates are significantly negative ($p = .001$), suggesting some support for the transaction costs dominated effect (H4b) – (see Web Appendix A, Table A6, panel b). So, there is some qualified support for the dominance of the internal administration costs of larger firms, more aggressively depleting the learning benefits.

Overall, we only get mixed support, and the evidence is not compelling for the “shift” hypotheses of H2 and H4.

To test the second type of moderation (steepening or flattening effect, H3 and H5), we check only the sign and significance of β_4 (coefficient for interaction of the squared term of conflict with the moderator). For firm age, this is negative and statistically significant ($-.0007, p = .031$) (Please refer to Web Appendix, Table A7). So, as hypothesized in H3, for older firms, both the rate of increase in the benefits of learning from conflict is higher, as is the decline in performance due to the transaction costs of conflict. This alludes to the better embedded processes in older firms, which facilitate learning, as well as the significant hazards that drive the transaction costs of conflicts and aggressively deplete the learning benefits in older firms.

For firm size, the estimated β_4 is positive and statistically significant ($3.32 \times 10^{-6}, p < .000$). So, as hypothesized in H5, the rate of increase in the benefits of learning from conflict becomes higher for smaller firms than larger ones (see Web Appendix A, Table A8). Correspondingly, smaller firms also face relatively steeper transaction costs of conflict since they lack the scale economies of larger firms, which depletes the steeper benefits curve more aggressively than for larger firms. So, the conflict – performance curve is flatter for larger firms as hypothesized. Our marginal plots of the effects of conflict on performance for different age and size of firms clearly show the steepening effects of the variables (see Figures 1b and 1c)

Robustness check for the moderation test

In the main moderation tests, we consider the interaction terms of conflict and conflict squared as endogenous variables. We repeat the moderation analyses without considering the

endogeneity of interaction terms. We obtain the same results for both types of moderation and different moderators (See Web Appendix, Tables A9 and A10).

DISCUSSION

Our key conclusions are that firm competencies to learn from, and manage the transaction costs downsides of channel conflict, matter. In particular, they come together to determine how channel conflict impacts the firm's business outcomes. Specifically, firm performance exhibits an inverted U-shaped relation to conflict, where the firms' benefits of learning from conflict only sustains up to moderate levels of conflict, after which the transaction costs of conflict progressively chip away at the benefits, eventually dominating at higher levels of channel conflict. The firm's competencies in managing how it can leverage the learning, and manage the transaction costs, determine the range of channel conflict that it can "bear" before its business outcomes are negatively impacted. These competencies also determine the marginal impact of channel conflict on the firm's business outcomes. There are several intertwined takeaways from our research that contribute significantly to the channel conflict literature specifically, and to our understanding of conflict between business partners, more generally.

Research Implications

Our most important of the research takeaways, pertain to that of conflict management, a key underlying concern for marketing channel relations. With channels as the key structure through which business entities engage with end users, the frictions of channel conflict impede business outcomes, not just in terms of the business' inability to meet customer needs but also in terms of compromising competitive advantage in the process. So, there is no question that channel conflict acts as a significant boundary condition to the efficiency and effectiveness of businesses. Not surprisingly, marketing channel systems, such as franchises, invest in building competencies to deal with such conflicts. Much of these efforts are naturally seen through the lens of the dark side of conflict, where the negative effects of channel conflict hang heavy on firm outcomes. Yet, the intriguing possibilities of channel conflict potentially having positive effects on firm outcomes have long been part of the scholarly and industry narratives (*cf.* Assael, 1969). Unfortunately, both the mechanisms underpinning such potential bright sides of channel conflict, as well as the evidentiary bases of such claims, form a rather sparse backdrop of research in the domain. Our research directly fills this gap in literature and is quite unique in its scope. By focussing on such mechanisms, we consciously step away from reductionist arguments of "too little or too much of something is bad" that have characterized some recent studies of the non-linear impact of channel conflict. To the best of our knowledge, in establishing the bright line boundary conditions simultaneously with the dark lines of channel conflict, we are among the pioneers to offer not just a theoretical explanation but also robust empirical evidence in support.

Our key arguments draw upon organizational learning and transaction costs. The paradigmatic literature on channel conflict, for the most part, looks upon the cooperation – conflict spectrum to justify the bright line considerations (e.g., Assael, 1969; Pearson, 1973; Pearson & Monoky, 1976). We contend that, while reasonable, a purely dyadic approach to establish the bright line boundary conditions may be too reductionist in scope. In contrast, we highlight the specific firm level competencies that may also determine such bright line boundary conditions. New technologies, particularly innovation in digital technologies – such as customer

relationship management (CRM), enterprise resource planning (ERP), smart contracts, blockchain, and Industrial Internet of Things (IIoT) have been populating the channel ecosystem in recent times. These new technologies endow channel partners with new competencies that allow them to learn and adapt at different speeds and scopes than was possible earlier. While the dominant sense is that these lead to greater efficiency and effectiveness in channel operations, there is growing evidence that such positive outcomes may not be a given (Shekari & Ray, 2024). It becomes even more compelling, therefore, that we examine the propositions of the legacy literature in the context of contemporary data, especially when empirical evidence is sparse. To this end, our highlighting of the learning competencies of the firm expands the set of considerations underpinning the bright lines of channel conflict, (Assael, 1969; Nordin, 2006; Rosenbloom, 1973; Rosson & Ford, 1980).

Our highlighting of the transactional competencies of the firm fits more immediately with the tenets of the existing literature (e.g., Duarte & Davis, 2003; Lusch, 1976; Pearson, 1973; Pearson & Monoky, 1976). We believe our focus on firm competencies contributes to the theoretical bases of the coordinated Types II and III adaptation discussed by Williamson (1991). We build on existing results with evidence that the adaptive competencies of channel partners are critical considerations, despite the inevitable process of dyadic adaptations.

Methodologically, one key challenge of the legacy literature has been data limitations. With much work built on perceptual data from surveys, concerns about data quality and consequently, potential for bias in results, e.g. due to common method variance, has never been too far from the surface (Assael, 1969; Brown, 1977; Kelly & Peters, 1977; Leckie et al. 2017; Pearson & Monoky, 1976; Shekari & Ray, 2024; Walker 1970). This has triggered increasing use of secondary data, which addresses some of the erstwhile data limitations (e.g., Antia, Zheng, Frazier, 2013; Hermans et al., 2024; Li & Wan, 2023; Van Crombrugge et al., 2025; Van der Maelen et al., 2017; Wang et al., 2020). Our research adds to this body of research, using contemporary data and methodology.

With our focus on manifest conflict, through the use of litigations, we avoid the measurement uncertainties associated with the scale and intensity of perceived conflict. Our secondary data, derived from grounded measures in company reports, avoids common method bias in our results. Our data structure also allows us to test the comparative statics relations of the impact of firm age and size, thereby allowing us to establish the underlying mechanisms with greater confidence. Our context of litigations also ensures that the adaptive processes we propose have a high probability of operating in the data generation processes. Our sampling of a relatively large sample of firms from a sampling frame that is non-exceptional and common (franchises) suggests greater generalizability of our results. While not unique in the domain, our use of panel data and instrumental variables allows us to better control for both unobserved cross-sectional and temporal sources of variation.

Overall, these combinations of method, data, sampling, and mechanism-anchored tests, generate greater confidence in the causal inferences we draw. This confidence is compounded by the supportive evidence from the myriad robustness checks we perform. With new business models, e.g., two-sided platforms and sharing economy franchises, as well as temporary organizations (Ghazimatin, Mooi, & Heide, 2023) emerging in the ecosystem, both the nature and consequences of channel conflicts are evolving in unpredictable ways. So, while our results

may seem to be somewhat new and novel (inverted-U, shifts in the apex, and sharpening of the curve), we feel these are also quite robust and offer a solid evidentiary platform for future research in the domain to build upon with confidence.

Managerial Implications

We start our discussions of the managerial implications with a cautionary observation. The apparently counterfactual finding that channel conflict may have a bright side, does not absolve channel managers from the need to do what they can to avoid conflict. In fact, the finding that should loom large for all managers is that conflict does negatively impact business performance, albeit only at higher levels. Quite in contrast to the general suggestion that channel conflict can be good for channel partners, we hope the overwhelming main takeaway should be that managers should put their utmost efforts to keep conflict levels low. This is not trivial, for conflict is often an organic outcome of ongoing transactions, rooted in contingencies that are either not contracted for, or non-contractible, thus, inevitable in some sense. Even when experienced lawyers are involved in drafting franchise contracts for mature franchises, such contracts are inevitably incomplete, and grey areas emerge over time (Siebert, 2009). So, while avoiding conflict is a great heuristic to follow, firms should simultaneously set up processes for (a) learning from conflicts and (b) ensuring that the conflict does not escalate.

Our ability to give specific recommendations for how to learn from conflict and how to avoid escalatory costs of conflicts are limited. However, we draw from an understanding of the routines that come with firm age and size to offer some key lessons.

Repeated channel interactions with partners over time come with diagnostic information. Without such knowledge being recorded in the organization, so that they can be retrieved and interpreted appropriately, the lessons of experience will be lost. So, we encourage managers to pay particular attention to how the knowledge base is created and stored. While our results suggest that older firms are better at these than younger firms, that is only in the aggregate and does not suggest that these competencies are inevitable.

Often these lessons and learnings reside in key boundary spanning personnel that have learnt from earlier interactions. Top level managers should think of ways to disseminate that knowledge to multiple levels of the organization. In that effort, identifying best practices should be important but not the only consideration. It stands to reason that it is really important to build a thinking organization, which can go beyond blindly parroting best practices to making sense of the underlying mechanisms and influences, much of which could be unexpected and previously unknown information. It is through such an effort the firm can simultaneously benefit from learning as well as manage to keep down conflicts from escalating transaction cost wise.

Such a careful look at channel relations should also come with a deep look into how the relationships evolve over time. While it is not a given that such a longer relationship will necessarily build in hazards that come with dependence; it cannot be ruled out that the channel partners will fall into relational routines that will acquire dimensions of non-deployable relational assets. While these will come with their own efficiencies of relational transactions, it is our advice that firms should be mindful of not falling into such a hazard unknowingly. These require channel managers taking stock of the spectrum of channel relationships periodically.

Lastly, we want to point out that our results point to both the advantages and disadvantages of firm size. Larger firms have benefits of scale, which gives them advantage over smaller firms; however, it is clear that smaller firms learn faster and are more nimble in terms of adapting. While not a surprising result, it just reinforces the need for larger firms to also pay attention to building adaptive flexibilities while leveraging their scale advantages. In that sense, it is perhaps even more important for larger firms to try and keep their channel conflicts within manageable limits, even if they naturally have the capacity to bear more conflict than smaller firms.

CONCLUSIONS, LIMITATIONS AND FUTURE RESEARCH

Overall, and to reiterate the key findings, we find robust evidence that channel conflict at moderate levels, can spur improvements in business performance, before the transaction costs of conflict start eroding these benefits. This manifests in an inverted U-shaped conflict-performance curve. We find firm age and size, factors that frame the firm's competencies to benefit from learning, and to manage the transaction costs imposed by the conflict on the franchise, moderate this non-linear relationship. These factors shift the apex of the inverted U conflict-performance curve and also change its slope by flattening and steepening it predictably. To the best of our knowledge, these results are among the first in the domain that shows both the dark and bright sides of channel conflict. In particular, our context of franchise litigations contributes to a sparse literature.

Like any research, ours also have some limitations. We do not believe these limitations impact our conclusions, but these could present boundary conditions on our results that we call upon future research to address. First, while channel conflict is an inherently dyadic construct, we focus only on an individual firm – the number of litigations, is measured at the level of the franchisor. There are three reasons why this limitation may not significantly impact our results. (1) Even if aggregated at the franchisor level, each litigation involves other franchisees; so, they are still dyadic in essence; (2) the aggregation captures the level of conflict within the franchisor's franchise network; doing so ensures that the essence of learning and transaction costs operate for the franchisor, as conceptualized in the framework; (3) our focus on franchisor performance, a firm-level construct, makes such a firm-level measure of conflict more appealing since it captures the aggregate firm-level learning and transaction costs. That said, getting data from both sides of the dyad might uncover different effects since the importance and intensity of the conflicts may vary across the dyad.

Second, alternate measures of both performance and conflict could bring greater nuance to our results. Going beyond sales revenue, looking at outcomes such as return on investment or net income would help in improving our broader understanding of the impact of conflict. In a similar vein, going beyond simple counts of litigation, it is possible to measure conflicts by incorporating their intensity and importance to create a composite index. As it stands, our neutrality to this complexity may not be a significant limitation given that (a) our conceptual framework focuses on the net of benefits of learning and transaction costs, and (b) much of the variation is aggregated over different types of conflict within a franchise network. However, we believe a more nuanced measure would also improve our understanding and shed greater light on the underlying mechanisms and call upon future researchers to follow through.

We end with a call for channel researchers to further explore this domain of channel conflict and its impact on firm performance. The general area has a rich history in the marketing channels literature, but the research has limitations both in terms of conceptual frameworks, as well as empirical evidence. With new technologies such as smart contracts, blockchain, Industrial Internet of Things (IIoT), and new business models, such as sharing economy and double-sided platforms emerging in the marketing channels ecosystem, we believe marketing channel conflict will re-emerge as an important, if understudied domain. Much of any new work will have to build upon our current understanding of the impact of channel conflict on firm performance – an impact that we claim is neither well understood, nor very well documented, and to which end the current research aims to contribute.

Table 1- List of variables used in this study

Variable	Label	Description	Source
Conflict	Conf	The incidence of litigation is a proxy for channel conflict.	Franchise Disclosure Document (item 3)
Conflict square	Conf_sq	The square of the number of conflicts	Franchise Disclosure Document (item 3)
Performance	Perf_Rev Perf_FT Perf_Roy Perf_FF Perf_FR	Natural logarithm of overall revenue (in dollars) Natural logarithm of revenue from franchise operation (in dollars) Natural logarithm of revenue from franchise operation: royalty fee, franchise fee, and their sum (in dollars)	Revenue from the income statement (FDD's attachment) and sales from Franchise Times's ranking
Size	Total_n	Total number of outlets in the franchise system	Entrepreneur Magazine + FDDs
Firm age	Cexpr	The number of years the firm has operated in the sector since its establishment.	Entrepreneur Magazine + FDDs
Number of Trademarks	Ltrad	Natural logarithm of the number of trademarks registered by franchisor (specific to franchise relationship)	FDDs (item 13)
Relationship state law	Rel_st	It is one if the headquarters is the relationship law, otherwise 0	Entrepreneur Magazine from + FDDs
Mediation clause	Mediat	It is 1 if there is a mediation option in the contract; otherwise, it is 0.	FDDs (item 17)
Arbitration clause	Arbit	It is 1 if there is an arbitration option in the contract; otherwise, it is 0.	FDDs (item 17)
Growth in past three years	Grth3	The average growth of the franchisor in the past three years	Entrepreneur Magazine + FDDs
Franchise experience	Fexp	Natural logarithm of franchise experience based on the number of years since the firm began franchising	Entrepreneur Magazine + FDDs
Number of franchise outlets	Lfran	Natural logarithm of the number of franchise units	Entrepreneur Magazine + FDDs
Transaction specific investment	Lavest	Natural logarithm of initial franchise investment (dollar value)	Entrepreneur Magazine + FDDs
Advertising intensity	Adv	The advertising expense is normalized by the number of total outlets.	FDDs

Table 2: Regression results of performance (overall revenue) as dependent variable

	Dependent variables		
	Conf	Conf_sq	Perf
	Coef (std err)	Coef (std err)	Coef (std err)
Conf _(t-1)			.276 (.047)
			[<.000]
Conf_sq _(t-1)			-.007 (.002)
			[<.000]
Ltrad _(t-1)	-.014 (.055) [.798]	-.166 (1.17) [.887]	
Ltrad_sq _(t-1)		-.075 (.286) [.794]	
Fexp _(t-1)	.001 (0.064)	-1.204 (1.467)	
	[.991]	[.412]	
Fexp_sq _(t-1)		.228 (.265) [.390]	
Lfran _(t-1)	.296 (.043)	3.708 (.987)	
	[<.000]	[<.000]	
Lfran_sq _(t-1)		-.199 (.097) [.041]	
Arbit _(t-1)	-.126 (.097) [.194]	-.990 (1.25) [.427]	
Grth3 _(t)	.002 (.001) [.009]	.035 (.009)	
		[<.000]	
Mediat _(t-1)	-.034 (.096) [.725]	-.107 (1.24) [.931]	
Rel_st _(t)	.221 (.094) [.018]	2.585 (1.251)	
		[.032]	
Size _(t)			.001 (.000)
			[<.000]
Lavest _(t-1)			.650 (.065)
			[<.000]
Age _(t)			.016 (.004)
			[<.000]
Adv _(t)			.00002 (.000)
			[<.000]
Year dummies			included
Category dummies			included
Constant	-.846 (.194)	-8.91 (2.946)	7.27 (1.481)
	[<.000]	[.002]	[<.000]
Number of observations	1,264	1,264	1,264
R-sq	.1134	.0468	.4170
Chi2	179.15 [<.000]	81.47 [<.000]	931.02 [<.000]

Standard errors in parentheses. P-values in brackets.

Table 3: Regression results of performance (FTsales) as the main dependent variable

3SLS	Dependent variables		
	Conf Coef (std err)	Conf_sq Coef (std err)	Perf Coef (std err)
Conf _(t-1)	-	-	.152 (.031) [<.000]
Conf_sq _(t-1)			-.004 (.001) [<.000]
Ltrad _(t-1)	-.086 (.092) [.346]	-1.132 (2.087) [.587]	-
Ltrad_sq _(t-1)		-.062 (.465) [.895]	-
Fexp _(t-1)	.031 (0.127) [.803]	-1.285 (3.68) [.727]	-
Fexp_sq _(t-1)		.427 (.645) [.508]	-
Lfran _(t-1)	.465 (.083) [<.000]	5.447 (2.40) [.023]	-
Lfran_sq _(t-1)		-.202 (.205) [.324]	-
Arbit _(t-1)	-.287 (.161) [.074]	-2.001 (2.02) [.323]	-
Grth3 _(t)	.001 (.001) [.623]	.02 (.012) [.067]	-
Mediat _(t-1)	.225 (.164) [.170]	3.77 (2.06) [.067]	-
Rel_st _(t)	.152 (.160) [.341]	1.267 (2.001) [.527]	-
Size _(t)	-	-	.001(.000) [<.000]
Lavest _(t-1)	-	-	.732 (.054) [<.000]
Age _(t)	-	-	.007(.003) [.022]
Adv _(t)	-	-	.000 (.000) [.333]
Year dummies	-	-	included
Category dummies	-	-	included
Constant	-1.731 (.394) [<.000]	-18.99 (6.86) [.006]	-1.907 (.612) [.002]
Number of observations	562	562	562
R-sq	.1219	.0642	.6837
Chi2	99.48 [<.000]	51.51 [<.000]	1250.57 [<.000]
Standard errors in parentheses. P-values in brackets.			

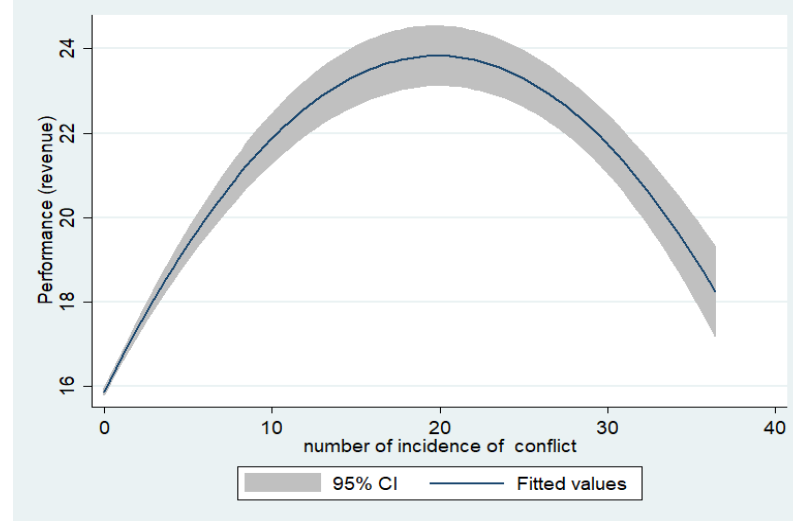


Figure 1a: Marginal plot of conflict – performance relationship- (Inverted U-shaped relationship based on the data)

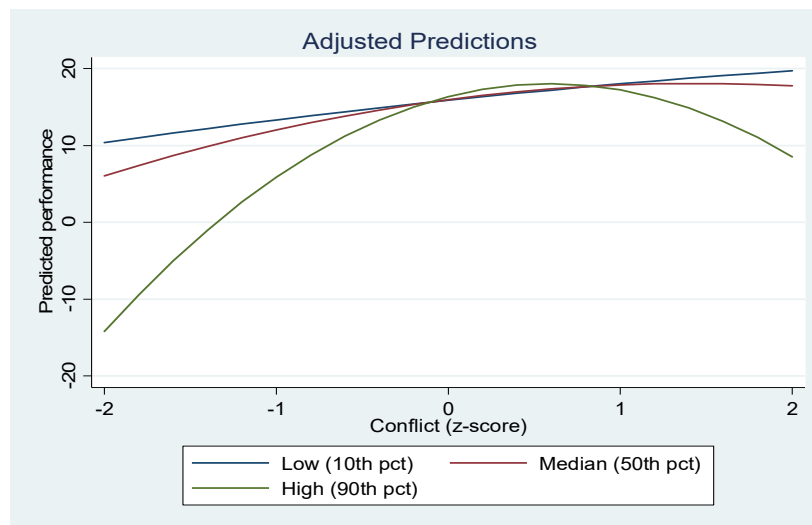


Figure 1b: Marginal plot of conflict – performance for different firm age (steepening effect for older firms based on estimated model)

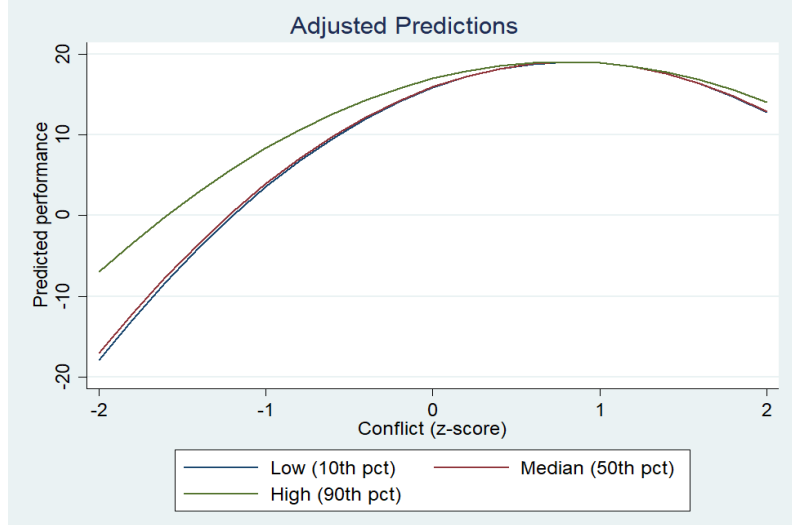


Figure 1c: Marginal plot of conflict – performance for different firm size (steepening effect for smaller firms based on estimated model)

APPENDIX

Equations (4) and (5) follow from taking the partial derivative of the FOC (equation 3) with respect to **a** and **b**, respectively. First, from $\partial/\partial a [\partial L(x^*,a)/\partial x - \partial T(x^*,b)/\partial x = 0]$, we get $\partial^2 L/\partial x^2 \partial x^*/\partial a + \partial^2 L/\partial a \partial x - \partial^2 T/\partial x^2 \partial x^*/\partial a = 0$, and:

$$\frac{\partial x^*}{\partial a} = \frac{\frac{\partial^2 L}{\partial a \partial x}}{\frac{\partial^2 L}{\partial x^2} - \frac{\partial^2 T}{\partial x^2}} \quad (W1)$$

Next from $\partial/\partial b [\partial L(x^*,a)/\partial x - \partial T(x^*,b)/\partial x = 0]$, we get $\partial^2 L/\partial x^2 \partial x^*/\partial b - \partial^2 T/\partial x^2 \partial x^*/\partial b - \partial^2 T/\partial b \partial x = 0$, and:

$$\frac{\partial x^*}{\partial b} = \frac{\frac{\partial^2 T}{\partial a \partial x}}{\frac{\partial^2 L}{\partial x^2} - \frac{\partial^2 T}{\partial x^2}} \quad (W2)$$

Based on assumption (A2), $\partial^2 L/\partial x^2 < 0$ and assumption (A7), $\partial^2 T/\partial x^2 > 0$; so, the denominator, which is same in both equations (W1) and (W2), is negative. From assumption (A5), $\partial^2 L/\partial a \partial x > 0$, so the numerator is negative in equation (W1); hence $\partial x^*/\partial a > 0$. Similarly, from assumption (A10), $\partial^2 T/\partial b \partial x < 0$, so the numerator is negative in equation (W2); hence, $\partial x^*/\partial b > 0$.

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