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Geographical Dimensions
of Business Format Franchising

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ABSTRACT

FACULTY OF SCIENCE

GEOGRAPHY

Doctor of Philosophy

GEOGRAPHICAL DIMENSIONS OF BUSINESS FORMAT FRANCHISING

By Juliet Anna Cox

Franchising is one of the most understudied areas of entrepreneurship (Fenwick and Strombom, 1998) despite the economic significance and international scale of franchise activity. This thesis aims to redress this neglect by examining business format franchise systems in the UK. The research focuses on three key geographical issues. Paradoxically, geographical dimensions of franchise activity have not been acknowledged in past research despite the fact that franchising is inherently geographical and issues of expansion, location, territory and local environment are central to franchising.

Forty in-depth interviews with franchisors across six different sectors of franchise activity have been conducted. The first issue examines why firms franchise and how spatial expansion is achieved. The findings suggest that franchise firms undergo a four-stage spatial expansion life cycle: the initial (pilot), roll out, consolidation and maturity stages. Three strategies were used to achieve network growth: (i) a franchisor-led approach; (ii) a franchisee-led approach; and (iii) a hybrid approach (franchisor and franchisee-led). Methods of growth included utilising single, multi-unit and area operators. These expansion strategies illustrate the locational decision making processes of both the franchisor and the franchisee.

The second issue examines how franchise systems manage the dynamic nature of network growth over time from early to latter stages of expansion. As a franchise network grows and with increased market penetration as a franchise format becomes better known, the basis of a franchise network may need to be restructured (i.e. new units added to existing operational areas). The sample of franchise systems had three models of network allocation: networks allocated on the basis of exclusive territories; networks allocated on the basis of non-exclusive territories; and networks where neither exclusivity or territories were allocated - units were simply licensed to franchisees. Network allocations had different contractual and operational implications for the restructuring process and the ability of a firm to take advantage of new market potential if it arose over time. Therefore, it was necessary for firms to employ restructuring mechanisms to facilitate new expansion opportunities.

The third issue examines the role of the local environment and its effect on format implementation. Business format franchising is based on a system of replicating a comprehensive, tried and tested business formula based around a tradename or trademark, in different localities. However, franchisees operating in different geographical environments (which vary in terms of competition, consumer preference and level of resources) may not be able to adapt to the demands of their local environment because of the constraints of operating to a national or international standardised franchise format. A model is developed which demonstrates the circumstances in which format standardisation or adaptation occurs in response to local environmental pressures. Franchisors permit some format adaptation when the overriding benefits of modification lead to enhanced format implementation and operation. Format standardisation is enforced if adaptation negatively distorts system and brand integrity.

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Chapter 1 The Growth of Franchise Activity

1.1 Introduction

> *"Franchising has emerged in recent years as a highly significant strategy for business growth, job creation and economic development both in the US and in world markets"* (Hoffman and Preble, 1995, p80).

Since the 1970s, most developed countries have experienced a significant increase in franchise activity. North America, Europe, Australia and Japan all have extensive franchise markets (Price, 1997). In the US, sales from franchise operations between 1975-1990 reputedly expanded by 300% (Trutko *et al.,* 1993). Franchising currently accounts for 10% of GNP and 34% of all retail sales in the US with this figure projected to reach 40% in the early part of the 21st century (Hoy, 1998; Hoy *et al.,* 2000; Julian and Castrogiovanni, 1995). Between seven to eight million people are employed either directly (i.e. through ownership) or indirectly (i.e. as employees) in US franchising activity (Falbe and Dandridge, 1994). In Europe, approximately 3,500 franchisors employed 1 250 000 people and generated an annual turnover of 75 billion ECU in 1997 (European Franchise Survey, European Franchise Federation, 1997). Approximately 600 franchisors and 30,000 franchisees operate in Australia and the Australian Bureau of Statistics (1994) estimated that, between 1991-1994, the number of franchised businesses increased by 14% per annum. Japan has 700 franchisors and is the second largest franchisee market world wide, with approximately 140, 000 franchisees (the US has the largest number of franchisees at 250,000). Franchise activity has also extended into some developing markets such as South America (e.g. Mexico, Brazil), South East Asia (e.g. Indonesia, Malaysia and Singapore), South Africa and Central and Eastern European countries (e.g. Czech Republic, Hungary and Slovenia; McCosker, 1998; Pavlin, 1996; Scholtz, 1997; Swartz, 1995). (See Table 1.1).

Table 1.1 Franchise Activity Worldwide 1995[1]

Number of Franchisors		*Number of Franchisees*		*Population[2]*	*GDP/head[2]*
United States	3,000	United States	250,000	266.5m	$27,500
Canada	1,000	Japan	139,788	125.4m	$21,300
Brazil	932	Canada	65,000	28.8m	$24,400
Japan	714	Brazil	60,000	162.7m	$6,100
Australia/NZ	600	France	30,000	58.3m	$20,200
France	520	Britain	26,000	58.5m	$19,500[3]
Germany	500	Australia/NZ	26,000	21.8m	$21,482
Britain	414	Mexico	18,724	95.8m	$7,700
Italy	400	Spain	18,500	39.2m	$14,300
Mexico	375	Italy	18,500	57.5m	$18,700
Netherlands	341	Germany	18,000	83.5m	$17,900
Spain	280	Netherlands	11,975	15.6m	$19,500
Austria	200	Hungary	10,000	10.0m	$7,000
Hungary	200	Sweden	9,000	8.9m	$20,100
Sweden	200	Norway	3,500	4.4m	$24,500
Norway	185	Argentina	3,500	34.7m	$8,100
South Africa	180	Belgium	3,083	10.2m	$19,500
Switzerland	170	Austria	3,000	8.0m	$19,000
Belgium	150	Singapore	1,600	3.4m	$22,900
Malaysia	125	Denmark	1,210	5.2m	$21,700
Indonesia	105	Finland	900	5.1m	$18,200
Argentina	100	Malaysia	800	20.0m	$9,800
Singapore	85	Yugoslavia	620	22.3m	$2,994[4]
Hong Kong	84	Columbia	300	36.8m	$5,300
Portugal	70	Czech Republic	100	10.3m	$10,200
Finland	70	Philippines	61	74.5m	$2,530
Denmark	68	Chile	25	14.3m	$8,000
Philippines	56	Israel	15	5.4m	$15,500[5]
Columbia	48	Bulgaria	7	8.6m	$4,920
Yugoslavia	45				
Chile	45				
Czech Republic	35				
Israel	18				
Bulgaria	0				

[1]The data were derived from a survey of franchise associations in 40 countries (a 90% response rate was achieved).
[2]The population and GDP values are estimates (1996, and 1995, respectively) used by Stanworth *et al.*, 1998
[3]UK figures
[4]Bosnia and Herzegovina, Croatia, Macedonia, Serbia and Montenegro, Slovenia
[5]Excluding Gaza Strip and West Bank

SOURCE: Swartz, L. N., (1995), *'Worldwide Franchising Statistics: A Study of Worldwide Franchise Associations'*, Arthur Andersen (in co-operation with the World Franchising Council), CIA 'World Factbook', 1996

Franchise activity is pervasive in most sectors of the economy:

> *"most [people] will be familiar with the most successful companies in which franchising is at work: Coca-Cola, Seven-Up, McDonald's, Kentucky Fried Chicken, Burger King, Wimpy, Prontaprint, Tie Rack, Body Shop, Dyno Rod and ServiceMaster, to name but a few. Yet there are many other less well known firms in which franchising is at work...franchising is big business...almost every local high street or shopping centre can boast several franchise operations. Some will be newly formed; others will be nationally, even internationally, well known"* (Felstead, 1993, p38).

Franchise operations can be found in both 'blue' and 'white collar' sectors, such as, retailing, hospitality (i.e. fast food and hotels), health and beauty, home maintenance, construction, domestic cleaning, distribution and delivery, professional and business services (e.g. consultancy, recruitment, accountancy), reprographics, printing and photo processing (Price, 1997; Stanworth *et al.*, 1998). As Curran and Stanworth, (1983, p9) observe: *"franchising is a widespread business form encompassing a wide and diffuse range of economic activities."* The term 'franchising' has also been used to describe and label business relationships as diverse as the right to broadcast television programmes within certain territories; distributorship and agency arrangements (i.e. retailing petrol, cars, beers and soft drinks) to using a complete handed-down franchise business package (Domberger and Middleton, 1985; Mendelsohn, 1991; Prager, 1990; Shepard, 1993; Stanworth *et al.,* 1995). As well as its use in the private sector, franchising has also been used to describe functions in the public sector, such as operating airline and railway routes, supplying water and electrical utilities, and offering library services and university and college courses (Price, 1997).

However, franchising is not a recent phenomenon. The earliest origins of franchising have been traced to the Middle Ages when in medieval England 'franchises' were granted for the privilege of collecting taxes for the Crown (Felstead, 1993; Macmillan, 1996; Price, 1996; undated). The tied-public house system used by the brewing industry since the eighteenth century in the UK is also an example of the early origins of franchise activity (Curran and Stanworth, 1983; Hough, 1982; Stern and Stanworth, 1994). In the US, franchising has been traced to the end of the Civil War and to the Singer Sewing Machine Company, which established a distribution and maintenance system, giving financially independent operators exclusive selling or servicing rights within defined territories (Price, 1996). In the early twentieth century, motor car manufacturers/distributors, petroleum distributors, soft drink syrup manufacturers, drug stores, grocery and hardware chains began to use franchising as a strategy to distribute their products (Vaughn, 1979). The evolution of this type of franchise relationship centred on different elements of the supply chain and has been termed *'product or tradename franchising'* (see Table 1.2). Product/tradename franchises are:

> *"where the franchisor is typically either a manufacturer seeking outlets for its branded products, or a product component manufacturer seeking someone else to make-up the finished product and distribute the branded product to retailers. Under this arrangement the franchisor may provide some of the advertising, management assistance and training, but the franchisee generally conducts business as an independent distributor acquiring the identity of the franchisor through the product/trademark"* (Felstead, 1993, p47).

Table 1.2 Typology of Product/Tradename Franchising

Manufacturer-Retailer
The manufacturer is the franchisor and the retailer is the franchisee, who sells directly to the public. The franchisee may operate the franchise as their sole business concern or, as an activity within an existing business. Examples of this type of franchise include car/ truck dealerships and petrol service stations.

Manufacturer-Wholesaler
The manufacturer is the franchisor and the wholesaler is the franchisee. The main example of this type of franchise is the soft drinks industry. The manufacturer is the franchisor who licenses independent bottlers as franchisees to act as the wholesaler. Examples include Coca-Cola, Pepsi-Cola and Seven-Up.

Wholesaler-Retailer
Co-operatives of retailers may form a wholesaling company to act as the franchisor. The co-operative franchisor may then contractually oblige a retailer (i.e. a licensee) to purchase through the co-operative. Examples of this include the 'voluntary' grocery groups (such as Spar, Mace, Londis, and VG) in the UK and some of the drug store chains (such as Rexall Drug Co. and Union Prescription Inc.) found in the US (Macmillan, 1996; Mendelsohn, 1979; Stern and Stanworth, 1994).

SOURCE: Vaughn, C (1979) Franchising: Its Nature, Scope, Advantages and Development, Lexington Books, Lexington, Massachusetts.

A more recent form of franchising - and the central focus of this thesis - is the evolution of *'business format franchising'*. Business format franchising differs from product franchising, as it is a system of 'cloning' a comprehensive tried-and-tested business formula rather than merely licensing a name or product. It therefore involves a more complex, closer relationship between franchisor and franchisee than in the case of product franchising (Mendelsohn, 1991; Spinelli, 1994; Stanworth, 1994). Business format franchising also differs from product franchising, as it is concentrated in the service sector.

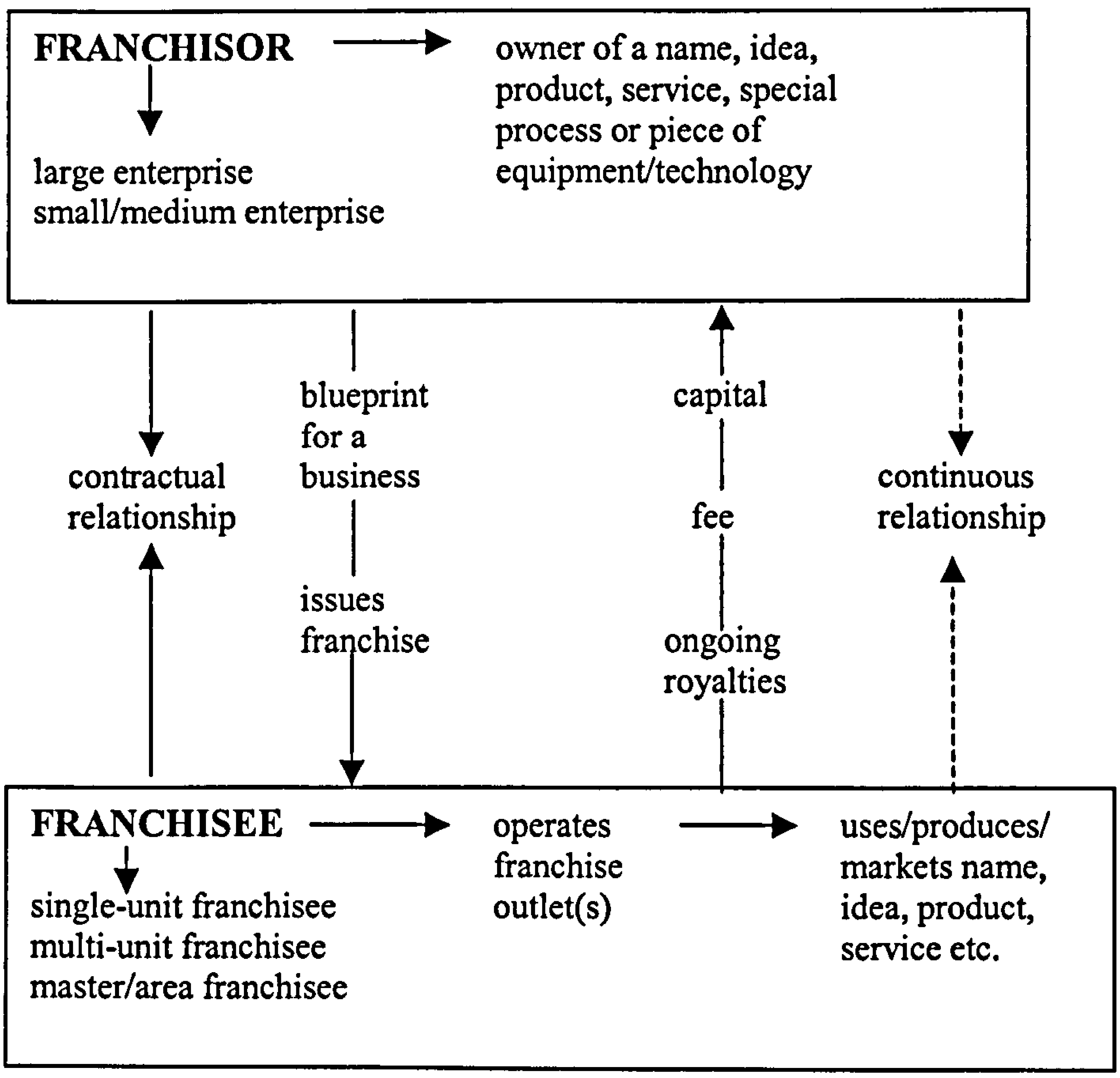
Business format franchising consists of a contractual relationship between a franchisor and a franchisee. The franchisor is the owner of a name, idea, product, service, confidential process or specialised piece of equipment while the franchisee is allowed to use, produce or market the name, idea, product, service etc. through a franchised outlet or outlets (which are legally separate entities). A franchisee must operate the outlet in accordance with the franchisor's 'blueprint' or 'format' (i.e. the procedures and regulations relating to the daily operation of the business) devised by the franchisor and set out in the franchise contract. The franchisee can be either a single unit operator or a multi-unit operator. In some cases, a franchisee will be a master or area franchisee. The master/area franchisee will be responsible for developing a territory (either a country or region) by selling franchises to sub-franchisees who operate at the local level. The franchisee pays an initial fee to the franchisor for use of the format and a continuing royalty fee, and/or a management service fee and/or payments for franchisor produced supplies. In return, the franchisor provides services such as help, advice and support with research and design, advertising and marketing. Thus, the relationship between franchisor and franchisee is a continuous one (Felstead, 1991a; 1993; Mendelsohn, 1982; 1991; 1997). The following quote from Felstead underlines how comprehensive business format franchising is:

> *"[f]ranchisees not only receive the right to use the franchisor's trade mark, but also operate under specific guidelines covering all aspects of the business, including a marketing strategy and plan, operating manuals and standards, accounting and finance procedures, the design of the premises and even the colour of the uniforms worn. The franchisor may provide training in the operation and methods of the business prior to opening, and offers advice and assistance in the areas of staff training, management, advertising, plus research*

and development. In return, the franchisee pays a one-off franchise fee and a royalty, usually expressed as a percentage of total business sales." (Felstead, 1991a, p40).[1]

The description of business format franchising outlined above draws on the European Franchise Federation's definition, which is based on four key elements: (i) the franchisor owns a name, idea, process, product or piece of equipment; (ii) a contract exists between franchisor and franchisee which allows the franchisee to use the franchisor's assets; (iii) the franchisor has a blueprint or regulations for the operation of the business; and (iv) franchisees make some form of payment to the franchisor for use of the franchisor's proprietary assets (See Figure 1.1).

Figure 1.1 The Business Format Franchise Relationship



[1] Definitional issues are discussed more thoroughly in Chapter 2, as the definition of business format franchising was one of the earliest themes of the academic franchise literature.

The origins of business format franchising dates back to the 1940s and 1950s in the US, when some of the more renowned present day franchise operations were established. For example, Hilton Inns was established in 1947; Dunkin' Donuts in 1950; Holiday Inn in 1952; Burger King in 1954; McDonald's in 1955; Pizza Hut in 1958 and ServiceMaster in 1959 (Price, 1997; Trutko *et al.*, 1993). However, it was not until the 1960s and 1970s that the US experienced rapid expansion of business format franchising activity. During this period, business format franchising became the fastest growing segment within franchising, as product franchising declined in importance (Trutko *et al.*, 1993). It has been estimated that 100,000 new business format franchise businesses were started between 1964 and 1969 and a further 50,000 between 1969 to 1973. In 1968, more fast food franchise operations were started than in all previous history (Trutko *et al.*, 1993; Vaughn, 1979). In the 1970s and 1980s, American business format franchisors began to internationalise their operations. Internationalisation, as well as domestic development has meant most other developed countries have experienced growth in business format franchising since the 1970s.

The first part of this chapter (Section 1.2) outlines the economic significance and international scale of business format franchise activity in greater depth. In so doing, the justification for the focus of this thesis on business format franchising is made. It is business format franchising that has experienced phenomenal growth in sales, units and employment generation (Felstead, 1993) while remaining an understudied topic of research, (Elango and Fried, 1998; Hoy *et al.*, 2000). Given the economic importance, growth and scale of business format franchise activity, it is a topic that warrants more thorough academic attention.

However, there are a number of difficulties, which arise when trying to compile a comprehensive and authoritative picture of the significance of business format franchising, both economically and internationally. Data is at best partial, incomplete and dated, or at worst, unavailable and may only be gleaned from a patchwork of diverse sources. Data are also often variable and inaccurate depending upon sources and definitions used[2] (McCosker and Walker, 1992; Preble and Hoffman, 1995; Stern and Stanworth, 1994). In some countries, franchise activity may be in infancy (as may be the research that is conducted) and there may therefore be no formal means of data collection and measurement. Hence, section 1.2 outlines the most current and authoritative sources of franchising statistics that are available for each country, whilst attempting to distinguish between product and business format franchising statistics. The remainder of Chapter 1 (Section 1.3) accounts for the growth of business format franchising activity by offering macro-scale theoretical explanations, from the wider context of economic, social, cultural and political change.

1.2 The Economic and International Significance of Franchise Activity

1.2.1 United States

Franchise activity is more developed in the US than in any other country (Hoy *et al.*, 2000; Swartz, 1995). The US has the oldest and largest franchise market (Table 1.1) and the contains the greatest diversity of franchising activity. For example, US franchise operations can be found in the automotive, distribution, wholesaling, and retailing sectors, as well as in 'blue-collar' activities, such as home maintenance, cleaning services, industrial services, printing and construction. Franchising has also embraced 'white-collar' activities such as real estate, health, employment and training services, legal services, business services, financial services and consultancy services (Price, 1997; Shane and Woo, 1998). Hence, research, data collection and measurement are more extensive and advanced in the US than in other countries (Hoy *et al.*, 2000; Stanworth, 1995).

A report for the Small Business Administration (Trutko *et al.*, 1993) represents the most comprehensive and authoritative survey of franchising activity in the US, and data from the report have been much-quoted subsequently

[2] Some statistical sources do not, for example, distinguish between product franchising and

(e.g. Falbe and Dandridge, 1994; Hoy, 1996; Hoy *et al.*, 2000; Price, 1997; Stanworth, 1994; 1995). The report detailed the growth of franchising activity in the US economy between 1975-1990 in terms of the number of franchisors, units established, franchise sales and employment created.

The number of franchisors in the US more than doubled between 1975-1988.[3] In 1975, 1,115 business format franchises were in existence, but by 1988, this figure had risen to 2,239 (100.8% increase over the period). Although comparative data are not available, it is estimated that approximately 200 product franchisors were in operation in 1988. It is, however, possible to update the analysis of this report by using the figures in Table 1.1 (Swartz, 1995). It was estimated that there were 3,000 franchisors in operation in the US in 1995 (an increase of 169% over the twenty year period). It was estimated in 1995 that there were approximately 250,000 franchisees operating in the US (Swartz, 1995).

There was a net increase of 5,800 franchise units established per year since 1975 and over the 15 year period, the number of total units established was 86,677. However, these figures *"mask one of the most important developments in franchising"* (Trutko *et al.*, 1993, p2): the number of product franchise units declined significantly from 1975 to 1990. Product franchises accounted for approximately 52% of all franchises established in 1975, but by 1990, this figure had fallen to one quarter. However, the number of business format franchise units increased significantly over the 15 year period. In 1975, business format franchise units totalled 210,814, but in 1990, the number of units had reached 386,118 (a percentage increase of 83.2%). Whilst on average 11,700 business format franchise units were established annually over the fifteen year period, there was an average annual loss of 5,900 product franchise units between 1975-1990 (see Table 1.3).

business format franchising activity.

[3] Figures for 1989 and 1990 were not included in this analysis, as the analysis was based on data used from the surveys of the US Department of Commerce, which ceased in 1988.

Table 1.3 Key Developments of US Franchising 1975-1990

Number of franchisors	*1975*	*1988*	*1995[a]*	*%Change 1975-1990*
Product Franchisors	/	200	/	/
Business Format Franchisors	1,115	2,239	3,000	169%↑
Number of franchisees			*1995[a]*	
(Product and Business Format)			250,000	
Number of Units	*1975*	*1990*	*Total Change 1975-1990*	*% Change 1975-1990*
Total Franchising	434,538	521,215	86,677	19.9%↑
Product Franchising	223,724	135,097	86,627	39.6%↓
Business Format Franchising	210,874	386,118	175,304	83.2%↑
Franchise Sales	*1975*	*1990*	*Total Change 1975-1990*	*%Change 1975-1990*
Total Sales	US$185.8bn	US$714.5bn	US$528.7bn↑	294.6%↑
Inflation-adjusted	/	/	/	58.5%↑
Product Franchising Sales	US$144.9bn	US$500.7bn	US$355.8bn↑	245.5%↑
Inflation-adjusted	/	/	/	42.2%↑
Business Format Sales	US$40.9bn	US$213.8bn	US$172.9bn	422.7%↑
Inflation-adjusted	/	/	/	115.5%↑
Number Employed in Franchising Activity	*1975*	*1988*	*Total Change 1975-1990*	*% Change 1975-1990*
Total Franchising	3.57m	7.02m	3.45m	96.6%↑
Product Franchising	1.50m	1.77m	0.27m	17.7%↑
Business Format Franchising	2.07m	5.25m	3.18m	161.5%↑

SOURCES: Trutko, J., Trutko, J., Kostecka, A., (1993) *'Franchising's Growing Role in the US Economy, 1975-2000'*. Report submitted to The Office of Chief Counsel for Advocacy, US Small Business Administration. [a]Swartz, L. N., (1995) *'Worldwide Franchising Statistics: A Study of Worldwide Franchise Associations'*, Arthur Andersen (in co-operation with the World Franchising Council).

Sectoral trends also reflect the growth of business format franchise units that were established and the decline of product franchise units over the 15 year period. All types of product/tradename franchising experienced decline in unit establishment (e.g. gasoline service stations decreased from 43.6% of all franchise units in 1975 to 20.6% in 1990). However, business format franchise sectors experienced considerable growth in the number of units established (for examples see Table 1.4).

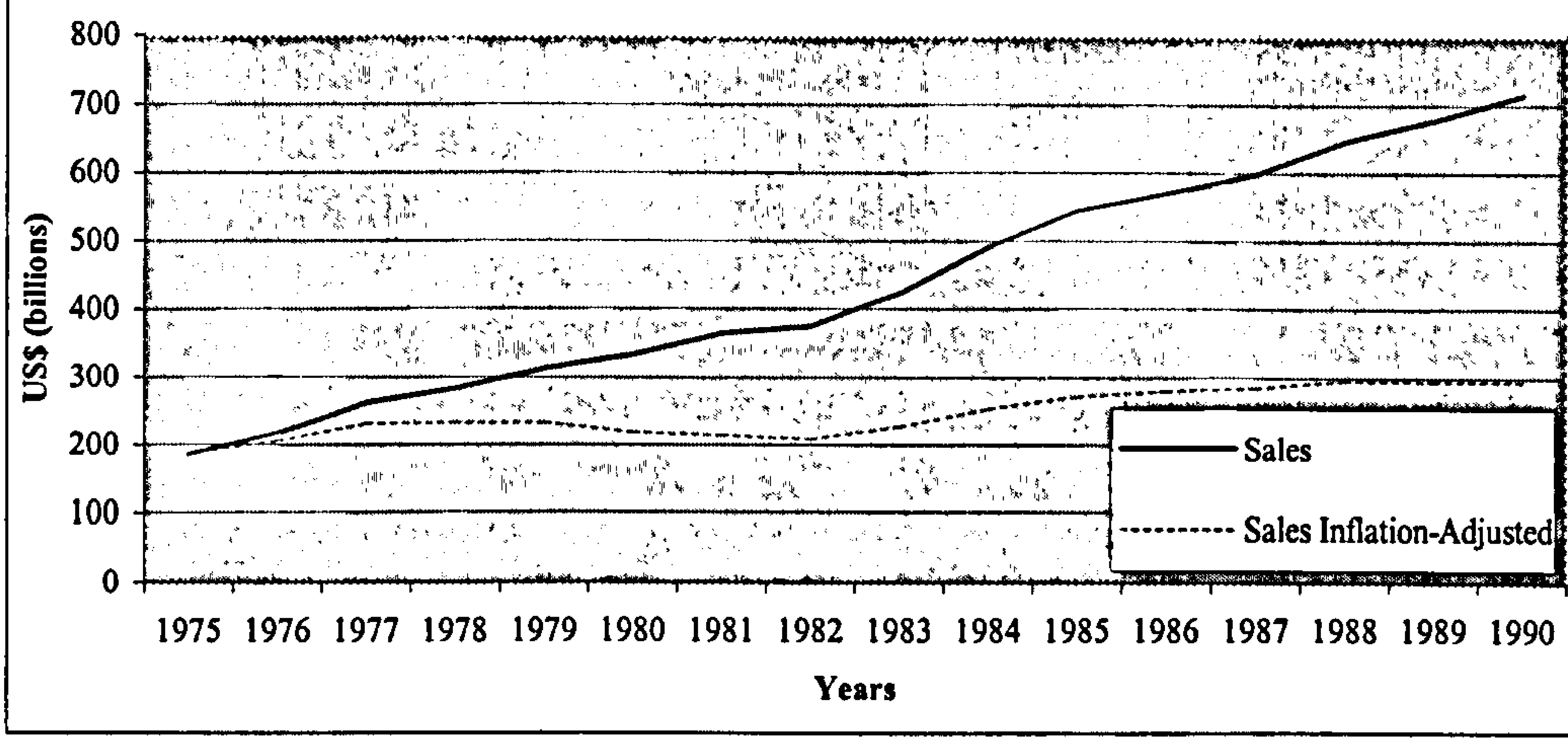
Table 1.4 Business Format Franchise Sector Growth in the US, 1975-1990: Selected Services

Sector	*1975 units*	*1990 units*	*% increase 1975-90*
Restaurants	42,983	99,340	131%
Educational services	1,304	12,539	862%
Recreation/ Entertainment/Travel	3,410	10,887	219%
Construction/ Home improvement	10,821	27,415	153%
Business aids/services	22,159	64,407	191%
- printing/copying	1,141	6,845	500%
- employment services	2,721	7,508	176%
- real estate	3,808	16,440	332%

SOURCE: Trutko, J., Trutko, J., Kostecka, A., (1993) '*Franchising's Growing Role in the US Economy, 1975-2000*'. Report submitted to The Office of Chief Counsel for Advocacy, US Small Business Administration.

Franchise sales have undergone substantial growth between 1975 and 1990. Annual sales grew from US$ 185.8 billion in 1975 to US$ 714. 5 billion in 1990, representing an increase of 294.6%, or annual growth rate of 9.4%. However, if adjusted for inflation, the increase in sales over the fifteen year period decreases to 58.5%, with an average annual growth rate of 3.1%. Whilst franchise growth has been substantial, it has not been as exceptional as the non-inflation statistics suggest (Figure 1.2). Expansion and contraction of franchise growth in the US has also followed general economic trends. Between 1975-1989, GNP in the US grew by 52.7% (in real terms) against a comparable growth in franchise sales of 58.5%. The decline in franchise sales (in real terms) between 1979-1982 closely reflected the wider economic situation of recession. During the mid-1980s, as the US economy recovered, franchise sales reflected the upturn, before declining during the subsequent downturn towards the end of the 1980s (Trutko *et al.*, 1993). Thus, franchising activity does not operate in a vacuum, but reflects economy-wide trends.

Figure 1.2 US Franchise Sales, 1975-1990



SOURCE: Trutko, J., Trutko, J., Kostecka, A., (1993) 'Franchising's Growing Role in the US Economy, 1975-2000'. Report submitted to The Office of Chief Counsel for Advocacy, US Small Business Administration.

The growth of franchising is also reflected in the substantial increase, between 1975 and 1990, of the proportion of sales accounted for by franchise activity in the share of total retail sales in the US. In 1975, retail sales by franchise firms totalled US$ 166 billion (28% of total retail sales), but in 1990, this figure had risen to US$ 615 billion (34% of total retail sales). Whilst product/tradename franchising accounted for two-thirds of franchise sales, this masks the significant growth of business format franchise sales. Product franchising sales increased from US$ 144.9 billion in 1975 to US$ 500.7 billion in 1990, (245.5%). Business format franchise sales rose over the same period from US$ 40.9 billion to US$ 213.8 billion, an increase of 422.7%. Once these figures are inflation adjusted, product franchising grew by only 42.2% between 1975-1990, whereas business format franchising grew by 115.5%, or around 5.1%, (in real terms, per annum). Thus, business format franchising activity grew at a much faster rate than product franchising (see Table 1.3).

The number of people employed in franchising activity in the US doubled between 1975-1988. In 1975, 3.5 million people were employed in franchising activity, either directly of indirectly. By 1988, this figure had increased to 7 million people. However, 90% of the employment growth within franchising activity resulted from the expansion of business format franchising. In 1975, 2.07 million people were employed in business format franchising, but in 1988, the number had increased to 5.25 million people, an increase of 161.5%. In comparison, the number of people employed in 1975 in product franchising was 1.50 million people, but by 1988, this had increased to only 1.77 million people (17.7% increase). By 1988, three times as many people were employed in business format franchising as were in product franchising (see Table 1.3).

1.2.2 Europe

Only limited data are available investigating the extent, growth and development of franchising in Europe. One of the few sources of this information is the European Franchise Federation (EFF), which produces *ad hoc* surveys outlining the number of franchisors, franchise units, annual turnover and the number of people employed in franchise activity (the most recent survey was conducted in 1997; Table 1.5[4]). EFF data reveals that France, Germany, Italy, the Netherlands and the UK have the most extensive franchise markets in terms of numbers of franchisors, franchise units, as well as employment and turnover, reflecting the size and population of these countries. Some of the smaller European countries (e.g. Austria, Belgium and Denmark) have less extensive franchise markets (Table 1.5).

Although there is a dearth of research surveying franchise activity in Europe, there is an exception: the UK. According to Stanworth, (1995, p3)

> *"possibly the most comprehensive source of national statistics in Europe is that assembled annually for the UK by the British Franchise Association (BFA) and the Franchise Section of the National Westminster (NatWest) Bank Plc."*[5]

[4] Stanworth (1995) criticises that this information is based on uncorroborated estimates reported to the E.F.F. by national franchise associations. This data could therefore be viewed with a certain amount of scepticism, as franchise associations will have a vested interest in promoting a positive picture of franchising activity in their respective countries. However, as research and data collection are still in infancy, there is little or no other data available, and this information at least provides a starting point on which further research can be conducted, in order to gain an accurate picture of franchise activity in Europe.

[5] However, it needs to be reiterated that the bodies producing these statistics also have a vested interest in presenting and promoting a positive image of franchise growth and activity in the UK.

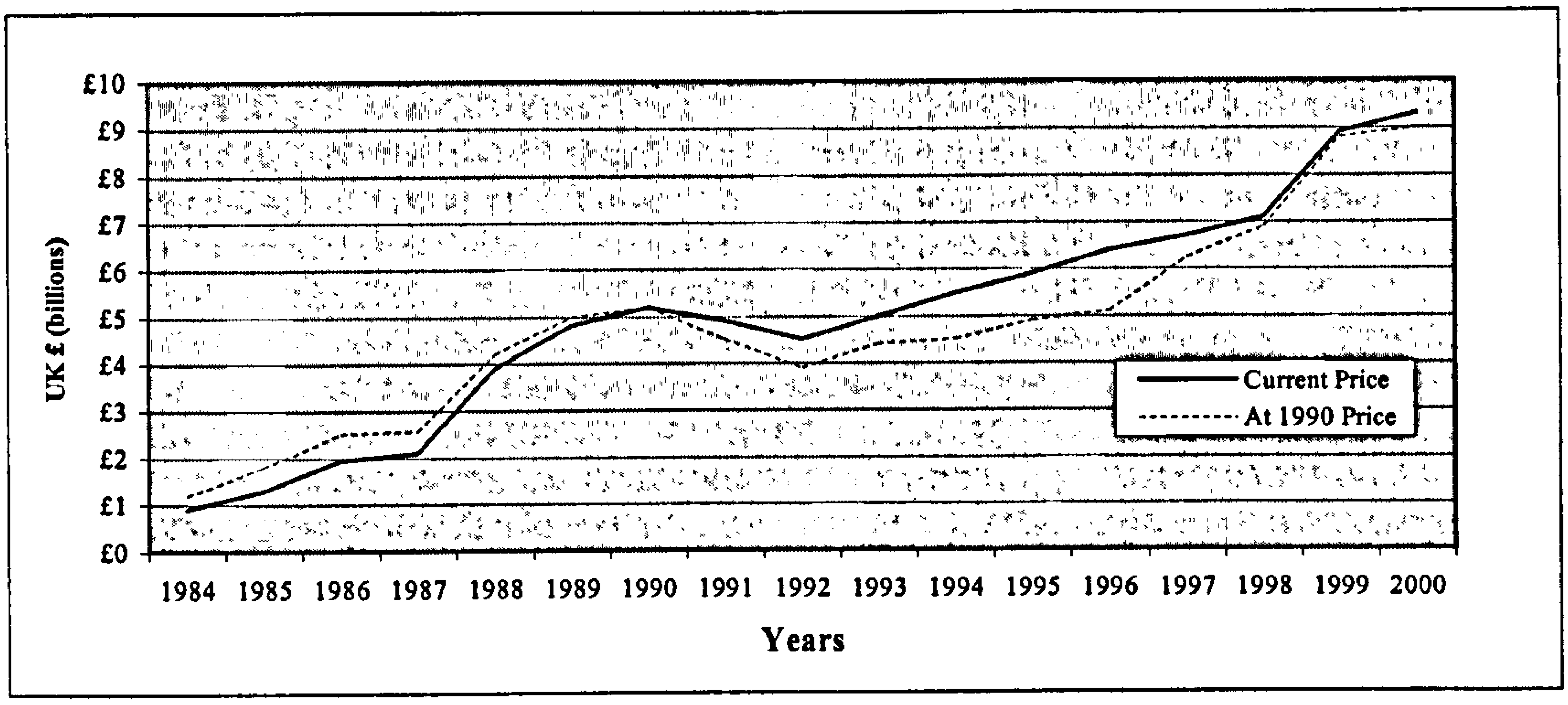
Table 1.5 Franchise Activity in Europe

Country	*No. of Franchisors*	*No. of Franchise Units*	*Annual Turnover*	*Total Employment*
Austria	*210*	*3,000*	/	*40,000*
Belgium	*170*	*3,500*	*2.4bn ECU*[a]	*28,000*
Denmark	*98*	*2,000*	/	*40,000*
Finland[b]	*70*	*2,000*	*6.1bn FM*	*15,000*
France	*470*	*25,000*	*9.2bn ECU*	*355,000*
Germany	*530*	*22,000*	*14.6bn ECU*	*230,000*
Italy	*436*	*21,390*	*12.0bn ECU*	*49,658*
Netherlands	*345*	*11,910*	*9.2bn ECU*	*100,000*
Norway	*185*	*3,500*	/	/
Portugal	*220*	*2,000*	*1.0bn ECU*	*35,000*
Spain	*288*	*13,161*	*6.8bn ECU*	*69,000*
Switzerland	*170*	/	/	/
Sweden	*230*	*9,150*	*5.7bn ECU*	*71,000*
United Kingdom[c]	*665*	*24,000*	*8.9bn ECU*	*273,800*

SOURCES: European Franchise Survey, (August, 1997) European Franchise Federation
[a]*1 ECU = US$ 1.11 as at 29.12.97*
[b]*Koiranen, M., Kimmo, H., Tuunanen, H. and Laakso, H. (1997) 'Finnish franchisees' entrepreneurial satisfaction: some preliminary considerations', Franchising Research: An International Journal, 2, 2,pp95-102.*
[c]*BFA/NatWest Annual Survey, 2001 (based on 2000 estimates)*
/ = Denotes no data available

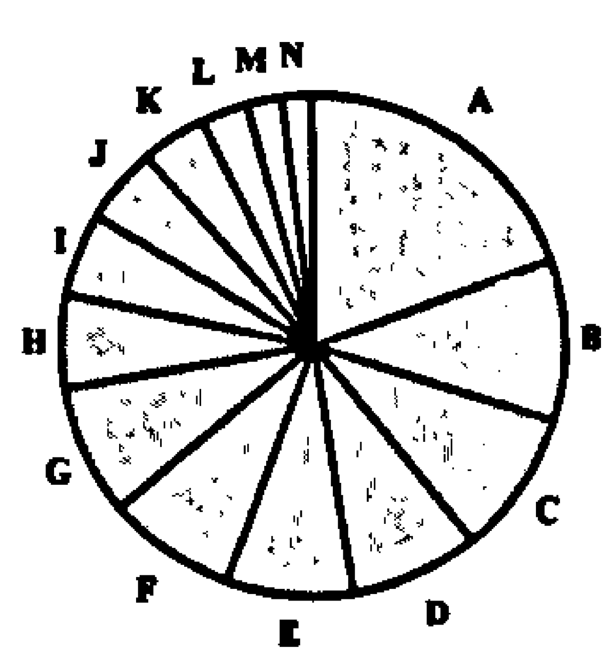
These surveys make it possible to analyse the growth of business format franchising in the UK since 1984. The NatWest/BFA annual surveys report that 170 franchisors were in operation in the UK in 1984, but by 2000, this figure had increased to 665. Employment rose from 60,000 in 1984, to approximately 316,000 in 2000. The total turnover of business format franchise activity rose from £0.9 billion in 1984, to £9.3 billion in 2000. However, if these figures are inflation adjusted business format franchising turnover decreases from £6.4 billion to £5.1 billion in 1996 (at 1990 prices; Figure 1.3). According to Stanworth *et al.,* (1998), the business service sector accounts for the greatest proportion of business format franchise activity (18%), followed by 'specialised' services (10%) and the fast food sector (9%; see Figure 1.4).

Figure 1.3 UK Franchise Sales (Total Outlets) 1984-2000



SOURCE: The NatWest/BFA Annual Surveys

Figure 1.4 UK Franchisor Sectoral Breakdown 1996



A	Business Services	18%
B	Specialised	10%
C	Food Franchising	9%
D	Home Care Services	8%
E	Motorist Services	8%
F	Property Services	8%
G	Walk-in Retail	9%
H	Distribution Services	6%
I	Cleaning Services	5%
J	Health and Beauty	5%
K	Estate Services	4%
L	Leisure/Travel	3%
M	Delivery/Haulage	2%
N	Fast Print	2%

SOURCE: Lloyds Bank/IFRC (1998)

1.2.3 Australia

The most comprehensive survey of franchising in Australia was conducted by the Australian Bureau of Statistics (ABS) in 1994.[6] The survey

[6] The ABS survey and an earlier survey by the Bureau for Industry and Economy (BIE) conducted in 1990 (Papadopoulos and Smith, 1990) are in fact the only nation wide surveys that have investigated franchising in Australia. However, it is not possible to compare data from the BIE survey with the ABS survey to ascertain the extent of business format franchising growth, because different measurement categories were used in the two surveys. For example, the BIE study only surveyed business format franchising activity, whereas the ABS survey included both product and business format franchising activity. Also, in the BIE survey, the total number of

found that there were 555 franchisors and 30,600 franchise units operating in 1994.[7] Total systems turnover was A$ 42.7 billion for the 1993/4 financial year and franchising activity was estimated to account for 10% of GDP (Hing, 1995). Almost half of the franchise systems in Australia were in the retail sector (49.2%) with property and business services accounting for 17.1%. Employment figures and trends were not calculated.

A more recent survey, conducted in 1998 estimates that there are approximately 700-800 franchisors and over 40,000 franchise units operating in Australia (McCosker, 1998).[8] According to McCosker (1998), international expansion by US franchisors has been the catalyst for the development of franchising in Australia and in the 1960s and 1970s, fast food firms, such as KFC, Pizza Hut and McDonalds's began to establish units in Australia. Initially, franchising had a poor reputation among the Australian business population as a form of organisation because of high failure rates of some systems and units, which resulted largely from a lack of expertise and knowledge of the strategy at that time. However, by the 1980s there was rapid growth of franchise activity, in both the domestic and international markets (Papadopoulos and Smith, 1990; McCosker, 1998), although the ABS survey found that only 13% of franchise systems in Australia in 1994 were imported (the majority of which were from the US). The remaining 87% of franchise systems were Australian in origin.

The BIE survey (1990) also provided a comparative analysis of US franchise systems with Australian franchise systems. Australian franchise systems tended to be much smaller than US systems, with approximately half the number of outlets (Australia had 671 outlets per million population while the US had 1456 outlets per million population between 1986-1988). However, on a per

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franchise units were not calculated and total system turnover was measured as a percentage, and not in absolute figures. Again, this illustrates the lack of accurate and consistent data collection and measurement.

[7] However, the survey did not distinguish between product/tradename franchising and business format franchising. Although according to Frazer and McCosker (1996), the number of product franchisors is low (e.g. oil companies), the corresponding numbers of franchisees could be high, and so the figure of 30,600 franchise units includes both product and business format franchise units.

[8] The 1994 ABS figures are widely viewed as conservative estimates (Frazer and McCosker, 1996; McCosker, 1998).

capita basis, there were more franchisors in Australia than in the US. Average sales per system outlet in the US are also significantly higher than in Australia (A$ 751.0 million compared to A$ 505.3 million respectively; Papadopoulos and Phillips, 1990). Demographic and geographic differences are the main causes underlying the differences in US and Australian franchising activity, as well as the relative infancy of franchising activity in Australia (Frazer and McCosker, 1996; McCosker and Walker, 1992; Papadopoulos and Phillips, 1990; Walker, 1989).

1.2.4 Franchise Markets in Developing Countries

Franchise activity has also developed in South and Central America, Central and Eastern Europe, South African markets and South East Asia, although the extent and scale of development is variable.

South and Central America

Franchise activity in South America varies from country to country. Brazil and Mexico have the most extensive franchise markets (with 932 franchisors and 60,000 franchisees and 375 franchisors and 19,000 franchisees respectively in 1995). Franchising activity is less extensive in Argentina, Columbia and Chile (see Table 1.6). Little research has been conducted into the development of franchising in South America. However, according to Stanworth *et al.,* (1995), Brazil's extensive franchise market is as a result of direct penetration by US franchise systems. Although US franchise operations account for less than 15% of the total franchise systems in Brazil, they are the strongest brand names and have the largest franchise networks. Proximity to the US and increasing cultural assimilation between the two countries has fostered the rapid growth of franchising in Brazil. The domestic franchise systems in operation have embraced niche markets as diverse as ethnic foods, dental clinics, construction products, cosmetics, play centres, language schools and car rentals (Josias and McIntyre, 1995).

Central and Eastern Europe

According to Pavlin (1996) there has been rapid growth of franchising in Central Europe. Although during the 1980s and 1990s, some Central European countries were going through 'transitional' periods in their economies (i.e. an intensive process of privatisation and economic restructuring) as well as extensive political changes, franchise activity developed in places such as Hungary, the Czech Republic, Poland, Slovakia and Slovenia. The development of franchising has been most prevalent in Hungary (with 200 franchisors and 1,500 franchisees) followed by the Czech Republic (40 franchisors and 80 franchisees) and Slovenia (31 franchisors and 140 franchisees; see Table 1.6).[9] The development of franchising activity in these countries has been mainly due to the establishment of US franchise systems, either through direct penetration or through European master franchisees of US franchisors. Neighbouring European countries (e.g. Austria, Italy and Germany) have also penetrated Central European markets and set up franchise units in these countries. The type of franchise systems that have been established include a wide range of activities from car rental, hotels, soft drink production and bottling, restaurants, fast food outlets and cosmetic shops. However, more recently, domestic franchise systems have developed and emerged in sectors such as retail clothing, footwear, computer and business services and copy shops. Pavlin (1996) argues that by fostering government and technical support, franchising could be used as one of the most important economic development tools in central European markets.

South Africa

Franchising in South Africa has expanded rapidly since 1980. The number of franchises established doubled between 1980-1985. The number of new franchises established between 1986-1990 increased by 37%, and 33% between 1990-1994. The most current estimates calculate that there were approximately 170 franchise systems and 6,200 outlets operating in South Africa in 1994. The total turnover generated by franchise activity (excluding petroleum retail outlets) totalled 9,278 Rand in 1994. The majority of franchise systems are domestic in origin (77%) operating mainly in the speciality retail, automotive products and services and fast food sectors of activity. Changes in the political situation in 1994, and the subsequent improvement to the South African

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[9] No data were available for Poland and Slovakia. However, Pavlin (1996) notes that four of the five countries (except Slovenia) have established franchise associations, which others have noted

economy brought by these changes, as well as a favourable regulatory environment for franchising, has opened up the South African market to international franchise opportunities. For example, McDonalds opened its first two outlets by the end of 1995. South African franchise systems have also taken the opportunity created by the political dispensation, to expand internationally (Scholtz, 1997).

South East Asia

Until the mid-1980s, few, if any, foreign or home-based franchise systems were established in Indonesia, (mostly because of stringent foreign investment laws; Stanworth *et al.*, 1995). However, these regulations have been relaxed and, whilst all foreign investments must still receive official approval, in the late 1990s there are approximately 260 franchise systems and 2,000 units in operation (Table 1.6). Imported franchises have had a useful 'role model' effect by encouraging local entrepreneurs to establish their own franchise systems. According to Chan and Justis (1995), there are approximately 100 different locally-based franchise registered companies operating in service activities such as restaurants, retail, hair/beauty salons, real estate and hotels.

Franchising development has also been growing in Malaysia since the late 1980s and early 1990s (McCosker, 1998). Approximately 200 franchise systems are established, which operate around 2,500 units. Although over half of these franchise systems are foreign-based franchisors, the proportion of domestic operators in increasing. The growth of Malaysian franchising has been fostered by government funding, support and assistance, with for example, the establishment of the Franchise Development Division (FDD) in 1992 (which is now part of the Ministry of Entrepreneur Development).

Franchising activity has also developed in Singapore. Over 200 franchise systems are reported to be operating, with 1,600 units established (McCosker, 1998). Approximately 50-60 franchise systems are domestic operations, which represents a significant increase from only 2 local franchise operations known to

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(e.g. Preble, 1995) that to warrant the formation of a trade association, a country must have a sufficiently developed franchise sector.

be in existence in 1984 (Goh and Lee, 1996). It is estimated that franchise sales in Singapore amount to US$ 2 billion (or approximately 5% of GNP).[10] Domestic franchise systems contribute approximately 15% of the 5% GNP, with the remainder contributed by foreign franchisors. Government assistance and funding (e.g. through the Economic Group Service Centre (EGSC) and Management Group Assistance (MEGA) have helped to foster the growth and development of franchising in Singapore (McCosker, 1998).

Table 1.6 Franchising Activity in Developing Markets

Country	*No. of Franchisors*	*No. of Franchise Units*	*Annual Total Turnover*	*Employment*
[a]*Brazil*	*932*	*60,000*	/	/
[a]*Mexico*	*375*	*18,724*	/	/
[a]*Argentina*	*100*	*3,500*	/	/
[a]*Columbia*	*48*	*300*	/	/
[a]*Chile*	*45*	*25*	/	/
[b]*Hungary*	*200*	*1500*	/	/
[b]*Czech Republic*	*40*	*200*	/	/
[b]*Slovenia*	*31*	*140*	/	/
[b]*Poland*	/	/	/	/
[b]*Slovakia*	/	/	/	/
[c]*South Africa*	*174*	*6,200*	*9,278bn Rand*	/
[d]*Indonesia*	*264*	*2,000*	/	/
[d]*Malaysia*	*202*	*2,500*	/	/
[d]*Singapore*	*200*	*1,600*	/	/
[a]*Hong Kong*	*84*	/	/	/
[a]*Philippines*	*56*	*61*	/	/

[a]*SOURCE: Swartz, L. N, (1995) 'Worldwide Franchising Statistics: A Study of Worldwide Franchise Associations', Arthur Andersen (in co-operation with the World Franchising Council).*
[b]*SOURCE: Pavlin, I (1996) 'Franchising development in Central European countries' Franchising Research: An International Journal, 1, 1, pp33-40.*
[c]*SOURCE: Scholtz, G. L, (1997) 'An overview of South African franchising', Franchising Research: An International Journal, 2, 4, pp145-151.*
[d]*SOURCE: McCosker, C (1998) 'Franchising into Australia and South East Asia' Seminar presented at the Fifth Annual Strategy Seminar, International Franchise Research Centre, 3rd July 1998, London.*
/ = Denotes no data available

[10] This figure includes both product and business format franchising operations.

1.3 Explaining the Growth of Franchise Activity

1.3.1 Introduction

Having outlined the significant growth and economic importance of business format franchise activity on an international scale, the remainder of this chapter attempts to account for the growth of the franchised business form. A number of factors within the wider context of economic, social, cultural and political change, which has occurred since the post-war period, have created opportunities for and promoted the growth of the franchised business form. The five main factors that have facilitated the growth of business format franchising activity are the increased economic significance of services activity, consumption changes, corporate restructuring, internationalisation and globalisation of economic activity and small firm growth. Each will be discussed in turn. However, it is important to recognise the growth of the franchised business form cannot be attributed to any one single factor, rather it has occurred as a result of several factors working in simultaneous combination.

1.3.2 Growth of the Service Sector

The shift in industrial structure of most industrialised countries, away from economies based on manufacturing and mass production and towards service activities, has been one of the most important factors promoting the growth of the franchised business form (Curran and Stanworth, 1998; Felstead, 1991; Hoy *et al.*, 2000). Most business format franchise operations are concentrated in the service sector (Table 1.7).

The service sector has increasingly dominated employment in most advanced industrial economies (Marshall and Wood, 1995). In 1990, service industries accounted for 62 per cent of employment in the OECD, 61 per cent in the EC, 71 per cent in the US and 69 per cent in the UK. Between 1970-1990, service sector employment grew by 89.4 million (OECD, 1992). Whilst service employment has grown, manufacturing employment has decreased in significance (Ball *et al.*, 1989; Cooke, 1988). Indeed, in the UK, manufacturing employment has declined by more than 3 million since the 1960s (Marshall and

Wood, 1995). In the UK in 1999, approximately 18 million people were employed in service industries compared with 4 million people employed in manufacturing production (Labour Market Force Survey, 1999).

As the growth of the service sector has been so fundamental, some have argued that this structural change signifies the end of industrialism and the advent of a 'post-industrial' society in which services and knowledge-based activities assume predominance (see for example, Bell 1973; 1980). Others argue that technical innovations in the post-war period have resulted in a range of new products (e.g. cars, washing machines, TVs, videos, computers), which have made it easier for individuals to service themselves by owning and using material commodities (Gershuny, 1978). There is not, therefore, a formal service economy as Bell has suggests, but rather a 'self-service' economy, where individuals service themselves by substituting goods for services (highlighting the relationship between the manufacturing sector and service sector, e.g. cars replace public transport and washing machines replace laundry services). Growth in service sector employment has occurred because service workers not only provide services to consumers they also contribute to the production of material commodities. For example, 'white collar' (e.g. managers, technicians) service workers' labour is needed to increase the efficiency of manufacturing production. Growth in 'intermediate' consumer services (e.g. TV repair services, garage services and DIY stores) helps individuals and households to continue servicing themselves (Allen, 1988; Gershuny, 1978; Gershuny and Miles, 1983; Daniels, 1993; Marshall and Woods, 1995).

However, both perspectives have been criticised. The post-industrial argument does not take a long-term historical perspective (as it only deals with economic developments post-1945). The perspective fails to consider ways in which capitalism has shaped and reshaped the economy to satisfy profitability throughout history. The self-service economy perspective has been criticised as too technologically deterministic (Allen, 1988; Marshall and Wood, 1995). Neither theory explains the growth of services from the wider economic processes underlying structural change. Hence, the third theory from a institutionalist perspective explains the growth of service activity from the wider economic restructuring that has occurred in contemporary industrialised societies: the shift from Fordism (or 'organised capitalism') to Post-Fordism (or 'disorganised capitalism').

From the early twentieth century to around the 1970s, the dominant economic form in industrialised economies was 'Fordism'. The Fordist period was an era of intensive accumulation, characterised by mass production (organised around manufacturing assembly lines and standardised work routines) of homogenous, standardised goods for mass consumption, and the commodification of social life (Allen and Massey, 1988; Gibbs, 1992; McDowell, 1991). However, it has been argued that from the 1970s onwards, a combination of internal and external factors ultimately destabilised and led to a crisis in the Fordist Regime of accumulation. Inherent rigidities and inflexibility in the production process, along with market saturation, rising real wages and increased labour militancy led to falling rates of profitability, resulting in 'stagflation' - a combination of stagnant output of goods coupled with rapid inflation in prices (Harvey, 1990; Tickell and Peck, 1992). The break-up of the mass market/Fordism also resulted from major changes in consumption patterns. Less value was placed on mass individual and collective consumption and more on differentiated production and distribution. With stagnating demands for standardised goods, consumers increasingly demanded specialised, distinctive and high quality goods, leading to differentiated, fragmented and niche markets of consumption. Demand also shifted from the consumption of goods and into the consumption of services, in markets such as leisure, recreation, health and education for example, as mass commodity markets declined.

Internal problems of the Fordist regime were also exacerbated by external factors. The early 1970s OPEC oil crises (and subsequent soaring oil prices) increased the inflationary pressures experienced by western economies (Hirst and Thompson, 1996). The increasingly international scale of manufacturing production equated to greater competition (especially from newly industrialising economies - NICs) for industrialised economies. Manufactured products from

NICs succeeded in penetrating and eroding western supremacy of some low cost commodity markets, through cheaper labour and material costs.[11]

Rigidities in the production process, competitive pressures, changing consumer patterns resulting in the break up of the mass market and mass production ultimately led to the collapse of Fordism and the emergence of a new era of Post-Fordism to renew capitalist growth in industrialised economies. The new regime therefore instigated restructuring and reorganisation at the firm level. However, firms' restructuring responses take different forms according to theoretical orientation.

From a Marxist perspective, as manufacturing activity represented falling profitability, one way for capitalist enterprises to maintain the value of their investments was to divert excess capital into service industries and into activities such as wholesale and retail outlets, hotels, rental services and leisure centres. Firms increasingly had to restructure their activities in order to trade within competitive and differentiated markets and, consequently, diversification occurred as large, transnational corporations (such as BAT) entered the service sector and spread their investment across a range of products and services to minimise the risks of specialised investments (Allen, 1988; Mandel, 1975).

From an institutionalist perspective, in an environment of increased economic uncertainty, responses at the firm level were to move towards greater flexibility in the organisation of production (aided by new technological developments), the utilisation of labour and the organisation of relationships with other firms. It has been argued that post-Fordist business organisation involves a high degree of production flexibility, more decentralised and less bureaucratic management structures, more flexible working practices, higher skill densities in the workforce, increased inter-firm collaboration and substantial dependence on

[11] However, some manufacturing production in NICs has occurred because transnational corporations (TNCs) from industrialised countries have located operations in markets such as South East Asia, and utilised cheaper, international labour markets. For example, in 1988, Hong Kong, Singapore, South Korea, Taiwan, Malaysia and Thailand accounted for 82% of the total US manufacturing investment in the Far East. Thus, four fifths of US manufacturing investments were in six East and South East Asian NICs (Dicken, 1992). Corporations and capital have been

networks of suppliers (Aglietta, 1979; Atkinson, 1984; Cooke, 1992; Gertler, 1992; Hayter, 1997; Piore and Sable, 1984; Shutt and Whittington, 1987). However, the extent to which there has been a shift from 'Fordism' to 'post-Fordism' remains disputed. Critics point out that binary categorisations are too generalised and often idealised, stylised versions of Fordism/post-Fordism are recounted. Others argue that if a broader international perspective is taken, then mass production has not simply disappeared but is still crucial to many economies, despite organisational changes. Others observe that it is also possible for different structural forms to be in simultaneous existence (Beynon, 1992; Gertler, 1992; Martin, 1994; Sayer, 1989; Sayer and Walker, 1992; Scott, 1988).

However the growth of services is theorised, the development of service activity has necessitated different organisational forms and arrangements, such as the franchised business form. Compared to manufacturing production, which can be organised around large plants remote from the market, most types of service activity are consumed at the point of consumption. Therefore, central to many service activities is the customer-organisation' interface, which is served most adequately by a large number of small, geographically dispersed units meeting customer requirements at the local market level:

> *"certain types of economic activity involve 'divergent scale economies'...in other words, the production of the good or service has widely differing economies of scale at different stages. Thus, the manufacture of motor cars is most economically carried out on a large scale but subsequent retailing is most efficiently conducted on the basis of relatively small-scale local outlets"* (Hoy *et al.*, 2000, p418).

A franchisor can regionally, nationally or internationally market the trademark/brand image of a standardised product or service, but servicing consumers with hamburgers, motel rooms, and car rental facilities is more efficiently achieved on a small localised scale, at the point of consumption (Caves and Murphy, 1976). Through franchising an operation, firms can achieve a large number of small geographically dispersed units, which are operated by franchisees at the local market level. By franchising, firms can also achieve *rapid* penetration of a market, as franchisees' financial resources are used in the

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able to become increasingly mobile through advances in technology, communication and transport.

expansion process. Although large-scale service enterprises could achieve a geographically dispersed local-level operation through corporately owned decentralised multi-units, such organisational arrangements often suffered problems of personnel motivation, supervision and quality control. Decentralised units run by employees with few managerial responsibilities may not have sufficient incentives to work efficiently to promote the interests of the owners of a firm. As a consequence, firms may have to employ costly procedures to monitor decentralised units (Shane, 1995). Thus, new ways of retaining control and new organisational structures were sought to counter such problems:

> *"corporations were forced to seek other means of retaining control over outlying operations or consider abandoning them altogether...one strategy for retaining control of difficult-to-manage outlets was franchising"* (Hoy *et al.,* 2000, p418).

By shifting responsibility onto legally and financially independent individual unit operators (i.e. franchisees rather than unit managers) it has been argued that unit operators' motivation increases, quality control improves and supervision lessens, as franchisees have a greater incentive (through financial and human investment) to ensure a unit runs effectively and successfully. Thus, a franchised-based structure can enable a firm to *"continue unencumbered by the bureaucratic and infrastructural problems of a fully integrated operation"* (Hoy *et al.*, 2000, p418).

The growth of franchising can also be linked to two factors, which were highlighted in the preceding discussion – consumption changes and corporate restructuring. Economic and social structural change has created opportunities for new small and medium sized firms, including the franchised variety, to fill market niches and such firms have emerged to meet the demands of changing consumer patterns and corporate restructuring strategies, as will be examined in the following section.

1.3.3 Consumption and Societal Changes and Franchising Opportunities

Relatively high wages, increasing affluence, reduced working hours and more leisure time for the majority of the population and the growth of new forms of credit have led to an increase in consumerism in the post-war period (Gardner and Shepard, 1989; Gibbs, 1992; Hamnett *et al.*, 1988; McDowell, 1988; 1991; Marshall and Wood, 1995). Consumption expenditure on both goods and services in the UK alone, has risen from approximately £170 million in 1955 to approximately £500 million in 1998 (The Labour Market Force Survey Supplement, 1999). The culmination of the Fordist economic era in the 1950s and 1960s witnessed the full emergence of mass consumption, a period of:

> *"mass striving to acquire a range of goods - cars, refrigerators, TVs etc. - which were socially defined as necessary to achieving a good standard of living"* (Curran, 1997, p16).

However, as basic needs for durable goods were increasingly satisfied, new needs and demands emerged for non-essential or luxury goods and services. Thus, in the 1980s and 1990s, it has been argued that fragmented consumption replaced mass consumption. As mass produced goods became the norm, consumption patterns became more diverse, complex and changeable, as individuals of different ages, genders, educational backgrounds strived to express their individuality by the kinds of goods and services they purchased (Gibbs, 1992). Some have argued that a 'retail culture' has emerged in society, as shopping has become a new leisure pursuit and consumption has become more symbolic than utilitarian through advertising and media exploitation. Consumption has become part of identity reflecting personality, self-image, social position, and attitude and aspirations (Bocock, 1993; Featherstone, 1991; Gardner and Shepard, 1989; Harvey, 1989; Lash and Urry, 1994).

One way consumers have expressed greater disposable incomes, individuality and differences in lifestyle is through the goods and services they consume. Personal expenditure on services such as, leisure, entertainment, restaurants, hotels, home maintenance, travel and tourism and sports and fitness for example, have all increased (Goffee and Scase, 1995). There has also been a trend for consumers to use services that are external to the home (Marshall and Wood, 1995). In the post-war period, women's role in society has changed significantly as women have increasingly participated in the labour market, and dual income households and working mothers have become the norm.[12] For such households the changes in lifestyle may have created a need for convenience and efficiency in routine domestic tasks. Thus, demand for 'bought in' services or services that are external to the home, such as domestic cleaning, child care facilities,[13] eating out and convenience foods have increased in significance (Gregson and Lowe, 1994; McDowell, 1991; Marshall and Woods, 1995). These developments have created opportunities for firms to fulfil such consumer demands and franchise operations are among the suppliers doing so (Preble, 1996; Price, 1997; Stanworth, 1996). For example, Molly Maid or Service Master can clean a busy working mother's house, and McDonald's or Pizza Hut are places to have a family meal out (Table 1.7).

1.3.4 Corporate Restructuring and Franchising Opportunities

Large firms have restructured and reorganised in response to increased macro-scale disorganisation and economic uncertainty at the national and international levels (Atkinson, 1984; 1985; Goffee and Scase, 1995; Keeble *et al.,* 1991; Piore and Sable, 1984). Large firms are now more fragmented and flexible in operation to meet the demands of rapidly changing and differentiated markets. Organisational structures are now flatter, decentralised and less hierarchical and organisations once operating across several functions have shrunk by focussing on areas of 'core' strength by spinning off, out-sourcing and sub-contracting some functions to other firms. For example, firms may buy in semi-finished components or buy in a range of services, such as personnel training and development, accountancy support, transport and distribution, catering, cleaning, security, maintenance and printing. By externalising operations previously conducted in-house, large organisations can minimise costs and maximise flexibility and focus more on the market and competition. The modern large-scale organisation may therefore be built around a network of inter-firm relationships. Thus, it has been argued that corporate out-sourcing

[12] For example, in the UK, in 1971, 56% of women were economically active, but by 1999, this figure had increased to 72% (Labour market Trends, 2000).

[13] Although, arguably, a resurgence of domestic services has occurred only in the 'new middle classes' (i.e. those centred around the professional, white-collar occupations) and through greater

strategies have created market opportunities for small and medium sized producer firms. Such firms can meet large firms' demands by delivering specialist goods and services more cheaply, with greater responsiveness and flexibility (Goffee and Scase, 1995). Large-firm out-sourcing strategies have, therefore, created opportunities for producer service franchise firms in areas such as industrial cleaning, distribution and recruitment. For example, firms such as Jani-King and ServiceMaster can fulfil firms' cleaning contracts, Amtrak and Interlink can meet firms' courier and distribution needs and Humana International and CNA Executive Search can help firms with recruitment procedures (Table 1.7).

Table 1.7 The Service Based Nature of Business Format Franchising Activity - Examples of Consumer Services and Producer Services

	Examples of Franchise Operations
Consumer Services	
Retail	*Alldays, The Body Shop, Benetton*
Hotels	*Holiday Inn, Quality Inn*
Fast Food	*McDonalds, KFC, Dunkin Donuts*
Health and Beauty	*Applewoods International, Nutri/System*
Vehicle Services	*Mr. Clutch, Avis, Hertz*
Property Services	*Century 21, Molly Maid, Dyno Rod*
Producer Services	
Distribution	*Interlink, City Link, TNT Express*
Professional/Business Services	*Pitman Training, CNA Executive Search*
Industrial and Commercial Services	*Kall Kwik, Prontaprint, Alphagraphics, Jani King, ServiceMaster, Dublecheck*

1.3.5 Internationalisation and Globalisation of Economic Activity

The increased significance of small-scale service activity and corporate restructuring, discussed in the preceding sections has not meant the end of the large-scale organisation, however. The post-war period also witnessed economic activity occurring on an international, and increasingly global, scale and such developments have facilitated and developed the franchised business form.

In a drive to sustain or increase profit, accumulate capital, and improve market positions (particularly if the domestic market is near saturation or

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affluence (Gardner and Shepard, 1989; Gregson and Lowe, 1994; Marshall and Wood, 1995).

saturated) firms have increasingly internationalised their activities. Thus, a new world economy has evolved which involves large, international/global manufacturing and service enterprises - the transnational corporation (TNCs) - organising and locating their corporate operations across several national borders. Through an increase in volume and variety of cross-border transactions in goods and services, and of international capital flows, a growing economic interdependence and integration of countries world-wide has occurred (Dicken, 1998). TNCs have been facilitated by favourable nation-states policies towards international inward investment and development. Technological changes (particularly the space-shrinking technologies of transport and communications) have also helped to make possible the internationalisation of economic activity and the development and spread of transnational corporations. However, such developments have intensified competition on a global scale.

Traditionally, firms exported their products to international markets through conventional arms-length transactions. However, by increasing the geographical scale of production and setting up production facilities and sales subsidiaries in other countries, firms can potentially achieve greater cost effectiveness and profitability, as well as a number of other benefits. First, a firm may be able to exploit a new or under-developed market, as well as protect and control a product/service more effectively through a direct presence in the market place rather than trying to do so at arms-length. Second, a firm may be able to take advantage of indigenous resources (e.g. cheaper labour and raw material sources). Third, a firm's distribution costs will be reduced because of closer proximity to the market. Fourth, a firm will have a greater ability to keep in touch more closely with local market conditions (e.g. changes in consumer tastes, competitors' actions). Fifth, a firm may be able to avoid government restrictions on market access (e.g. tariffs and quotas) and may be able to benefit from other 'country-specific advantages' such as the availability of government cash grants and subsidies for inward investment (Pass *et al.,* 1991). Sixth, as the intangible nature of service activity cannot be exported, setting up operations in another country enables a service firm to establish a market presence on an international

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However, firms have filled such market niches.

scale (Aydin and Kacker, 1990; Dicken, 1992; Dunning, 1980; Eroglu, 1992; Frobel *et al.*, 1980).

Thus, firms have increasingly engaged in foreign direct investment (FDI) and/or some form of network or collaborative relationship (e.g. strategic alliances, joint ventures, licensing, franchising) as a means of establishing a presence in an overseas market to sell their product/service. However, there are three main reasons why *franchising* is used as a strategy in the process of internationalisation. First, franchising is one strategy for international/global service firms to organise their operations at a local scale. Second, the global economy has also provided opportunities for domestic-based franchise operations to increase their scale of geographical operation. In some instances, international franchisors based in foreign markets have also encouraged growth of domestic franchise operations (Price, 1997). By franchising on an international scale, domestic-based franchise operations can utilise the 'competitive advantages' they posses over some indigenous firms and seek opportunities to exploit these advantages in overseas markets and realise greater profitability. However, both propositions do not explain why a franchising strategy is used rather than other methods (e.g. FDI, corporate ownership, joint ventures, strategic alliances, mergers and acquisitions) in the internationalisation process. Thus, a third explanation outlines, from the perspectives of risk management, resource and agency theories, the strategy specific advantages of the franchise method. The following discussion outlines the three reasons for using franchising in the process of internationalisation in more depth

First, the franchised business form is one strategy that global firms can use to organise their operations at a local scale. The globalisation of the economy produces specific organisational problems in linking international/global corporations effectively with local markets and individual consumers. As Hoy *et al.*, (2000) observe:

> *"articulating the global level with the national, regional and local levels poses considerable problems demanding new kinds of economic arrangements and business forms"* (Hoy *et al.*, 2000, p418).

According to Goffee and Scase (1995) the types of new business forms that will emerge to overcome such organisational problems, will comprise networks of small firms (operating at the local level) and large firms (operating at the global level). The franchised business form is one strategy for a large international/global service firm (either an existing franchise operation or a non-franchised operation) to organise their activities at the national, regional and local scales. It has already been argued that services are consumed at the point of consumption, and a large number of small, geographically dispersed units are needed at the local level to serve such markets. By franchising the local-scale units directly to individual operators or a master franchisee and sub-franchisees,[14] a large firm can establish a presence in a foreign market. Thus:

> *"there is a dynamic or contradiction within the emerging global economy that promotes large and small enterprises, including the franchised variety"* (Hoy *et al.*, 2000, p418)

Secondly, according to Dunning (1980; 1989) firms which expand and compete in international markets, must possess compensating competitive advantages or 'ownership specific advantages' which are not available to indigenous firms on the same terms. Ownership-specific advantages may be those:

> *"which an enterprise may create for itself (e.g. certain types of knowledge, organisation and human skills) or can purchase from other institutions, but over which, in so doing, it acquires some propriety right of use. Such ownership-specific assets may take the form of a legally protected right, or of a commercial monopoly, or they may arise from the size, diversity or technical characteristics of firms"* (Dunning, 1980, p9).

Competitive advantages may include size and market power. In general, the larger the firm, the better the position for gaining access to resources and finance. Other competitive advantages may include the possession of a patented process technology or a uniquely branded product by a firm, for example. It is such

[14] An international franchisor will franchise directly to franchisees in foreign countries or pursue a joint venture with another firm, resulting in the formation of a third firm owned by both partners to handle operations in a particular territory or country. However, the most common method of international franchising, used by the vast majority of franchisors, is the master franchisee approach. The master franchisee is responsible at a national/territory level for selling franchises to sub-franchisees, which normally operate at the regional/local level (Barrow *et al.*, 1999).

advantages, which enable firms that are international in origin, to compete with indigenous firms and develop market potential on a national/regional/local scale.

Domestic-based franchisors possess competitive advantages of a core product/service, the 'know-how' of operating the business and trademark/brand identity of the product/service. It is these three essential elements that constitute a business format franchise, and which are owned by the franchisor and legally protected through contractual mechanisms. It is such competitive advantages which may help compensate franchisors and franchisees and allow the operations to exploit market potential and out-compete indigenous firms. For example, a small convenience food operator would not be able to compete with a small business person that joined with a large internationally renowned fast food firm such as McDonald's or KFC, for example. The franchisee would also benefit from the franchisor's or master franchisee's assets and resources in the form of back-up and support, access to suppliers and advertising campaigns for example.[15]

Another advantage that a franchisee can benefit from is the established brand name of the franchise operation. If a franchisor can expand internationally, it will probably have sufficient resources and support to reinforce the brand image through product/service differentiation and mass advertising campaigns (although establishing a brand name may take time to develop). Caves (1971) emphasises the advantages a well-known brand name can have over a lesser-known competitor, especially in the consumer goods and service industries. Branding gives security to consumers buying a service when they cannot 'see the quality' (as in a product). For example, hiring a car at a foreign airport or eating out can leave the consumer with a choice. They can either choose a local firm where the quality, service and value for money are unknown, or a consumer can patronise a firm with an established reputation for quality and service (Barrow *et al.*, 1999).

[15] If a franchisor is going to expand internationally, evidence shows that, generally, the operation will be of a certain size and capability for such resources to be sufficiently developed (Hopkins, 1996; Huszagh *et al.*, 1992; Shane, 1996; Walker, 1989; Walker and Etzel, 1973). Chapter 2 and the 'international franchising section' (2.5) critically reviews the literature examining the

Therefore, competitive advantages within the context of an international market place have provided opportunities for domestic-based franchise firms to increase their scale of geographical operation. Whilst other countries have their own domestic franchise operations (discussed in Section 1.2) and such operations may also operate at an international scale, the major reason for the present day global scale of franchise activity is because of international expansion by US franchisors since the 1970s (Price, 1997; Stanworth, 1994; Hoy *et al.*, 2000). For example, in 1971 approximately 156 US franchisors were involved in international franchising, but by 1986 this number had increased to 354 and by 1990, approximately 400 US franchise systems were operating 37,600 units in over 160 countries (International Franchise Association, 1991). Price (1997) also argues that, in some instances, the increasingly international scale of US franchise operations has helped to encourage the growth of host country, domestic-based franchise operations, through raising the profile of the franchised business form. For example:

> *"the emergence of business format franchising in Britain is due, in part, to the entry of US-based franchisors, such as Wimpy and ServiceMaster. While instrumental at the early stages of growth, the continued expansion of business format franchising has also been facilitated by other market entries from the US"* (Price, 1997, p86).

Thus, international expansion by US franchisors has also facilitated the growth of domestic-franchise operations in countries as diverse as Australia, Indonesia, Brazil and Mexico for example (McCosker, 1998; Price, 1997; Stanworth et al., 1995).

Therefore, franchising is a strategy for firms to achieve international expansion. First, it is argued that by franchising, service firms can organise their operations and link the global/international level with the local level. Second, it is also argued that franchise firms operating at a domestic level may have a number of competitive advantages over some indigenous firms (in the form of a uniquely branded product/service, business know-how and franchisor support) and this is why some franchise operations may internationalise their activities.

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questions when, where and why domestic franchise firms decide to operate internationally and the 'capabilities' (i.e. size, management infrastructure) that are needed for international expansion.

However, other methods (such as FDI and corporate ownership) can also achieve the global-local relationship. In addition, the 'competitive advantages argument' does not explain why other firms which may possess different competitive advantages choose strategies other than franchising to achieve internationalisation. Also, both propositions do not explain why firms which operate a corporate structure in the domestic market, operate a franchise structure in international markets.

Therefore, although both reasons provide partial explanation for the growth and use of franchising as a strategy for achieving international expansion, neither perspective comprehensively explain why the franchised method is specifically used over other methods. Thus, a third explanation utilises risk management, resource constraints and agency theories to understand why firms may use a franchise strategy in the internationalisation process. Growth achieved through a franchise strategy can offer a number of advantages over other expansion methods. Franchising is one way for firms to manage the risks associated with internationalisation and it can enable a firm to have access to financial, human and local market knowledge resources of the franchisee as well as access to highly motivated unit operators (as franchisees have invested time, money and effort in their own unit).[16]

Risk management theory attempts to explain why firms use a franchising strategy on an international scale as opposed to other methods such as corporate ownership, FDI and mergers. This perspective argues that firms (either an existing franchise operation or non-franchise operation) are essentially risk averse and will use franchising as a means of managing that risk:

> *"this view suggests that [firms] will try to reduce their risk by using corporate ownership only in locations that are relatively more reliable and will tend to franchise in locations that may have higher risk due to factors such as geographic distance and cultural differences "* (Fladmoe-Lindquist, 1996, p422).

The risk management perspective is therefore implicit in theories of international franchising. Although a firm may be aware of a market opportunity, possess competitive advantages over some indigenous firms and be successful on a domestic scale, entering an unknown foreign market where success may not be achieved may represent significant risk for firms. Differences in culture, consumer behaviour, political and legislative systems may exist, and a firm may be unaware or unable to assess how such factors will affect their operation. Thus, firms may join with a third party to manage such risk, by forming a strategic alliance or joint venture with indigenous firms or by entering into a franchise relationship with indigenous firms.[17] However, three main advantages have been identified in the literature (Aydin and Kacker, 1990; Eroglu, 1992; Price, 1997), which may make franchising a more attractive internationalisation strategy compared to other methods.

The first advantage is that a firm will be able to 'test the waters' of a particular location or country without necessarily incurring the significant risk that can be associated with international expansion, as this risk will be transferred to a third party - the master franchisee. Master franchisees buy the rights to develop a country or territory from a franchisor or non-franchised firm, and therefore the onus of risk and ownership is placed with the master franchisee. It is the master franchisee who takes responsibility for developing a national network. Although there may be some initial input from a franchisor, the master franchisee will also be responsible for the marketing and advertising of the franchise operation, recruiting and training sub-franchisees and supporting and monitoring the network, for example.

A second advantage is that by using a franchising strategy on an international scale, a franchised or non-franchised firm can gain access to the resources of, not only the master franchisor, but the sub-franchisees also. If a firm lacks the financial capital to expand internationally, or does not want to invest their own capital in corporate international expansion, franchising is a method to utilise other financial resources (i.e. the financial capital of the master franchisee and sub-franchisees). If, for example, an international firm entered a

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[16] Chapter 2 explores the reasons why firms franchise in more depth.

[17] A franchisor or non-franchise firm can, of course, form a strategic alliance or joint venture with indigenous firms, who act as master franchisees and then expand through franchising (Hoy *et al.*, 2000). Examples of strategic alliances and franchise networks in the UK include Allied Domecq

joint venture with an indigenous firm which intended to expand through a corporate-owned structure, both firms in the partnership would need considerable resources (i.e. financial and human capital) to achieve expansion in a foreign market. However, one advantage with a franchising-based structure is that through utilising the financial and human capital of franchisees, a firm is able to achieve *rapid* penetration and growth at little financial cost to the franchisor. A further advantage for a potential international franchisor is gained as a result of the fact that the firm licenses the rights to franchisees to use the firm's proprietary assets, a format fee, as well as some form of royalty, will be generated. Of course, if a firm succeeded in setting up a corporate-owned structure, any profit that was generated would accrue directly to the firm and not via franchisees, as in a franchise-owned operation. However, it is argued that such firms would not be able to expand as rapidly if they operated a corporate structure and some firms would be risk averse to investing significantly in an unknown market. By using a franchise-based ownership structure in an international market the potential franchisor can gain instant access to market knowledge. Such market knowledge will be at two levels. Firstly, market knowledge will be available from the master franchisee at the national level (e.g. regarding the legal and political systems), and second, market knowledge will be from sub-franchisees at the local level (e.g. regarding consumer markets and level of competition). A corporate operation would generally not have such instant access to national and local market knowledge. If a firm lacks such a resource, this may make expansion to unknown international markets more difficult in the early stages of operation.

A third advantage is that, as sub-franchisees will have a financial stake in their business, franchisees will be more motivated to ensure the businesses are profitable and successful: thus, ultimately more revenue and profit will be generated for the master franchisee and franchisor. Monitoring of franchisees should therefore also be reduced. Firms operating a corporate structure may suffer problems of personnel motivation because performance is not related to

who operate the UK master licence for Dunkin' Donuts and Tricorn Restaurants International who operate the KFC master franchise licence.

compensation, and units may therefore need greater supervision (Hoy *et al.*, 2000; Shane, 1995).

In summary, internationalisation and globalisation of economic activity in the post-war period has facilitated the growth of the franchised business form. Franchising has developed as a strategy for firms to internationalise their activities as it is one way for global/international service firms to organise their operations at the national/regional/local level. Franchising has a number of advantages over other internationalisation strategies (such as corporate-owned expansion) notably the ability for firms to manage the risk associated with international expansion, as this risk is transferred onto a third party (i.e. the master franchisee). By franchising, firms can also utilise franchisee resources and gain access to highly motivated unit operators.

The global economy has also provided opportunities for domestic franchise operations to increase the scale of their geographic operation and US franchise systems have been the most dominant and progressive in this pursuit. In some instances, international franchise operations based in foreign markets have also encouraged growth of domestic-based franchise operations, as in the case of the US in the UK, Australia and some developing countries (Price, 1997; Stanworth *et al.*, 1995).

1.3.6 Resurgence of Economic Individualism and Growth of Small Firms

There has been a resurgence of economic individualism and small firms in industrialised economies since the 1970s. For example, in the UK, there were approximately 2.4 million enterprises in 1980; by 1998, this figure had increased to 3.7 million enterprises, and four out of every five enterprises were run by the self-employed (Labour Market Force Survey, October 1999). It is within this wider context of self-employment and small firm growth that the franchised business form has also developed (Hoy *et al.*, 2000; Price, 1997; Stanworth, 1994; Stanworth and Curran, 1998). Franchise operations are a sub-set of the small firm population and according to Stanworth (1994), the majority of franchisors within the UK are small operators (43%) which operate with approximately six franchisees and are less than five years old. The vast majority of franchisees are individual unit operators and are in most cases self-employed.

According to Hoy *et al.,* (2000) there are times when economic individualism is more prominent in society than others. The 'enterprise culture' fostered by the Thatcher Government in the UK during the 1980s is an example of where economic individualism became prominent in the economy and society, through political promotion and cultural acceptance. Small firm formation and self-employment were encouraged by the Conservative government because of their perceived potential contribution to job creation and increasing competition and innovation (Carter and Cannon, 1992; Curran, 1997). Thus, small firms benefited from the new enterprise ideology promoted by the government through various schemes from financial packages (e.g. the Loan Guarantee Scheme, the Enterprise Allowance Scheme) to advice and support organisations (e.g. Training and Enterprise Councils).

Although the growth of an enterprise culture among the general population is open to question (Blackburn *et al.,* 1990; Curran, 1997), the tendency towards self-employment in the labour market, and the increased profile of small firms in general in the UK, has arguably helped the franchised business form develop and increase in significance (Price, 1997). The trend towards individuals wishing to enter self-employment and become their own boss has been a source of potential franchisees. According to some, if franchising had not existed as an option, some individuals may not have considered self-employment (Curran and Stanworth, 1983; Hunt, 1972; Stanworth, 1977). With a higher profile of small firms and self-employment, it could also be argued this favoured and encouraged smaller franchise firms to start up. Certainly, with the increased involvement of clearing banks, other financial institutions and advice and training organisations to provide not only funds, but specialist advice to both franchisors and franchisees, franchising has received increased legitimisation as an option for setting up in business (Price, 1997).

However, it is important to situate the growth of the small firm sector and self-employment within the wider context of broad structural changes and economic restructuring, which have occurred within industrialised economies since the post-war period (Allen, 1988; Curran, 1997). The so-called 'enterprise culture' is therefore seen as a response to uncertainty and economic restructuring rather than an independent cause of the increase in small-scale enterprises (Burrows, 1991; Curran, 1997). Sections 1.3.2 - 1.3.5 have outlined the structural changes in contemporary industrialised economies and societies. Such factors, from the increased significance of service activity, to changes in consumption patterns, to corporate restructuring and internationalisation and globalisation of economic activity have created opportunities for the small enterprise. Economic restructuring and the resurgence of the small firm have therefore also created opportunities for the franchised business form. How these structural changes have created opportunities for small firms and franchised operations are examined in the proceeding discussion.

As manufacturing employment declined and service employment rose in significance in industrialised economies, so the small firm population increased (Allen, 1988; Price, 1997; Storey, 1994). In the UK in 1997, six out of ten small firms were in service based activities (DTI, 1997). As service activities are generally carried out at the point of consumption, this necessitates a local-level operation. Small scale operations may therefore have more advantages over large scale operations in such situations, through lower levels of economies of scale, and a greater ability to meet customer requirements at the local level (Curran, 1997; Hoy *et al.*, 2000). In some activities, where the quality of service is crucial, smaller enterprises run by owner-managers who are directly involved in all aspects of the business, can be much more effective than branches of larger enterprises, relying on poorly paid employees, with few managerial responsibilities which are located either at regional or head offices (Curran, 1997). It has also been argued that changes in consumer markets have created opportunities for the small firm. Demand and tastes have become increasingly differentiated and dynamic, producing niche markets. Consumption differentiation can often produce rapid unpredictable changes in markets, which makes it difficult for large firms to manipulate changes in demand and respond flexibly. However, small firms can adapt to market niches and respond more flexibly to consumption changes through an ability to produce small batches in small runs, which a differentiated marketplace requires. Thus, small firms can compete with large firms (Piore and Sable, 1984; Hirst and Zeitlin, 1989). Therefore, by utilising a franchising strategy, firms can organise their service activities as a small-scale operation on a local level to effectively meet customer needs, whilst also achieving increased levels of commitment and motivation from individual unit operators (i.e. franchisees).

In an increasingly uncertain and competitive global economic environment, large firms have restructured by fragmenting and decentralising their operations. Some large firms have increasingly out-sourced and sub-contracted peripheral service functions (such as catering, cleaning, transport and distribution) to concentrate on core activities in an aim to create greater cost-effectiveness and competitiveness in the UK during the 1980s. Some have argued that such fragmentation actions have created opportunities for the small firm, as small firms can react with greater responsiveness and flexibility to the out-sourcing needs of larger firms (Goffee and Scase, 1995; Piore and Sable, 1984; Shutt and Whittington, 1987; Storey, 1994).[18] Large firm out-sourcing strategies have also arguably created opportunities for franchise firms and producer service franchise operations can be found in areas such as accountancy, recruitment, distribution and commercial cleaning, for example (Price, 1997).

However, the growth of small-scale, local-based service operations and firms' fragmentation strategies have not meant the demise of the large-scale enterprise. Large international/global firms have reorganised and restructured their operations to overcome the problem of articulating the global scale with the local scale. Thus, new organisational arrangements and business forms have emerged, comprising alliances and networks of large and small firms. Global/international enterprises have linked with small-scale enterprises to effectively service local markets and individual consumers, therefore ensuring a

[18] Although evidence from a study of large firm-small firm relations indicated that large firms mainly out-sourced from other large or medium-sized firms. However, small firms may benefit

role for both types of operations in the global economy (Goffee and Scase, 1995). Franchising is one strategy, which enables large international service firms to organise their activities at the local level by linking with small-scale operators (i.e. franchisees). Therefore, it is against this wider backdrop of economic and social change that the small firm population and opportunities for the development of franchise operations have increased.

1.4 Summary, Research Rationale and Thesis Overview

Franchising is a major business form of considerable international economic significance in the contemporary world economy. Although the US has the most mature and extensive franchise market, Europe, Australia, and to a lesser extent South America, Africa, and South East Asia have all experienced growth of business format franchising activity. The internationalisation of US franchise operations have created much of this international activity as well as encouraging the growth of domestic-based franchise operations (Price, 1997).

A number of factors from the wider context of economic, social, cultural and political change have facilitated the growth of the franchised business form and led to an increase in business format franchising activity. Firstly, the increased economic significance of service activity in most industrialised economies since the 1970s has necessitated new organisational arrangements. Central to many service activities is the customer-organisation interface, which requires many small dispersed outlets to service local markets. Business format franchising is one business form which has developed to meet such organisational necessities (Hoy *et al.*, 2000; Stanworth and Curran, 1998).

Secondly, large-scale corporations have restructured their organisations in response to the increased economic uncertainty that has arisen since the post-war period and is now a part of the modern business environment. One corporate restructuring strategy has been for large-firms to spin-off, out-source and sub-contract peripheral activities (such as catering and cleaning) to other firms in

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from 'second-level' opportunities, where small firms receive orders from firms who are the prime order to focus on core activities. Such restructuring actions have provided opportunities for the franchised business form, as franchise operations, among other supplier firms, have filled such out-sourcing niches (Goffee and Scase, 1995; Hoy *et al.*, 2000).

Thirdly, since the 1970s, some firms have operated on international and, increasingly, global scales. New economic arrangements and business forms have developed to enable firms to operate at the international/global-local scales. Franchising is one strategy for firms to achieve a global-local level operation (Curran and Stanworth, 1998; Hoy *et al.*, 2000; Price, 1997). Lastly, the resurgence of economic individualism and small firm growth are also important explanatory factors affecting the rise of the franchised business form. Some franchisors are small operators and most franchisees are self-employed small business people (Curran and Stanworth, 1998; Hoy *et al.*, 2000; Price, 1997; Stanworth, 1994).

Conversely, it is arguable that the development of franchising may have facilitated and *caused* some of the wider structural changes - discussed in Section 1.3 - to increase in significance. For example, without the franchise method the geographical scale and level of internationalisation may not be so extensive if franchising did not exist as an option to enable firms to achieve international expansion. Also, if franchising had not existed as an option, some individuals may not have entered into small business. However, the extent to which the development of franchising has caused wider structural changes to occur or whether wider structural changes caused franchising to develop is impossible to distinguish.

The macro-scale explanations of service growth, consumption changes, corporate restructuring, internationalisation/globalisation of economic activity, economic individualism and small firm growth provide only partial understanding of the growth of franchise activity. The first part of Chapter 2 therefore outlines a micro-scale (i.e. firm-level) perspective to provide a more

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or 'first-level' contractors to larger firms (Curran and Blackburn, 1994).

fuller explanation of the growth of the franchise business form. The reasons why firms franchise has also been one of the dominant themes and debates of the academic franchise literature. Thus, the purpose of the first part of Chapter 2 is to outline this debate as well as review other key themes of the existing franchise literature. However, what becomes evident from the discussion in Chapter 2 is that the economic significance and international scale of franchise activity outlined in this chapter is not reflected by the attention it has received from academia, and in part by geography. The second part of Chapter 2 (section 2.3) outlines the largely limited nature of the existing geographical franchise literature. Given that franchising is inherently geographical (issues of expansion, location, territory and local market environment, for example, are central to franchise activity), it is something of a paradox that these geographical dimensions have not been sufficiently explored. However, it is proposed to redress this imbalance and lack of academic attention by examining a number of the geographical aspects inherent in franchise activity in this thesis. Chapter 2 therefore concludes with an agenda for research, focusing on three key geographical issues. The first geographical issue examines expansion strategies that are used by franchisors to achieve growth. The second issue explores how firms manage the dynamic nature of network growth over time and the third issue examines the role of local market environment and the effect of this on format standardisation/adaptation.

In Chapter 3, a discussion of how the research was conducted is provided. The methodology adopted in the thesis is a qualitative approach as the nature of data and information that was required for this study necessitated access to the underlying reasons and decision-making processes of key actors in order to understand and analyse firm behaviour. This therefore required face-to-face in-depth interviewing. Justification for this method is discussed along with the research design and limitations of the approach.

In the remaining chapters, results from a study of 40 franchisors are reported in an attempt to answer the three main research questions which are posed at the end of Chapter 2. Chapter 4 seeks to contribute to existing theoretical debates by examining why firms franchise, but the main analysis focuses on the expansion strategies that are used to achieve growth over the course of a franchise system life cycle. Chapter 5 goes on to explore, in more depth, the latter stages of the franchise system expansion life cycle and examines the dynamic process of network growth over time. One of the central features of franchising can be the allocation of a defined operational area to a franchisee – the franchise territory. However, with shifting demographics and increases in market penetration as the format becomes better known, over time the underlying geographical basis of a network may need to be restructured to accommodate new franchise units. Therefore, this chapter examines the network allocation and network restructuring process. In Chapter 6, the issue of franchise format standardisation/adaptation in response to the local market environment is addressed. Whilst format standardisation/adaptation has been examined at an international scale, there has been little examination of this issue at the national or local scales.

Finally, Chapter 7 draws together a number of conclusions and puts forward some implications of the study findings for both the academic and practitioner audiences, as well as outlining future research avenues. The overall aim of this thesis is to therefore provide an in-depth exploratory study of the inherently geographical aspects of franchise activity: to examine expansion strategies, issues of network allocation and restructuring and format adaptation/standardisation in local market environments.

Chapter 2 A Review of the Franchise Literature and Thesis Rationale

2.1 Introduction

The growth of the franchise business form and increasing economic significance and international scale of franchise activity, which was outlined in Chapter 1, has led to a burgeoning academic literature on the topic with:

> *"this organisational form assuming an increasing importance in a number of academic debates"* (Price, 1997, p90).

However, it has been argued that the franchise literature is fragmented and limited in an academic sense and has only a narrow disciplinary and topic focus (Elango and Fried, 1997; Hoy *et al.,* 2000; Price, 1997). The majority of the academic franchise literature originates from the business, management and economic disciplines (Stanworth, 1994; Price, 1997). Moreover, there has been a tendency to concentrate on a narrow range of themes within the literature. Many researchers argue, therefore, that the franchise business form is an understudied area of activity given its economic significance and international prevalence (Bates, 1995; Fenwick and Strombom, 1998; Knight, 1984; Withane, 1991).

This chapter has three aims. The first aim is to review the key themes of the franchise literature to summarise the main theoretical debates and focus of academic inquiry thus far (Section 2.2). In so doing, the section also demonstrates the narrow focus of franchise research to date. The themes examined are: definitions of franchising, the franchise relationship (including why firms franchise and why individuals become franchisees), internationalisation of franchise activity and franchise failure. Each topic is discussed in Sections 2.2.1-2.2.4. The second aim of the chapter is to outline the rationale for this thesis by arguing that franchising is inherently geographical (Section 2.3). There has, however, been a distinct lack of research from this disciplinary perspective and this thesis aims to redress this imbalance - as well as broaden the disciplinary basis and topic focus of the franchise literature - by exploring three geographical issues which are key to franchise activity.

Therefore, the third aim of the chapter is to conclude with a research agenda with which to address the issues under examination.

2.2 Review of Existing Franchise Literature

2.2.1 Issues of Definition

In a recent review of franchise research (Hoy *et al.*, 2000) outline that one of the earliest themes and debates of the academic franchise literature centred on seeking a definition of franchising as: *"theoretical discussion of a phenomenon first requires clear definition*" (Hoy *et al.*, 2000, p409). There have been many attempts to define and classify franchise activity since the 1970s. Early attempts at definition demonstrated some of the difficulties of conceptualising franchise activity. One of the first definitions of franchising (Hunt, 1972, p33) focused on the elements of a franchise relationship. According to this definition, franchising consist of:

- a contract which delineates the responsibilities and obligations of both the franchisor and the franchisee
- a strong continuing co-operative relationship between the two parties
- the franchisee operating the business substantially under the trade name and marketing plan of the franchisor

Hunt (1972) argued that this definition encompassed both 'first generation' franchising (car and petroleum distributorships and wholesaler-retailer franchises) and 'second generation' franchises (business format franchising). However, Hoy *et al.*, (2000) contend that this definition is problematic as it is only the last characteristic which distinguishes franchising from other business forms. The definition also understates what is involved in the franchise relationship: a franchise unit is a legally separate business with its own capital base, employees, organisational structure and specific customer relations, for example.

A second definition of franchising was provided by Caves and Murphy (1976, p572), who defined the franchise relationship as:

> *"...one lasting for a definite or indefinite period of time in which the owner of a protected trade-mark grants to another person or firm, for*

> *some consideration the right to operate under this trade-mark for the purpose of producing or distributing a product of service"*

However, Curran and Stanworth (1983, p10) question the emphasis of Caves and Murphy's definition on the trade-mark alone as this:

> *"draws attention away from the point that another aspect essential to the franchise business form is the way in which it involves a package containing not only a trade-mark or corporate image centred on a distinctive logo but, just as importantly, a set of procedures, organisational prescriptions and technical information. The latter is embodied in written form and/or in technical equipment and/or supplies. Without the rest of the package the trade-mark would be worth little. An important aspect of the ongoing franchisor-franchisee relationship is the strength of the non trade-mark aspects of the franchise package."*

A third, much cited definition was provided by Rubin (1978, p224):

> *"a franchise agreement is a contract between two (legal) firms, the franchisor and the franchisee. The franchisor is a parent company that has developed some product or service for sale; the franchisee is a firm that is set up to market this product or service in a particular location. The franchisee pays a certain sum of money for the right to market this product."*

Rubin also highlighted other aspects of the franchise arrangement: the initial and ongoing managerial assistance provided by the franchisor to franchisees, the franchisor's tight control over the operation of franchisee outlets, royalty payments and/or purchase of supplies by franchisees from the franchisor and the right of the franchisor to terminate the contract almost 'at will' (Curran and Stanworth, 1983). However, Rubin (1978, p225) also claimed that *"the definition of the franchisee as a separate firm, rather than as part of the franchisor, is a legal not an economic distinction."* As Hoy *et al.*, (2000) point out, research in both the US and the UK has demonstrated that many franchise businesses are independent operations, which incorporate a close and continuing relationship with a franchisor. Research such as Sklar (1977), Stanworth, Curran and Hough, (1984) and Stanworth (1995) has highlighted that franchisees can experience a significant level of operational independence in the day-to-day running of a franchise unit. Analysis such as Rubin (1978) often fails to distinguish between the formal contractual level (which favours the franchisor) and the informal operational level, where greater independence and autonomy can be experienced by the franchisee.

Vaughn (1979, pp1-2) offered a fourth definition of franchising which described franchising as:

> *"a form of marketing or distribution in which a parent company customarily grants an individual or a relatively small company the right, or privilege, to do business in a prescribed manner over a certain period of time in a specified place. The parent company is termed the franchisor; the receiver of the privilege the franchisee; and the right or privilege itself, the franchise."*

Although this was a much cited American definition, with the merit of making the distinction between the franchise, the franchisor and franchisee (a failure of past definitions), Hoy *et al.*, (2000) argue that the characterisation of franchising as a form of marketing or distribution understates the extent to which franchising has evolved into a distinct business form and total business package. Moreover, Vaughn's definition only emphasises the motivations of the franchisor and not the franchisee. According to Hoy *et al.*, (2000, p410):

> *"any attempted explanation of franchising needs to place equal emphasis on the motivations of the other major party involved, the franchisee. Continuing economic relations cannot be explained adequately by reference to the motivations of the initiator alone."*

A fifth definition offered by Curran and Stanworth (1983) therefore attempted to meet some of the previous definitional inadequacies. The authors defined franchising as:

> *"a business form essentially consisting of an organisation (the franchisor) with a market-tested business package centred on a product or service, entering into a continuing contractual relationship with franchisees, typically self-financed and independently owner-managed small firms, operating under the franchisor's trade name to produce and/or market foods or services according to a format specified by the franchisor"* (Curran and Stanworth, 1983, p11).

Whilst this definition essentially covers the core elements of the franchise relationship and most varieties of franchising (i.e. product and business format franchising), Hoy *et al.*, (2000) argue that there are a number of amendments that can be added to this definition in light of how franchising has evolved in the last fifteen to twenty years. First, franchisee self-financing may in fact be supported by loan finance from banks or other sources (sometimes including franchisors).

Second, in some sectors (such as fast food) multi-unit and corporate franchisees are not always owned by small-firm owner-managers and some corporate franchisees may be larger than their franchisors. However, in most franchise sectors, small-scale ownership is still typical. Third, whilst Curran and Stanworth's definition stated that the franchise relationship was a continuous one, the actual period of the contract will be variable from franchise to franchise, with the majority of contracts lasting on average between five to fifteen years. Fourth, there should be some reference included in the original definition to the payment of fees or royalties by franchisees to franchisors. Hoy *et al.*, (2000) therefore argue that if these points are included in Curran and Stanworth's (1983) original definition, this definition:

> *"embodies a gradually evolved consensus as the study of franchising has developed. Although the definitional debate occasionally re-emerges (e.g. Spinelli and Birley, 1996), it is largely a feature of earlier research"* (Hoy *et al.*, 2000, p410-411).

2.2.2 The Franchise Relationship

One of the dominant themes of the franchise literature has been research exploring the franchise relationship. A number of issues have been examined. First, the main focus of research has sought to understand why firms franchise, and explanations are related to the resource-constraints and agency perspectives. Second, research has sought to understand why individuals become franchisees. The legal and contractual aspects of the franchise relationship and the potential for conflict to occur between the franchisor and the franchisee is a third issue explored within the relationship literature. How the franchise relationship has been viewed in organisational terms (as a channel of distribution, a hybrid and federated organisational form, a strategic alliance and as an entrepreneurial act) has been a fourth issue explored in the literature.

Why Firms Franchise

Chapter 1 outlined how the franchise organisational form developed in the second half of the twentieth century as a result of wider economic and social processes – a macro scale perspective. However, Chapter 1 did not explain why firms adopt a franchise method for achieving expansion – a micro scale perspective. Within the academic franchise literature, there are two main theoretical perspectives which explain why firms use franchising as a strategy to achieve growth: the resource-constraints perspective and the agency perspective.

According to the *resource scarcity/constraints* perspective of franchising, firms may suffer from a number of inhibiting factors (such as a lack of funds) which can constrain growth. Early franchise theorists suggested that franchising was an effective strategy for firms to gain access to a number of these scarce resources to enable growth (Hunt, 1973; Oxenfeldt and Kelly, 1969; Oxenfeldt and Kelly, 1968-1969; Ozanne and Hunt, 1971; Caves and Murphy, 1976). However, the resource-scarcity perspective continues to gain empirical support (e.g. Alon, 2001; Dant, 1995; Kaufmann and Dant, 1996; Kirby and Watson, 1999; Lafontaine, 1992).

The first resource firms are able to gain access to through franchising is financial capital. A lack of capital is often an inhibiting factor to achieving expansion for small and medium sized firms (Hall, 1989; Kirby and Watson, 1999, SBRC, 1992). Franchisee funds are an effective source of expansion capital, as franchisees provide capital to the franchisors in the form of an initial franchise fee, as well as ongoing royalty fees. Franchisors may also accrue capital from franchisee investment through the purchase or rent of fixed assets. A franchise strategy therefore allows rapid and effective market penetration as the costs of opening new units are met by franchisees (Curran and Stanworth, 1983; Dant, 1995; Hunt, 1977; Mason and Harrison, 1985).

The second resource firms are able to gain access to, by using a franchise strategy, is human capital. Franchisees are portrayed as representing a pool of self-motivated managerial talent. Franchisees have chosen to invest their capital in a business, which is seen as having a lower probability of failure than independent firms. Therefore a franchise may be more likely to help franchisees accumulate further capital and status, and in turn, franchisees will be highly motivated to ensure their franchises are successful (Price, 1997).

The third resource firms would be able to access by franchising via franchisees is local market knowledge. Gathering information of local market conditions (such as sites, potential demand, and local culture) can be expensive for a franchisor. However, franchisees may be able to contribute cheap and reliable knowledge and information about local markets.

By accessing these three resources, a franchise strategy allows a firm to achieve rapid and effective market expansion. A franchisor can quickly establish a presence in the market place and achieve national coverage of their product/service if they choose to franchise their outlets. Rapid expansion can occur because a firm will not be reliant upon financial resources of retained profits or debt-secured finance as in company-owned chains or other organisational forms of expansion. Hunt (1973) also argues that even if a company does have ample financial capital for expansion, it may not have the human resources (i.e. the quantity and quality of suitable managers or local market knowledge) necessary for rapid expansion via company-operated units.

However, as a franchise business expands the effects of resource scarcity may diminish over time, and the capital and managerial constraints of early development may not persist with maturity and successful operation of several units. Thus, a stream of literature (initially proposed by Oxenfeldt and Kelly, (1969), followed by Hunt, (1972; 1973; 1977) and Lillis *et al.*, (1976) using organisational life cycle theory) has proposed that franchising is essentially transitory in nature and is a short-term early stage development strategy:

> *"franchising is advantageous to a franchisor mainly during infancy and adolescence of enterprises because it represents easy access to expansion capital, managerial talent and knowledge of local market conditions"* (Dant, 1995, p30).

Once a franchise system is successfully operating, having gained access to scarce resources, a franchisor may buy-back franchisee operated units and convert them into franchisor owned units until the firm may be turned into a wholly-owned operation. By re-purchasing franchises, the firm will re-gain control of the units as well as have additional revenues from those units.

However, subsequent research on the 'ownership redirection' topic within franchising has proved contradictory and inconclusive. For example, Hunt

(1973), Lillis *et al.*, (1976), Brickley and Dark (1987) and Manolis *et al.*, (1995) found that their sample of franchise systems did convert from franchise to corporate-owned operations. However, Shelton (1967), Martin (1988), Carney and Gedajlovic (1991), Frazer (2001) and Lafontaine (1992) found that ownership redirection had not occurred. Evidence for ownership redirection has proved inconclusive because surveys have employed different methodologies, data sets and measurements (Dant *et al.*, 1996a). Specifically, surveys have been unrepresentative in sample and sector selection. For example, the fast food sector has regularly been utilised within surveys because franchises are prevalent in this sector. However, Price (1997) argues that as franchising has varying levels of penetration and maturity in different sectors (as in the fast food sector), this could explain the mixed results of ownership redirection. Some research has also utilised cross-sectional data rather than using longitudinal research designs, which would be more able to capture the long-term development strategy of ownership redirection. Some studies have also relied on secondary data sources rather than primary data sources, which would be better suited to understanding the motives and intentions underlying ownership redirection trends (Dant *et al.*, 1996a).

Critics of the resource-constraints/scarcity perspectives have argued that franchising is, in fact, an inefficient method of obtaining capital compared to traditional capital markets. For example, Rubin (1978, p13) claims that:

> *"selling shares of a diversified portfolio of company-owned outlets is a superior option compared to recruiting franchisees with whom down-stream profits must be shared."*

However, firms may still need to tap into the resources of franchisees (or some other source) in the first instance to develop a 'diverse portfolio of company-owned outlets'. Lafontaine (1992) and Lafontaine and Kaufmann (1994) found that some franchisors offer financing to their franchisees and such firms had a greater proportion of franchise outlets than others. It appears that such franchise systems, which may have full access to capital markets, find franchising appealing for reasons that have nothing to do with a need for capital (Price, 1997).

In response to Rubin's criticisms, Norton (1988) contends that franchising is an attractive option for firms as potential franchisees supply all three-resource requirements (financial capital, human capital and information/market knowledge) at once. The costs of procuring these resources separately would exceed the costs of obtaining them simultaneously from one source: the franchisee.

However, criticisms of the resource scarcity theory shifted research emphasis towards alternative perspectives, namely *agency theory* and *risk management theory*. Agency theory, first identified by Jensen and Meckling (1976), is substantially employed in a number of disciplinary and theoretical contexts and it has also been used to explain why firms may franchise. Agency theory which is linked to transaction cost theory (which is based on the principle that the negotiation, monitoring and control of economic transactions, within and between organisations, necessarily incurs costs) explains how firms seek to minimise costs, where possible, to maximise efficiency. Franchising is one strategy firms can use to reduce transaction costs.

The agency perspective within the franchising literature has therefore explained the strategy as an effective response to the classic 'principal-agent'[1] problem: how to pre-empt the problem of shirking on the part of the agent without costly monitoring expenses (Rubin, 1978). As Shane (1995, p4) observes:

> *"managers [of company-owned outlets] often do not have sufficient incentives to work efficiently in the interests of the owners of firms because they are compensated by salaries that are independent of their performance. When employees receive the same compensation regardless of how much profit they generate for a firm they have an incentive to shirk in their efforts."*

However, the principal may not know if an agent is shirking and underperforming, or if any shirking and underperformance is due to extraneous adverse environmental and economic conditions beyond the control of the agent. This creates a 'moral hazard' for the principal. As a consequence the principal must monitor agents to ensure that the agents work efficiently to promote the owner's interest. However, this monitoring is costly because of the need to employ individuals to check the behaviour of agents, which involves investment in monitoring procedures (such as personnel reports and budgets). This is particularly costly when outlets are geographically dispersed or distant from the location of the monitors (Martin, 1988).[2] Therefore principals seek to find other solutions to the company-owned/manager-run outlet to reduce the costs of monitoring. Franchising is one strategy which effectively addresses the 'shirking' issue as it aligns the interests of the agent (franchisee) with those of the principal (franchisor), forging links between franchisee compensation and franchisee performance. In other words, because of a financial investment in the business, it has been argued a franchisee will be more highly motivated to make a business profitable and successful than an employee. This will lower the propensity to shirk, as any shirking will reduce the profits and compensation of the franchisee. The need for supervision and monitoring are therefore reduced (although not eliminated). In other words, the franchise relationship is a way of *"inducing self-monitoring by outlet controllers [franchisees] in situations where control by head office is otherwise extremely difficult*" (Curran and Stanworth, 1983, p17).

Agency theory is well established within the academic literature (Price, 1997) and empirical evidence has supported the agency explanation of the emergence of the franchise strategy (Brickley and Dark, 1987; Brickley, Dark and Weisbach, 1991; Carney and Gedajlovic, 1991; Caves and Murphy, 1976; Combs and Castrogiovanni, 1994; Lafontaine, 1992; Mathewson and Winter, 1985; Norton, 1988; Rubin, 1978; Sen, 2001; Shane, 1995, 1996a, 1997; Vaughn, 1979). However, criticisms have been made of this perspective. First, although the agency theory contends that monitoring costs are reduced, the theory fails to recognise the entry costs that are incurred when embarking on

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[1] The principal is the owner of a firm and the agent a manager of an outlet in this instance.
[2] Agency theory also links to a *risk management perspective* of franchising, which contends that firms are risk averse. Firms will therefore seek to retain control over more profitable and geographically concentrated locations (through corporate-ownership), where monitoring will be more difficult and costly for the principle, whilst shedding more 'risk-laden' remote locations by franchising these outlets (Brickley and Dark, 1987; Martin, 1988). The risk management theory

franchising.[3] Franchising is often portrayed as a low-cost growth option as it uses franchisee capital, but this ignores the substantial investments (e.g. legal fees for contract preparation and the establishment of a pilot unit) which are encountered when entering franchise-based expansion. Recruitment of the first franchisees may also be costly, especially as there may be 'high' and 'low' quality agents (franchisees). If the qualities of the agent are unobservable, there may be a financial incentive for low quality agents to misrepresent their abilities as being of high quality, because this is more likely to result in employment (Levinthal, 1988). It will be in the interest of the franchisor to expend effort on the problem of *adverse selection* to separate high quality agents from low quality agents, although this recruitment and selection process may be costly to the franchisor. Price (1997) therefore argues that these initial investment costs could prove prohibitive and unattractive to potential franchisors regardless of the potential long-term benefits.

A second criticism of the agency perspective is that it presumes that profit is the only objective individuals have for becoming a franchisee. However, Curran and Stanworth (1983; 1998) argue that profit is not the sole motivating factor for becoming a franchisee. Rather, independence and autonomy are other important goals an individual can obtain if they enter franchising. Such factors are, generally, not considered by the agency rationale.

A third criticism is that the agency approach does not explain the tendency for franchisors to use multi-unit franchisees which have become ubiquitous, especially in the US (Kaufmann and Dant, 1996). Although monitoring multi-unit franchisees is in theory, less costly, as multi-unit franchisees tend to employ managers in each of their units, the 'moral hazard' problem will not be solved. Employees and mangers of multi-unit operations will not have the same financial incentive as franchisees and may consequently shirk in their efforts (Price, 1997). Therefore, Bates (1998), Grunhagen and Mittelstaedt (2001) and Kaufmann and Dant (1996) argue that whilst agency theory is a perspective which can explain a franchisor's motivation for using

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is implicit in theories of internationalisation and a more fuller discussion of this perspective is outlined in Section 2.2.3 – internationalisation of franchise activity.

single unit franchisees it does not necessarily explain the motivation for using multi-unit franchisees.

Why Individuals Become Franchisees

Theoretical explanations for why firms franchise and the advantages of this method for achieving growth have been dominant themes of the academic literature. However, the franchise business form is a relationship involving not only a franchisor, but also a *franchisee.* Although franchisors' motivations have long been posited within the literature, individuals' motivations for choosing the franchise route to enter self-employment are comparatively less well-examined (Price, 1997; Stanworth and Kaufmann, 1994).

Empirical surveys which have examined the reasons individuals become franchisees indicates that the motivation to become a franchisee is related to the broader decision to become self-employed (Curran and Stanworth, 1983; Felstead, 1991, 1993; Kaufmann and Stanworth, 1995; Price, 1997; Stanworth and Kaufmann, 1996; Stanworth and Purdy, 1993; 1994). The specific advantages of entering franchising (as opposed to some other form of self-employment) centres on the potential benefits of this organisational form. Various studies indicate that the main motivation for entering franchising is because individuals gain access to an established business and known trade name, giving an advantage over other independent operators (Housden, 1984; Knight, 1986; Mendelsohn and Rose, 2000; Peterson and Dant, 1990; Price, 1997; Stanworth and Curran, 1998; Tuunanen and Hyrsky, 2001 and Withane, 1991). Second, franchisees have the advantage of utilising the franchisor's support system and help with things such as marketing, accounting procedures and business know-how for example (Hough, 1986; Price, 1997; Stanworth, 1977; Stanworth *et al.,* 1984; Withane, 1991). Third, franchisees also perceived that they had an opportunity to gain personal independence and autonomy by entering franchising (Knight, 1983; Peterson and Dant, 1990). Evidence has indicated that because of the advantages of franchising this attracts individuals

[3] This is also a criticism of the resource-constraints theory.

who would not have entered into self-employment independently (Hunt, 1972; Nunn *et al.,* 1998; Stanworth, 1977).

However, empirical surveys examining individuals' motivations for entering franchising have suffered from methodological inadequacies. First, past research has tended to examine the motivations of *existing* franchisees, because of ease of access to this sampling frame. Secondly, existing franchisees' responses will be subject to recall and hindsight. Responses may therefore be biased or have changed over time from when the franchisee first considered franchising through to operation, depending upon whether the franchisee has had positive or negative experiences (Stanworth and Kaufmann, 1995). Third, as the decision to become a franchisee is related to the broader decision to become self-employed, research has not related individuals' perceived attractions of franchising to prior employment experiences.

Subsequent research has redressed these methodological inadequacies and has included *potential franchisees* in research samples. Potential franchisees' employment backgrounds have also been taken into account, in order to understand the motivating factors of entering franchising of individuals with different employment backgrounds. Research has found that the majority of potential franchisees have an employment background of self-employment which accords with the findings of existing franchisees (Felstead, 1993; Hough, 1986; NatWest/BFA Annual Reports, Ozanne and Hunt, 1971; Stanworth, 1977, 1984). The motivating factor for entering franchising for individuals with self-employment backgrounds is the advantage of having access to a proven business system. For individuals interested in franchising with no previous self-employment history, the motivating factor for seeking a franchise opportunity was the advantage of gaining independence (Kaufmann and Stanworth, 1996; Mills *et al.,* 1997; Peterson and Dant, 1990; Stanworth and Kaufmann, 1995; Stanworth and Purdy, 1993, 1994).

However, individuals which consider buying a franchise but do not ultimately pursue the option has not been examined by extant literature (Kaufmann, 1999). Past research has focused on potential franchisees before the decision to purchase a franchise is made. This methodological failing has meant that it has only been possible to construct a partial picture of individuals' motivations for entering, or not entering, franchising:

> *"to fully understand the decision and the factors affecting it, both purchasers (i.e., franchisees) and non-purchasers (i.e., those who have considered franchising and rejected it) must be included...this permits the researcher to examine the franchise decision process not just the real or expected outcome"* (Kaufmann, 1999, p348).

Thus, subsequent research has found that the decision not to enter franchising for 'non-converts' was because individuals thought there would be too little control and too much risk associated with franchising. Motivations for individuals, which did enter franchising, centred on both business and personal benefits. Business benefits included having access to a proven brand name and the support of the franchisor and personal benefits centred on gaining independence (Mills *et al.,* 1997; Kaufmann, 1999).

However, Price (1997) argues that whilst previous research is insightful as it examines franchisee perceptions of the benefits of entering franchising and prior employment histories, it has not: *"examined or sought to explain the context or process by which the decision to become a franchisee is made"* (Price, 1997, p252). Past research has focused on prior employment experience, but this is too narrow in explanation. According to Price (1997) the decision to become a franchisee and alter career path is influenced by a number of other factors. Thus, a more holistic approach, taking into account cultural, social and economic factors is needed to understand franchisee motivation.

Baucus and Human (1994) identify the factors, which appear to influence the decision to become an entrepreneur as prior employment experience, the nature of an individuals' network and individual factors (i.e. age, gender, and educational levels). Following this, Price's (1997) conceptual approach contends that the motivation to become a franchisee is part of a wider *career decision making process*. How these career decisions are arrived at will be influenced by a number of factors including the values and opinions held about different jobs; awareness of different career options; prior employment experience; career stage;

the influence of social and institutional networks and characteristics of the individual.

Firstly, the values and opinions an individual holds for a particular career path, and awareness of alternative options will affect the career decision making process. Some people may view self-employment as a high-risk career option, but perceive franchising as a less risky option because of the know-how and support of the franchisor. Others may not be aware of the franchise option, as it may not be a part of their work and social networks. The decision to pursue a certain career path will be affected by not only individual values and opinions, but also by the collective cultural values of an individual's network, which may approve or disapprove of certain career options. Secondly, access to social networks (as well as more formal institutional networks) may not only provide individuals with information and knowledge of alternative career paths (e.g. franchising), but also sources of support if new career paths such as self-employment are sought.

Thirdly, the motivation to alter career path, become self employed, or become a franchisee will be dependent upon an individual's prior career experiences (as outlined in the preceding discussion) but also on career stage and an individual's commitment to a job, organisation or career. Fourthly, the characteristics of an individual can affect career choices and the decision to be enter into full-time employment, self-employment or franchising. Franchisees are not necessarily distinct from individuals that establish independent businesses, and franchisees are often drawn from a population involved in career transitions generally. Past research has attempted to distinguish the differences between franchisees and small business owners, focussing on the socio-economic characteristics (e.g. age, educational levels, gender) and personality traits (e.g. risk bearing tendencies) of both types of individuals (see for example, Knight (1983) and Hough (1982)). However, Price (1997) argues that instead of comparing similarities and differences between franchisees and small business owners, individuals' characteristics should be used to explain how such factors can affect career choices and the decision to become a franchisee.

Age, for example, can affect when an individual enters franchising. Evidence shows that the decision to become a franchisee, like the decision to enter self-employment occurs later in life,[4] at a time when an individual has sufficient capital and experience to enter the activity (Hudson 1987; Stanworth and Gray, 1991). Hough, (1982), Ozanne and Hunt, (1971), Stanworth, (1977) and Walker, (1971) found the majority of franchisees to be in their 30s and 40s. The NatWest/BFA (1996) Annual Report also found that, in the UK, almost 40% of franchisees are aged between 40-50 and 30% of franchisees are in their 30s.

Educational attainment can affect career choices. However, Price (1997) suggests that to become a franchisee, high levels of educational attainment may not be necessary. This is because the franchisor can act as an 'educator' by providing training and imparting business know-how to franchisees. Some evidence has demonstrated that franchisees' educational levels are low. For example, the NatWest/BFA annual reports indicate one quarter of all franchisees in the UK have no formal education, and a quarter of franchisees have only a basic level of state education. However, Hough (1982) and Stanworth (1977) found that approximately half the franchisees surveyed had selective state or private education and over three-quarters of Hough's sample achieved recognised educational qualifications. In the US, Ozanne and Hunt (1971) also found a high level of formal education amongst franchisees (only 10% of their sample did not complete high school). These studies seem to indicate that franchisees are well educated, at least in comparison to the population as a whole and in comparison to other small business owners (Stanworth, 1977; Stanworth and Gray, 1991).[5] Although educational attainment may not be a particularly important characteristic for entering franchising, for some career paths education and training are prerequisites for particular career paths and this may affect an individual's ability to enter the activity.

[4] the majority of small business owners are in the 30-40 age group when entering into small business ownership (Stanworth and Gray, 1991).

[5] However, the different findings are perhaps reflective of the differences in the samples used, how the samples were selected and the type of franchise systems surveyed. For instance, Hough's (1982) survey sampled 80 franchisees from four franchise systems. Therefore, it could be argued that the NatWest/BFA Annual reports are more representative.

As noted in Chapter 1, in the post-war period, women have increasingly participated in the labour market, but have primarily occupied part-time positions in the service sectors. However, female participation in self-employment generally, and in franchising, is low. Only 830,000 women were involved in self-employment, compared with 2,300,000 men in 1998 (Labour Market Force Survey, 1998). According to the NatWest/BFA annual surveys in the UK, males dominate franchising activity, as females account for only 20% of franchisees. In the US, although participation has increased (from 11% in 1986 to 18.5% in 1992) female franchisees are (as in the UK) under-represented (Dant *et al.*, 1996b; USSBA, 1993). Possible reasons for the lack of female participation in self-employment and franchising include a lack of support from formal and informal networks, ethnic/cultural reasons, lower risk-bearing tendencies and child-care issues. Such factors can therefore affect career paths and career choices for women.

Individuals' risk-bearing tendencies are a characteristic that can affect career choice. Entering self-employment is often viewed as a high-risk activity compared to other, more traditional forms of employment (such as full-time employment). The popular franchise press and the franchise community maintain that franchising is a less-risky strategy compared with starting an independent business, because of the perceived potential benefits associated with joining a franchise system (as opposed to setting up a new business alone and from scratch). However, the claim that franchising is a low-risk strategy is largely unproven, but is one that persists. Different people will, have differing levels of bearing risk and this will affect career choices. For the risk-averse individual, entering self-employment will not be a consideration. For an entrepreneur, setting up in business will involve undertaking a number of calculated risks, maintained by the entrepreneur's belief that they have the necessary skills and resources to run their own business successfully. Franchisees are often viewed as between the two extremes (Fenwick and Strombom, 1998; Hough, 1982; Knight, 1983; Price, 1997; Withane, 1991). Research has argued that the franchise route provides an 'easier' avenue into small business ownership for an individual, because franchisees have access to the franchisor's product/service and franchisor support services, helping to minimise some of the risks normally encountered when establishing a new business. This argument ignores, however, that such benefits may only be achieved if a potential franchisee joins with an established franchise system. A franchisee that joins with a small, young franchise system may still incur the risks associated with establishing a new business.

Franchisor-Franchisee Relations

Early research on franchisor-franchisee relations focused on the legal aspects of the relationship and examined issues such as the franchise contract and, in the US, the disclosures made when recruiting franchisees (Hunt and Nevin, 1976; Porter and Renforth. 1978). The legal and contractual aspect of the relationship continues to be a theme of the literature with issues such as royalty and fee structures examined (Baucus, *et al.*, 1993; Baucus and Baucus, 1997; Katz and Owen, 1992; Phan *et al.*, 1996; Rao and Srinivasan, 2001; Tikoo and Nair, 1999). However, the dominant theme of the franchisor-franchisee relations literature has been the issue of conflict between the two parties.[6]

Although conflict can be a part of any economic inter-dependent transaction, not all conflict will be serious, and can even be a positive force in a commercial relationship (Spinelli and Birley, 1996; 1998). However, negative conflict can occur when the inter-dependency between each party is unequal and when one party can exercise the use of power over the other. Conflict can also be a negative source when it manifests itself as dissatisfaction by either party in the relationship. In a franchise relationship, the balance of power resides with the franchisor and is reflected in the franchise contract, which is heavily weighted in favour of the franchisor. Conflict can occur within the franchise relationship if a franchisor has failed to adequately develop an organisational culture and structure necessary for the management of its franchisee network (Forward and Fulop, 1995; Price, 1997). A lack of trust, ethics and communication may also lead to conflict in the relationship (Dant and Nasr, 1998; Darr *et al.*, 1995; Meaney *et al.*, 1997; Meloan, 1988; Price, 1997; Ryans *et al.*, 1997).

[6] This theme is alternatively identified within the literature (and particularly the practical 'How To' literature) as 'disadvantages' of franchising for the potential franchisor and franchisee.

Within the literature, four main sources of conflict, specific to the franchise relationship, have been identified: the divergent goals of the franchisor and franchisee; unfulfilled contractual obligations; intensive system development (potentially resulting in encroachment) and a lack of strategic flexibility. First, Cavaliere (1988), Phan *et al.,* (1996), Price (1997), Spinelli and Birley (1996) and Spinelli and Bygrave (1992) argue that franchisors and franchisees will have divergent goals within the franchise operation. This could potentially result in conflict between the two parties, as a franchisor's goal will be geared towards system-wide sales growth, whereas a franchisee's goal will be more orientated towards unit profit. As Spinelli and Bygrave (1992) and Wadsmith (1996) argue, conflict may arise when a franchisor enforces sales policies within the franchise network (such as price discounts and promotional activities which a franchisee is contractually obliged to implement) which could be detrimental to the franchisee's unit profitability.

A second source of potential conflict arises when the franchisor or the franchisee does not fulfil the contractual obligations to the other party's expectations. For example, a franchisee may not run a unit effectively and the level of sales and product quality/service may be inadequate. However, a poor reputation of one unit could damage the trade name, brand equity and reputation of the franchisor as well as the other franchisees in the network and conflict may therefore arise. For a franchisee, profits may not be as high as the franchisor predicted in its original marketing and forecasting material. A franchisor may also not fulfil their contractual obligations as specified in the agreement (Elango and Fried, 1997. Withane, 1991).[7] Spinelli and Birley (1996, 1998) and

[7] An empirical illustration of this is 'Perfect Pizza' and a small number of its franchisees. After United Biscuits (which owned Perfect Pizza) was sold to Grand Metropolitan in 1989, some franchisees suffered a number of difficulties. For instance, Grand Metropolitan, in its role as franchisor, increased the price of pizza ingredients it supplied to its franchisees by as much as 25% (the franchisees were contractually obligated to buy supplies from Grand Metropolitan). Other problems involved pizza delivery costs and other operating expenses being far higher than the estimates shown in the Perfect Pizza promotional literature. Approximately ten Perfect Pizza franchisees were involved in lengthy litigation with Perfect Pizza during 1993, claiming misrepresentation, duress or breach of contract (The Mail on Sunday, 5th May, 1996). A further example, is the U.S. firm, 'Arby's Inc.' and its expansion to Mexico. Hoy (1994) reports that the master franchisee and sub-franchisees in Mexico received very little help from the franchisor in areas such as site selection, contract negotiations and equipment purchases.

Wadsmith (1996) outline how conflict can arise in the franchise relationship if franchisor-provided services (such as a lack of advertising and market research) are perceived to be inadequate, particularly as franchisees are contractually obliged to pay for them. The franchisee will also be dependent on the franchisor to maintain brand equity and value. Brand mis-management or adverse publicity concerning the franchisor-franchisee relationship could be detrimental to not only the system, but also to an individual unit (Price, 1997).

A third source of potential conflict results from system growth and development over time (Bygrave and Spinelli, 1992; Mayfield, 1997; Kaufmann and Rangan, 1990; Ryans *et al.,* 1997; Vincent, 1998). According to Bush *et al.,* (1976) and Zellar *et al.,* (1980), franchisor and franchisee goals will ultimately conflict over market development. As suggested in the preceding discussion, a franchisee's goal will be to maximise individual unit profit, but a franchisor's goal will be to maximise system-wide sales. Maximising system-wide sales can be achieved most rapidly by expanding the number of units in the system which can increase market share and maintain competitiveness (Vincent, 1998). However, intensive market development may have negative consequences for existing franchisees, particularly if they are operating in unprotected, non-exclusive territories. A franchisor could locate a new unit too close to an existing unit thereby encroaching on a franchisee's territory, possibly cannibalising a franchisee's sales and profits. Wadsmith (1996) found that 40% of franchisees had suffered problems of territorial encroachment.

A fourth source of conflict is if the franchisee does not stick to the franchise format. Although franchisees can be a useful source of new ideas and product development, extreme opportunistic behaviour or non-conformity to the franchise format could be potentially detrimental to not only the unit, but the franchise system as a whole and brand equity (Price, 1997). Although some operational leeway can occur (Stanworth *et al.,* 1983; Stanworth, 1995) it is in the interest of the franchise system that the franchisor expends effort through monitoring mechanisms to ensure non-conformity to the format does not have negative consequences. However, for the more entrepreneurial franchisee, such restrictions could lead to conflict (Price, 1997). Therefore, studies have suggested that franchisors should recruit individuals that do not display entrepreneurial traits and individuals which are not independent in character also make good recruits (Fenwick and Strombom, 1998; Stanworth and Purdy, 1993, 1994; Price, 1997; see Exhibit 2.1).[8]

Conversely, conflict could arise from a lack of strategic flexibility or lack of adaptation by the franchisor at the national and international scales, resulting in operational difficulties for franchisees. Although franchisors must guard against non-conformity, a franchisor may need to demonstrate a degree of strategic flexibility in operation, particularly at the international level. If there is some strategic flexibility, this will allow a franchisee the ability to modify the franchise format to meet the demands of the local operating environment. Some US research has found that a lack of strategic flexibility can be a source of conflict between a franchisor and a franchisee on a national scale (Beisel, 1993; Pintel and Diamond, 1991). On an international scale, Ryans *et al.*, (1997) demonstrate that a lack strategic flexibility caused conflict between international franchisors and master franchisees and sub-franchisees.

Exhibit 2.1 "If You're Not Creative and Independent We Want You as a Channel Member"

That's right – if you're not a creative or independent personality you are more likely to be selected as a channel member in many franchised channels.
This is how it should be, according to Ken Franklin (president of Franklin Development Inc.)...He argues creativity and independence are the trait most heavily displayed by true entrepreneurs and therefore exactly the wrong traits needed in franchising. Why? – because he claims that creative and independent people will naturally want to do things their way rather than conform to rigid policies an operating procedures characteristic of most successful franchise systems. Thus, they will inevitably try to change the system based on their own ideas and initiative. But in a successful franchise these usually admirable qualities can be disastrous, because the essence of so many franchised systems is standardisation and identical formats among all franchisees. Franklin's firm sells its services to the franchisors who want to assure that the franchisees they select will not be so creative and independent that they would resist taking directions from the franchisor. Franklin's method relies on in-depth psychological test to assess prospective franchisee to have a creative and independent bent, Franklin recommends that person not to be selected as a franchisee. The 'hot prospect' – those who according to the psychological profile are not very creative and independent – are the 'winners' that Franklin recommends his clients select as franchisees.

SOURCE: Price, S (1997) The Franchise Paradox, Cassell, pxvii-xviii

[8] This point is returned to and discussed more fully in the section: 'Franchising as an Organisational Form'.

If left unresolved, conflicts can become exacerbated, and in the US particularly, litigation is often the next step to try to resolve or conclude problems that have arisen between a franchisor and a franchisee. The most frequent sources of litigation between US franchisors and franchisees are over franchisor support services, royalty fees, (including advertising costs), performance requirements, franchisor inspection and evaluation methods and territorial infringements (Hunt and Nevin, 1976; Hoy, 1994; Porter and Renforth, 1978; Witzman, 1993). Thus, some research has sought to examine mechanisms for conflict resolution, in a pragmatic attempt to abate difficulties in the franchise relationship and minimise litigation. The mechanisms used for conflict resolution have included mediation, arbitration and the creation of franchise advisory councils (Baucus *et al.,* 1996; Christensen, 1996; Dant and Schul, 1992; Falbe and Dandridge, 1992; Meaney *et al.,* 1997).

Franchising as an Organisational Form

Although only a small poorly integrated theme, the franchise relationship as an organisational form has been viewed in four distinct ways within the academic literature: as a marketing distribution channel; a hybrid organisational form; a strategic alliance and an entrepreneurial act.

Some of the earliest franchise research appeared predominantly in the marketing literature and examined franchising as a form of distribution channel. For example, the literature dealt with themes such as channel conflict (Schul *et al.,* 1983), how franchisors could achieve channel control (Frazier and Sumers, 1984; Anand, 1987) and identifying means of achieving co-operation in franchise channel relationships (Sibley and Michie, 1982).

Coase (1937) argued that economic activity is organised into two general forms – the market and the firm. However, some types of organisational forms are 'hybrid' and include elements of both the firm and the market. Therefore, a small body of literature (e.g. Brickley and Dark, 1987; Falbe and Walsh, 1998; Mathewson and Winter, 1985; Michael, 2002; Norton, 1988; Rubin, 1978; Shane, 1996a; Williamson, 1991) has argued that franchising is a hybrid organisational form, encompassing elements of both markets and firms:

> *"the franchise contract lies somewhere between conventional market exchange and the centralised firm"* (Falbe and Walsh, 1998, p158).

Franchising incorporates elements of a market transaction because a franchisee buys the right to utilise the franchisor's business formula. Franchising also demonstrates elements of a hierarchy or centralised firm because:

> *"a franchisor retains a degree of ownership and authority over the use of the trade name, operational procedures and locations of outlets and contracts with independent entrepreneurs to operate the units"* (Shane, 1996, p216).

Falbe and Walsh (1998) further ague that many franchise systems operate *between* the hybrid and the centralised firm, as such franchise systems operate both franchisee-owned units *and company-owned units.* As a variation of this, Curran and Stanworth (1998) outline how Daems (1983) argues that franchising is an example of a 'federated' organisational arrangement:

> *"economic activities in modern capitalist societies...are carried out in one of three types of organisational form: hierarchical, market or federated. Hierarchical organisations are large-scale, vertically integrated enterprises. Market organisations are small to medium-sized enterprises with relatively little vertical integration. Federated institutions consist of linked organisations where a higher net return can be achieved by units co-operating than in either hierarchical or market forms of organisations. Daems noted that franchising provides an excellent example of this federated arrangement. Recent organisational thinking has emphasised the idea of modern economies containing both small and large enterprises linked together and co-existing in a variety of ways [e.g. Piore and Sabel, 1984; Goffee and Scase, 1995]"* (Curran and Stanworth, 1998, p10).

The franchise relationship has also been classified as a strategic alliance (Hoy *et al.*, 2000; Fladmoe-Lindquist, 1996; Hoffman and Preble, 1991; McIntyre *et al.*, 1997; Pappu and Strutton, 2001; Strombaum and Fenwick, 1998), although this classification has been contested by some (e.g. Yoshino and Rangan 1995; Achrol, 1996). Perhaps the most comprehensive argument on this issue to date has been provided by McIntyre *et al.*, (1997). This study outlined how the seven core dimensions of a strategic alliance (strategic advantage, interdependency, commitment, constructive conflict resolution, co-ordination of work, flexibility in planning and goal compatibility) apply to the franchise relationship. The authors argued that the franchise relationship generally fits each of the dimensions of a strategic alliance as it provides strategic advantages to both a franchisor and a franchisee, resulting in an inter-dependent, legally committed and collaborative relationship (see Table 2.1).

However, the authors also note that some contradictory evidence in the literature conflicts with the view that the franchising relationship is a strategic alliance. For example, empirical evidence has pointed to saturated markets and high failure rates for franchise firms. Such situations will not result in strategic advantages for a franchisee. Franchisor 'buy-backs' are also potential threats to the commitment of the relationship, and litigation, at least in the US, is the ultimate means of conflict resolution. Incompatible goals (where a franchisor wants to maximise system-wide sales, but a franchisee wants to maximise unit profit) are further examples which undermines the strategic alliance perspective of the franchise relationship.

The franchise relationship has also been viewed as a form of entrepreneurship in the literature (Hoy, 1994; Hoy and Shane, 1998; Kaufmann and Dant, 1999; Shane and Hoy, 1996). These authors have contested the view that franchising is the antithesis of entrepreneurship, where franchisees simply replicate a proven standardised business format, therefore excluding creativity and innovation:

> *"the very act of creating a franchise network is an entrepreneurial act...many franchisors rely on franchisee experimentation to generate the innovations that keep their organisations healthy and competitive"* (Hoy and Shane, 1998, p91-94).

Kaufmann and Dant (1999) have classified contemporary definitions of entrepreneurship into three main categories: (i) definitions stressing the characteristic traits or qualities supposedly possessed by entrepreneurs; (ii) definitions stressing the process of entrepreneurship and its results; and (iii) definitions focused on the activities entrepreneurs perform. Kaufmann and Dant (1999) apply these three categorisations of entrepreneurship to franchising and conclude that franchising *is* an entrepreneurial venture (Table 2.2).

Table 2.1 Strategic Alliance Dimensions and their Application to the Franchise Relationship

Dimension	Supporting Evidence Within the Literature	Conflicting Evidence Within the Literature
Strategic Advantage	Franchisor achieves: *Rapid expansion of market presence *Greater quality assurance Franchisee secures: independents *Proven business concept *System-wide economies	*Recent evidence includes findings that young franchise start-ups exhibit higher rates of firm discontinuance and lower mean profitability than cohort [SEE SECTION 2.2.4]
Interdependence	*Franchisor depends on franchisee for financial inputs, innovative ideas, and knowledge of local market and culture *Franchisee depends on franchisor for tradename and managerial/marketing expertise	
Commitment	*Approximately 50% of franchise contracts specify relationship length of 15 years or more [e.g. Padmanbhan, 1988]	*Mixed conclusions regarding the conversion of previously franchised units into company owned units [see Dant *et al.*, 1996a]
Constructive Conflict Resolution	*Establishment of franchise advisory councils *Number of contract lawsuits in state courts [US] is down 37% since 1990	*Councils and mediation programme are perceived to be the result of franchisor abuse *Litigation remains the ultimate means of conflict resolution
Co-ordination of Work	*Products, conceptualised by the franchisor and created locally by the franchisee, are delivered to the customer	
Flexibility in Planning	*Sharing of research and environment analysis create an atmosphere of flexibility in franchise relationships *Higher levels of solidarity in franchise channels indicates open sharing and flexibility	*Rigid legal contracts limit flexibility [although contested by Curran *et al.*, 1984]
Goal Compatibility	*Franchise system is a network of organisations whose properties are greater than the sum of its parts *Franchisees have similar networking frameworks via master franchises and/or multi-unit franchisees	*Economic goals appear incompatible: franchisors desire an increase in gross sales, franchisees desire an increase in net profit *Differing market development goals lead to accusations of encroachment

SOURCE: McIntyre, F. S., Young, J. A., and Gilbert, F. W., (1997) 'A strategic alliance perspective of franchise relationships', *Franchising Research: An International Journal*, Vol. 2, (No. 1), pp 6-14.

Shane and Hoy (1996) also argue that franchising is a unique form of entrepreneurship because it depends on two entrepreneurs, the franchisor and the franchisee to make the franchise venture successful. Franchisors are entrepreneurial in behaviour because they have developed the business concept and operating system, risking resources (time, money, and effort) to do so. Moreover, the franchisor has to continue being entrepreneurial in response to competitors' strategies or in response to new market developments. Similarly, franchisees are entrepreneurial because they risk their own resources in developing the franchisor's concept in a local market (although a franchisee may be more familiar with the local market and its potential than a franchisor):

> *"although the risk they face may be reduced by this familiarity, franchisees' role as entrepreneur-partner is supported by the fact that they do accept the financial risk of introducing the franchisor's concept to a new and untried market"* (Kaufmann and Dant, 1999, p12).

As the franchisee is an investor in the franchisor's concept, the authors argue that a certain amount of flexibility in developing marketing strategies to suit local market opportunities can occur in some franchise systems. In comparison, an employee/manager of an outlet in a corporate chain with similar market expertise may incur more severe hierarchical constraints on any innovative activities. However, a franchisor must ensure the core standardised concept is maintained for the benefit of the franchise system as a whole:

> *"...some entrepreneurial behaviour within a franchise system may be beneficial, but...any on-going entrepreneurial activity must be tempered against knowledge and experience embodied within the franchise system"* (Fenwick and Strombom, 1998, p41).

However, Hoy *et al.*, (2000) argue that two arguments within the literature persist against franchising as an entrepreneurial act. The first argument is the issue of whether franchising is a permanent and unique organisational form or just a stage in corporate evolution where a firm may eventually become a corporately-owned hierarchically organised operation (the 'ownership redirection thesis' outlined in Section 2.2.2). Franchising may be used as a strategy to establish a business with the resources of franchisees. However, when expansion has been achieved and franchisee resources are no longer necessary to establish the network, a franchisor may buy back franchisee units and convert the network

Table 2.2 Definitions of Entrepreneurship and Their Application to the Franchising Context

Representative Definitions of Entrepreneurship	Application to Franchisors	Application to Franchisees
*Entrepreneur is an individual who possess qualities of risk-taking, leadership, motivation, and the ability to resolve crises (Liebenstein, 1968)	Yes	Yes
*Entrepreneur are leaders and major contributors to the process of creative destruction (Schumpeter, 1942)	Yes	No
*Entrepreneur is an individual who undertakes uncertain investments and possesses and unusually low level of uncertainty aversion (Knight, 1921)	Yes	Yes
*Entrepreneurship is the creation of new enterprise (Low and MacMillan, 1988)	Yes (concept)	Yes (market)
*Entrepreneurship is the creation of new organisations (Gartner, 1985)	Yes (concept)	Yes (market)
*Entrepreneurs introduce new combinations of the factors of production (land and labour) that, when combined with credit, breaks into the static equilibrium of the circular flow of economic life and raises it to a new level (Schumpeter, 1934)	Yes	No
*Entrepreneurship is the process of extracting profits from new, unique, and valuable combinations of resources in an uncertain and ambiguous environment (Amit, Glosten and Muller, 1993)	Yes	Yes (ambiguous environment)
*Entrepreneur performs one or more of the following activities: (1) connects different markets, (2) meets/overcomes market deficiencies, (3) creates and manages time-binding implicit or explicit contractual arrangements and input-transforming organisational structures, and (4) supplies inputs/resources lacking in the market place (Leibenstein, 1968)	Yes (1, 2, 3, 4)	Yes (2, 4)
*Entrepreneurship is the purposeful activity to initiate, maintain, and develop a profit-oriented business (Cole, 1968)	Yes	Yes
*Entrepreneurs perceive profit opportunities and initiate actions to fill currently unsatisfied needs or to do more efficiently what is already being done (Kirzner, 1985)	Yes	Yes
*Entrepreneurs are residual claimants with operational control of the organisation (Shane and Cable, 1997)	Yes (system profits/ shared control)	Yes (unit profits/ shared control)

SOURCE: Kaufmann, P. J, and Dant, R., P., (1999) Franchising and the Domain of Entrepreneurship Research, *Journal of Business Venturing,* 14, p5-16.

into a wholly-owned corporate chain. With the experience and time acquired developing the franchise system, a franchisor may also have had the opportunity to recruit and train managers to take over former franchisee units.

However, Hoy *et al.,* (2000) argue that the ownership redirection theory undermines the agency perspective of franchising. Agency theory argues that one of the main advantages of having franchisees as unit operators is a distinct advantage over employee/manager-run outlets, because franchisees are more highly motivated to make the unit successful because of a financial stake in the unit. More significantly, the ownership re-direction argument is not well supported empirically. Despite some well-documented cases of franchisor buy backs (e.g. Perfect Pizza in the UK) academic surveys have been unable to discern a clear trend towards ownership redirection among US and UK systems. As Hoy *et al.*, (2000, p412) observe:

> *"evidence has to be interpreted cautiously here since, at any given point in time, many franchises are relatively new and might be in the early stages of the cycle. On the other hand, the United States has the most developed franchise sector of all industrial societies with many large and long-established franchises and so might be expected to show the stage or life cycle pattern if it exists. But no such clear pattern is discernible."*

The second argument which undermines whether franchising is an entrepreneurial act is the status of the franchisee and whether they are true independent venture owners or quasi-employees of the franchisor. At one extreme, it has been argued that the franchisee is an independent business operator and has simply entered into a close relationship with another, usually larger organisation[9] (the franchisor). Hoy *et al.,* (2000) argue that the links between a franchisor and a franchisee are not too different, except in the degree an explicit form of the ties, to other associations between many small businesses and other firms with whom business may be conducted:

> *"in an increasingly interdependent economy, such a close association may simply be a reflection of the fact that 'no firm is an island entire of itself' in a modern economy"* (Hoy et al., 2000, p412).

Empirical evidence has also supported this argument. For example, McGuire (1971), Ozanne and Hunt (1971), Sklar, (1977), Vaughn (1979) and Walker (1971) found that franchisees reported high levels of independence and were satisfied with their positions as franchisees.

[9] although this may not be the case with some multi-unit franchisees, who may be larger than their franchisors.

However, this view has been contested. It has been argued that franchisees are not independent operators, but merely employees of the franchisor who simply manage franchise units and help the franchisor achieve and maintain an effective distribution system (Parker, 1973; Rubin, 1978). However, as Hoy *et al.*, (2000, p412-413) observe:

> *"this distribution strategy has certain advantages for the larger enterprise, but just because the manager of the outlet has a capital stake in the business dressed up in the language of entrepreneurship is no reason to confuse a franchise with a genuinely independent small business. The language of independence and entrepreneurship, it might be argued, is being used simply to tempt people into buying a franchise since it exploits the cultural approval given to economic independence in capitalist society, and afterward, the illusion of independence is maintained because it continues to service both parties' interests. This is not to say that the arrangement cannot be highly beneficial to both parties, but illusion should not be substituted for reality in a rigorous analysis of the status of the franchised outlet."*

Thus, Hoy *et al.*, (2000) have analysed franchisee autonomy and independence at both the 'formal' level (i.e. contractual) and 'informal' level (i.e. operational) as both levels indicate various degrees of independence for the franchisee. At the formal level, the franchise contract is typically drawn up by the franchisor, offered to franchisees without concession and ultimately favours the franchisor. Therefore, Felstead (1991a; 1991b; 1993; 1995) has argued that franchisees are not as independent as conventional small business owners as: *"franchisees are bound to franchisors by a number of contractual clauses"* (Felstead, 1991a, p43). An independent business can for instance, obtain equipment, materials or ingredients from a supplier of its choice, it is not tied (as in the franchise relationship) to obtaining supplies from the franchisor or the franchisor's choice of suppliers. Other contractual clauses are that a franchisee cannot exit at will and cannot sell the franchise without a franchisor's approval. Even if a franchise contract ends, the ex-franchisee may still be liable to abide by certain franchisor contractual clauses. For example, a franchisee will not be able to set up a competitive business near to the original franchise unit nor employ old employees (Price, 1997).

Felstead maintains, therefore, that franchising is a 'controlled' form of self-employment, as franchisees have to operate within strict procedures laid down by the franchisor, make turnover related payments to the franchisor and furthermore, the franchisee has no ownership rights in the intangible business assets (i.e. the intellectual property), the franchisee simply 'borrows' the business idea and format. The franchise relationship is, therefore, heavily biased towards the franchisor in terms of power and control.

Contrary to Felstead's argument, from a legal perspective the franchise unit is an independent business, which belongs to the franchisee. This factor is important because:

> *"the law, with its rather literal approach to social and economic reality, may from time to time give this point overall importance, countering the normal balance of power a the formal level. This explains the way in which in the United States, for example, state and federal law has often come down on the side of the less powerful franchisee. As a legally independent enterprise, the franchised outlet may be treated as the equivalent of the conventional enterprise for interpreting conventions on fair business practices, which has frequently meant bolstering franchisee autonomy"* (Hoy et al., 2000, p413).

At the operational level, Stanworth *et al.,* (1984) and Stanworth, (1995) have argued that a franchisee has more autonomy and independence than is suggested by consideration of the formal, contractual level alone. According to the authors, there are clear limits to the control franchisors can exercise over franchisees at the operational level. Although franchisors may have ultimate decision-making control over product mix, service presentation and in recommending pricing strategies, for example, the franchisee has considerable control and autonomy over issues such as operating hours, personnel and employee wages. Indeed, the franchisor may not wish to be too involved in the day-to-day running of a franchisee's business nor over-supervise, as this could create overly dependent unit operators.

An analysis of both the formal and informal levels shows that there are varying degrees of independence and autonomy for the franchisee within the franchise relationship. However, in answer to the question of whether franchisees are truly independent operators (which would qualify franchising as an entrepreneurial activity), Hoy *et al.,* (2000) argue that no small business is totally independent. For some small businesses operating independently, an economic downturn could cause a firm to experience operational difficulties or even push a firm out of existence. However in a similar economic situation, the majority of franchise businesses would be protected and sheltered from some of the external pressures, leading Hoy *et al.*, (2000, p413) to argue that, in fact, franchisees *"may well enjoy levels of autonomy substantially higher than many nominally independent small enterprises."*

Summary of the Franchise Relationship Literature Theme

In summary, the franchise relationship has been a dominant theme of the academic literature and four key issues have been examined. The first issue which has been addressed is the question of why firms use a franchise strategy to achieve expansion. It has been argued within the literature that the reasons why firms franchise is to enable access to a number of vital resources, which can facilitate rapid expansion of a network – the resource-constraints perspective. However, agency theory contends that a franchise strategy is used so that firms can access highly motivated unit operators. Both theories are well developed in the literature and both have received empirical support.

The second issue that has been addressed in the literature is franchisee motivations. Research has conclusively shown that individuals enter into franchising (as opposed to some other form of self-employment) because of the perceived potential benefits of gaining access to a proven business formula and established trade name. Franchising is also perceived to give individuals the chance to achieve independence through running their own business. It is these factors which motivate individuals to become franchisees. However, Price (1997) has argued that the decision to become a franchisee is part of a broader career decision making process which will be affected by factors of career stage, employment history, social networks and individual characteristics.

The third issue, which has been examined in the literature, is the potential for conflict in the franchise relationship. As the franchise relationship is inherently imbalanced, in terms of power and control, in favour of the franchisor (Felstead, 1993; Price, 1997) conflicts can arise in the franchise relationship. In the literature, four main sources of conflict have been identified: the divergent goals of the franchisor and franchisee, unfulfilled contractual obligations, intensive network development and a lack of strategic flexibility.

The fourth issue examined in the literature is the franchise relationship as an organisational form. The relationship has been viewed in four distinct ways: as a marketing distribution channel, as a hybrid organisational form, as a strategic alliance and an as entrepreneurial act. Whilst some of these arguments are well developed in the literature, others have been contested (e.g. the strategic alliance perceptive of franchising).

2.2.3 Internationalisation

The internationalisation literature of the early 1970s focused on describing the extent and development of franchising on an international scale. Two main studies of this time (Walker and Etzel, 1973 and Hackett, 1976) examined the international activities of US franchise systems. These studies found that the main reasons for firms expanding overseas were to take advantage of international market opportunities and to achieve competitive market positioning. Domestic market saturation and enquiries from potential franchisees were reactive reasons for entering a foreign market. In both studies, a mixture of single unit franchisees and area franchisees were the methods used to operate in foreign markets. Hackett (1976) contends that ownership strategies in international markets depended upon the risk factor of each nation or region. If total franchisee ownership was used, a franchisor could enter a foreign market whilst avoiding the risks of ownership and financing in local markets. The master/area strategy was used where the primary considerations were to maintain control and co-ordination in foreign markets. Joint ventures were embarked upon if the laws of the host country required a local national partner and prospective franchisees lacked the necessary financial base.

For US franchisors, Canada was the first target market for overseas expansion, because of physical and cultural proximity. Other countries where operations were established at that time included Western Europe, Australia, Japan and Mexico. Hackett (1976) also attempted to discern if US franchisors had to alter their business concept to adapt to international markets. From a sample of 85 firms, 41% made no major changes to their marketing strategy. However, 25% made a significant alteration to their product/service. This was most prevalent in 70% of the fast food franchisors, where changes to product offerings were made (such as menu additions and deletions).

Both studies found that the main problem of operating internationally were the difficulties of government and legal regulations (e.g. 'red tape' and tax systems). Walker and Etzel (1973) also found franchisee recruitment and management and insufficient local finance were problems with the franchisors they surveyed. For a small minority of franchise systems (9%), recruitment and/or obtaining suitable property had become such a problem that the strategy had resulted in failure and withdrawal from the market.

Charting the extent and development of US franchise systems on an international scale has been a theme periodically repeated throughout the 1980s and 1990s (e.g. Hopkins, 1996; Preble and Hoffman, 1995; Walker 1989). As earlier studies had found, the main reasons for expanding internationally were because of opportunities to increase profits and exploit enquires from potential foreign franchisees. Methods of entering foreign markets varied from individual franchisee units and master/area franchises. Canada, Western Europe, Australia, Mexico and Japan were the countries where US international operations were established and where penetration continued to occur. The problems of operating internationally concerned adjusting to government and legal regulations, overcoming language and cultural barriers and training and recruiting franchisees. It is therefore evident that such findings are similar to the findings of Walker and Etzel (1973) and Hackett (1976) some 10 to 20 years earlier. According to latter research, the reasons for franchising on an international scale, methods used and countries entered have altered little for US franchise systems.

Reflecting the development of franchise activity on a world-wide scale since the 1970s, research has also examined the international activities of non-US based franchise systems. For example, in the UK 14% of indigenous UK franchise systems were active in the EU in 1998 (although an additional 27% of

UK systems planned to franchise in the EU by 2001). Ireland, Germany, France, Spain and Italy were the countries where UK franchise systems were in operation. The main methods of entering European foreign markets were direct entry (57%) and master franchising (43%) (Stirland *et al.,* 1998). In Australia, franchise systems expanded internationally to increase profits and expand markets. Master franchising was the preferred method for entering international markets as the strategy utilised the local knowledge and contacts of foreign franchisees. New Zealand was the favoured market for initial overseas expansion, because of geographical proximity and cultural affinity, a similar expansion process of US franchise systems. Since 1990, a freeing of trade between Australia and New Zealand has also occurred therefore making establishing foreign operations easier. Overseas operations were also established in the UK, other parts of Europe, the US and in the South Pacific (McCosker and Walker, 1992 and Welch, 1989).

The internationalisation franchise literature in the 1980s and 1990s also focussed more specifically on understanding aspects of the internationalisation process. Issues that have been explored include the decision to operate internationally, the entry mode used (franchise versus corporate-ownership) and whether format adaptation occurs in host countries. Reasons for *not* operating at an international level related to size of the franchise operation and the extent of domestic market growth opportunities. If the operation was small and ample growth opportunities existed in the domestic market, internationalisation did not occur (Aydin and Kacker, 1989; Eroglu, 1992). Fladmoe-Lindquist and Jacque (1995) argue that franchising will be used as an entry mode (as opposed to corporate-ownership) when there is a high level of geographical and cultural distance leading to a high degree of host country environmental uncertainty.

Following Hackett (1976), Hopkins (1996), Hoy and Hoy Echegaray (1994) and Hoy *et al.,* (1998) found that franchisors need to adapt to host country conditions and local cultural differences when operating at the international scale. Adaptations included product adaptations, promotional and advertising changes and pricing strategy changes, for example. Hoy and Hoy Echegaray (1994) and Hoy *et al.,* (1998) demonstrated the difficulties that can occur if host country culture, market tastes and business practices are not taken account of. However, although it is important for franchise systems to adapt to cultural differences, maintaining standardisation (at the core of a franchise system's reputation and uniqueness) is still an important factor for international operation.

Thus, a re-current theme of the internationalisation literature has been to understand the nature, scale and development of franchise activity on an international scale. The literature has sought to explain why firms franchise internationally, where operations are established, the methods of entering foreign markets and the difficulties of operating on an international scale. However, early internationalisation literature has been criticised for its descriptive and non-analytical nature (Fladmoe-Linquist, 1996; Shane, 1996b). Previous studies explained the reasons why firms develop international strategies through an examination of external factors only. Firms either expanded overseas because enquiries from potential foreign franchisees were encountered, firms wished to take advantage of foreign market potential or because domestic market saturation was limiting growth opportunities (Aydin and Kacker, 1989; Hackett, 1976; Kedia et al., 1994; McCosker and Walker, 1992; Walker, 1989; Walker and Etzel, 1973).

More recent internationalisation literature has argued that external factors do not distinguish between firms within the same sector that develop an international expansion strategy from those that do not. If, for example, firms expanded internationally because of domestic market saturation, this explanation should act universally; all firms within a sector would choose to simultaneously enter foreign expansion because of limited market opportunities. Since this does not occur, other factors must lead firms to embark on international expansion. According to Shane (1996b) *firm-level* factors help explain why some firms franchise internationally and others do not. Prior research had made some attempt to discern the *characteristics* (e.g. age, size of the operation) of firms that have expanded internationally. For example, Walker and Etzel (1973) and Hackett (1976) found that older and larger systems had expanded overseas, but did not suggest why this was the case. Hopkins (1996) also found that US firms expanded overseas when reaching a certain size and geographical threshold within the domestic market (70% of respondents had 50 outlets or more and 75% operated in 10 or more states). Similarly, Julian and Castrogiovanni (1995) found that greater size and geographical breadth of operation in the domestic market (US) were important characteristics determining if firms developed international expansion strategies. However, the reasons why the characteristics of age and size distinguish between firms that develop international strategies from firms that do not are not explained by this research. A possible explanation, suggested by Eroglu (1992), is that larger firms are better able to absorb the risks of international expansion through greater financial and managerial resources if failure occurs. Age is a factor determining international expansion because generally, older firms will have greater financial resources and operational experience, lowering the perceived risks of expanding internationally for such firms.

Shane (1996b) therefore argues that previous attempts to understand firms' international expansion tendencies are limited. Thus, subsequent research has aimed to understand the *internal capabilities* of firms that have expanded internationally as this can distinguish between firms that operate on an international scale from those that do not.

Internal capabilities necessary for international operation have been identified as having appropriate management skills and attitudes for managing the internationalisation process (Fladmoe-Lindquist, 1996; Huszagh *et al.*, 1992; Kedia *et al.*, 1994). These authors argue that a firm needs internal capabilities centering on the ability to manage the difficulties of local cultural, political and financial uncertainty of foreign markets if it expands internationally. In addition, Shane (1996b) and Burton and Cross (1997) argue that an ability to bond against and monitor franchisee opportunism are the two capabilities firms need to develop to initiate successful international expansion. According to Ryans *et al.*, (1997) and Dant and Nasr (1998) franchisors that operate internationally must have, or be able to develop, an ability to communicate effectively with international franchisees. This capability is essential for developing a good franchise relationship, avoiding conflict, facilitating the monitoring process and obtaining market information, for example.

Fladmoe-Lindquist (1996) also argues that it is possible to develop a typology of international franchisor categories: the constrained, conventional, integrating and worldwide franchisors (Table 2.3). The typology outlines that not all franchisors possess the capabilities needed to franchise internationally, nor do all franchisors combine the capabilities to the same degree. Whilst one firm will franchise in just one geographically close country, another firm will franchise in several countries. The two firms will therefore possess different capabilities and need different resources and knowledge for different international expansion strategies. However, Fladmoe-Lindquist argues that there is a *dynamic* element to international expansion with firms able to learn, change and develop new capabilities over time according to knowledge and experience. By recognising that firms' abilities vary over time:

> "*helps to explain why some franchisors expand at some times, revert to a more restrained approach at another time, and then later renew expansion efforts*" (Fladmoe-Lindquist, 1996, p428).

The ability to learn new capabilities depends on the time and commitment of the franchisor/entrepreneur and the resources the firm has available at that point in time (the 'entrepreneurial capacity problem'). If firms have the capacity for developing new capabilities over time, franchisors may move from one category into another (Table 2.3)

Table 2.3 International Franchising Capabilities and Capacity for Development

Capacity for Developing International Capabilities	Existing International Franchising Capabilities: Low	Existing International Franchising Capabilities: High
High	*Integrating franchisors* *Pursuit of cautious growth *Uses multiple forms of franchising *Proactive evaluation	*Worldwide franchisors* *Focus on global markets *Uses multiple forms of franchising *Both proactive and reactive
Low	*Constrained franchisors* *Locally international *Limited involvement in international markets *Reactive evaluation	*Conventional franchisors* *Focus on several foreign markets *Uses fewer forms of franchising *Often reactive with some proactive efforts

SOURCE: Fladmoe-Lindquist, K, (1996) International Franchising: Capabilities and Development, Journal of Business Venturing, Vol. 11, 5, p419-39.

For example, an integrating franchisor may become a world-wide franchisor by increasing their set of capabilities (by improving host country management, improving franchisor-franchisee communication or fostering franchisee innovation) with such skills gained through existing international operations. According to Fladmoe-Lindquist (1996) it is the fact that firms have a dynamic capacity for learning new skills and abilities over time, which helps explain when and why international franchising strategies may be embarked upon.

In summary, recent internationalisation literature has aimed to explain why some firms develop international expansion strategies and other do not, as this was a failing of early internationalisation literature. Recent literature has argued that it is not only the characteristics of firms (size, age, experience) that determines international expansion, but the internal capabilities of firms which helps to explain why some firms develop internationalisation strategies and others do not. Firms that possess the desire to expand internationally, managerial skills, effective communication skills, monitoring capabilities, administrative efficiency and risk management capabilities are more likely to embark on international expansion. Such capabilities can also help to increase the likelihood of successful international development.

2.2.4 Franchise Failure

A key theme that emerged during the 1990s in the academic franchise literature was the issue of franchise failure. Franchising has, and continues to be, advocated as a more successful and secure strategy for business expansion and for business entry compared with entry into conventional small business ownership. This type of claim is frequently made by the franchise community (e.g. franchisors, franchise advisors, franchise exhibition organisers) and what Price (1997) calls the "How To" literature (e.g. franchise trade magazines and press, franchisor brochures/newsletters and recruitment pamphlets - see Exhibit2.2 for illustrations of such claims) (Stanworth *et al.*, 2001). Franchising is therefore portrayed by such groups as a highly successful business strategy, as it is based on replicating a proven business formula, which will ensure the franchisee success. The franchisor will be guaranteed success because it is able

Exhibit 2.2 The Populist Approach to Franchise Failure

1. "Relatively few franchises fail because most receive a comprehensive training package as part of the agreement" (Marketing Week, 27 October 1989)

2. "Putting success into the context of small business, commercial failures in franchising are considerably lower than the 42% defaults in the Government Loan Guarantee Scheme; and considerably less than the 43% closures within three years under the Enterprise Allowance Scheme or the general small business closure rate of 34% in the same time. The position in the UK is fast approaching that recorded in the US where nearly 38% of individual start-ups go out of business after the first year of operation, 57% after the second year; 67% after the third year; and 73% after the fourth year...by stark contrast...only 3% of franchises are discontinued in the US after one year; 6% after the second year; and 7% after the third and fourth years. After five years, 92% of franchises are still in operation..." (Brandenberg, 1989, p143)

3. "The knowledge and proven track record of the franchisor makes you around five times more likely to succeed with a franchise than with a conventional small business start-up" (Independent on Sunday, 21 February 1993).

4. "80% of Franchises Succeed" (Advertisement, Franchise World, May-June 1993)

5. "As a route for entrepreneurs to launch into business, franchising has one big plus: there are usually far fewer failures than other business start-ups" (the Times, 20 April 1994).

6. "Franchises are five times more likely to succeed than independent business start-ups" (Advertisement, Sunday Express, 1 October 1995)

7. "Whilst an increasing number of other countries also have thriving franchise industries, we remain the envy of many, because of the overall performance achieved here. I don't want to dwell on statistical data, which is available from reliable sources such as the British Franchise Association and the banks. Suffice to say, however, that the UK franchise industry has a record of continuing healthy growth with few failures" (Williams, 1995, p36)

8. "The success rate for franchise-owned businesses is very high. According to studies conducted by the US/Department of Commerce from 1971 to 1987, less than 5% of franchised businesses failed or were discontinued in each of those years" (Small Business Administration, 1996)

9. "Reputable franchising of the kind represented by the British Franchise Association has a nearly 95% success rate in establishing franchisees in business. This is not surprising. Surveys show that the vast majority (85%) of people becoming franchisees want to be in business on their own account. They also show that most of theme find the reassurance they expect from their franchisor" (Sir Bernard Ingham, President of the British Franchise Association, Franchise World Directory, 1997)

SOURCE: Price, S (1997) The Franchise Paradox, Cassell, p383 to gain access to highly motivated unit operators as well as front-end fees and on-going royalties from franchisees to fund further expansion of the network and system.

The franchise community's claim of low rates of failure is supported by several research studies (Bates, 1995; Price, 1997). For example, in the US the Department of Commerce 'Franchising in the Economy Series' (1988) indicated that between 1980-1986, an average of 140 franchisors withdrew each year, and annual franchisee failure rates have ranged historically from 2.1%-5.2% over the last two decades. Other research has also corroborated a figure of franchisee failure of around 4% annually (Castrogiovanni *et al.,* 1993; Cherkashy, 1996; Kursch, 1969; Lafontaine, 1992; Thompson, 1971; Vaughn, 1979). In the UK the NatWest/BFA Annual Reports indicate that the average annual franchisor withdrawal rate between 1986-1989 was 7% and for the period 1990-1994 it was 9% (Price, 1997). These reports also indicate that franchisee failure rate (i.e. the individual unit) is around 10% per annum (Price, 1997; Stanworth *et al.,* 1997).

Such favourable franchisee failure rates are also often compared to independent small business failure rates. The failure rate of independent businesses is reported to be around 50% in the UK (Storey, 1994). Thus, compared to independent business start-ups, it would appear that a franchise business is five times more likely to succeed, and this statistic is prominently reported within the franchise community. However, the failure rate of independent businesses is based on failure in the first five years of existence. Thus the 5:1 failure ratio commonly mis-quoted about franchise success is actually measuring *five-year* failure rates amongst independent small businesses with *annual* failure rates amongst franchisees. If this misinterpretation is corrected, the ratio declines to 1:1; a franchise business has the same chance of failing as an independent small business (Stanworth *et al.,* 1997).

Furthermore, previous research of franchise failure has been beset by definitional and methodological difficulties. First, definitional problems have meant that some research has failed to delineate franchisor and franchisee units and have therefore not distinguished between franchisor and franchisee failure rates. The word 'failure' is also interpreted in different ways. Firms that withdraw from franchising but continue to operate may or may not be regarded as failing. Franchisee failure is referred to in some surveys as 'under-performance' and 'decline', whereas other studies have used the term 'death' to define failure. Franchisee failure may also be difficult to detect because it can be 'disguised' by changing ownership or discontinuance. Therefore, McEvoy and Aldrich (1984) argue that 'turnover rate' (i.e. change of ownership or discontinuance) is actually a more meaningful statistic for franchisee failure rate. Thus, Mittlestaedt and Peterson (1980) demonstrate that franchisee failure rates for their survey were around the 5% mark, but if turnover statistics were added to this, franchisee 'failure' increased to twice this level. Ozanne and Hunt (1971) identified an annual failure rate of 6.7% amongst fast-food franchise systems in the US, but contend that actual failure (i.e. including outlet turnovers) could actually be two or even three times higher. According to data from the US International Franchise Association (1996), an annual closure rate of 4.2% increases to 8.9% if turnovers are added.

Second, surveys examining franchise failure have also suffered methodological difficulties in gaining access to accurate data from reliable sources. Some surveys have relied on franchisor-reported data (e.g. Castrogiovanni *et al.,* 1993). However this data may be unreliable because franchisors may under-report franchisee failures. The issue of failure is a contentious one, and franchisors will be defensive about franchisee failures, as this may result in adverse publicity which may subsequently affect brand equity, existing franchisee morale and the recruitment of future franchisees (Caves and Murphy, 1976: Kaufmann and Lafontaine, 1994; Lafontaine, 1995; Price, 1997). Thus, uncorroborated statistics are misrepresented in academic studies. Other surveys (e.g. the annual NatWest surveys) have utilised members of the British Franchise Association (BFA) and International Franchise Association (IFA) for sampling frames. However, the difficulty of using such sources is that a large number of franchisors (including disreputable franchisors) are not members of such bodies. Bates (1995) and Price (1997) observe that the BFA and IFA will also have a vested interest in promoting a positive picture of franchise growth and survival rates. Therefore, some commentators point to an 'information void' when trying to gain an accurate picture of franchise failure rates (Cross, 1994), particularly as failed or failing franchise systems rarely respond to research surveys (Price, 1997).

Another methodological problem, which some research has suffered from, is sample bias. For example, Castrogiovanni *et al.*, (1993) used predominantly older, larger and established franchise firms for their sample, but small, young franchise systems, which may have a greater propensity to fail, were not included in the sample and this may account for the favourable results of low failures rates. Bates (1998) demonstrates that 'unit of analysis' heavily influences firm survival rates. By using different parameters (i.e. different databases and definitions) Bates shows how different rates of franchise success are derived. For example, if establishment-specific data are used, franchise firms have better rates of survival then independent firms. However, if firm-specific data are used, independents have a better survival rate than franchise firms do. From a sample of approximately 52,000 young restaurant establishments started in 1986 and 1987, Bates (1998) found that independents were more likely to cease operations by 1988 than franchises. However, 84% of the new franchise establishments opened between 1986-1987 were units of multi-establishment corporations (i.e. multi-unit franchisees) and few of these corporations were new businesses. This accounts for the high success rate of franchises when using 'establishment' as the unit of analysis. If, for example, a multi-unit franchisee were to open its twentieth unit after several years of operating experience, that unit would have excellent survival prospects, more so than an independent start-up, or even a new single unit franchisee. However, when using 'young firms' as the unit of analysis, true 'newcomer' franchisees are likely to have lower survival rates than independent start-ups, and such differences persist when various firm and owner traits are controlled for statistically. Therefore Bates (1998) argues that data regarding franchisee start-ups should be disaggregated from data describing established firms in the franchisee population (although such data may be difficult to obtain) to gain a more accurate picture of franchise failure rates.

In response to these problems more recent research has attempted to generate more accurate data on franchise failure rates and overcome the definitional and methodological difficulties. More recent research has indicated a much higher rate of failure than previous surveys have shown. In the US, Lafontaine and Shaw (1996) surveyed 2,545 new franchisors started between 1980-1992, and found that 70% of the franchisors started in either 1980 or 1981 failed to survive to 1992. Shane (1995; 1996a) tracked 138 US franchisors originating in 1983 and found that only 25% survived ten years. Younger franchise systems were especially prone to failure, with years two, three and four illustrating the fastest rates of decline. Other evidence also suggests that franchisor failure is particularly prevalent in the early years of establishing a franchise system (see Price, 1996; 1997; Hough, 1982; IFA Educational Foundation, 1998; Ozanne and Hunt; 1971). Failure in the early years of operation is a trend mirrored in other forms of small firm development (Storey, 1994). In subsequent research (Shane, 1996a; 1998; Shane and Woo, 1998) similar rates of failure were also corroborated.

In the UK, Stanworth (1994) found from a sample of 74 franchise systems, operational since 1984, only one in four were still in existence over the ten-year period and were successfully operating franchise systems. [10] Price (1996; 1997) identified 1,658 firms which had franchises for sale between 1984 and 1995 in the UK, of which just (36%) were still in existence at the end of the period. The remaining had either failed outright or left franchising by choice. Younger franchise systems displayed higher withdrawal rates than older franchise systems. Stanworth *et al.*, (2001) found that of the 704 franchise systems listed in the two leading UK Franchise Directories in 1996, one third had failed or were untraceable and approximately one in eight had exited from franchising (although still in operation) when tracked two years later.

Reflecting the difficulty of obtaining accurate *franchisee* statistics, Bates (1995) has generated a more realistic picture of franchisee failure. Between 1984-1987, Bates (1995) found that 35% of franchisees had failed by 1991 compared to 28% of non-franchised businesses. Pre-tax income levels were also

[10] The sample consisted of five of the eight BFA original members as well as young franchise systems. Eight leading franchise experts were asked to categorize the 74 companies on a success and survival continuum.

higher for non-franchised businesses. However, the differences in performance rates between franchise firms and independent firms were based partly on differences in industry distribution: the franchise firms were over-represented in high-risk retailing for example. Bates also proposed that high levels of franchise fees and royalties, as well as saturated key franchise markets could be other contributing factors to the different performance rates between franchise firms and non-franchise firms. Similar results were also found in a follow-up paper (Bates, 1998); franchisees were more likely to fail than independent start-ups.

Reasons for franchise failure are four-fold. First, a franchisor may underestimate the costs of establishing the franchise concept and recruiting the first franchisees to initiate franchise-based expansion (Kirby and Watson, 1999; Price, 1996; 1997; Stanworth, 1995; Stanworth *et al.,* 1997). For example, in the US, the costs of developing a franchise systems have been estimated as being between $250,000-$500,000 (Trutko *et al.,* 1993; Entrepreneur Magazine, 1995) and £100,000 – £250, 000 in the UK (Ellingham, 1996). The production of the franchise manual and franchise contract, which are necessary for the successful implementation and operation of the franchise system, are costly documentation to produce (especially as the professional help of consultants, solicitors and accountants will be needed). Setting up and running a pilot outlet, as well as advertising for and recruiting franchisees may also be entry costs underestimated by the franchisor.[11] Ellingham (1996) contends that unless firms have an initial investment of a minimum £100,000 and recruit between 30-40 franchisees over a four year period, franchisors may not reach break-even point after six years in post pilot operation. Stanworth *et al.,* (1997) found that amongst a sample of 55 young franchise systems (0-2 years old), the majority were unrealistic and overly simplistic in predicting when breakeven would be achieved. Therefore, through a lack of understanding of the costs involved in franchise-based expansion and initial under-capitalisation a franchise system may fail.

Second, a firm may not have undertaken a feasibility study to ascertain if the business is suited to franchise-based expansion because of a lack of initial

[11] For example, the costs of exhibiting at a two day UK franchise trade fair would typically cost a franchisor between £8,000-£10,000 (Ellingham, 1996).

financial resource.[12] However, a lack of suitability to franchising and a lack of strategic planning could cause individual franchisee failure and even firm failure (Price, 1996).

Third, rapid over-expansion may cause failure.[13] Some franchisors may force expansion before they have the necessary experience, managerial expertise and management infrastructure to cope with the scale of operation (Cross, 1994; Stanworth *et al.*, 1997). As a result, individual units (franchisees) may under-perform or even fail as a franchisor may not have the resources, time or commitment necessary to support and sustain the rapid expansion of the franchisee network. Also, with rapid expansion, intrasystem competition (whereby franchise outlets are located too close together) may also occur. As a result, individual franchisees could suffer a decrease in outlet performance, sales and profitability or even failure of the outlet (Price, 1996; 1997).

Fourth, inadequate recruitment procedures may ultimately result in franchise unit failures (although this may be disguised by turnover rates). Poor franchisee screening may result in a mismatch between franchisee attributes and the franchisor's criteria for success (Bates, 1995; Cross, 1994). However, Macmillan (1996) observes that effective franchisee recruitment develops overtime and with experience, although this may not help young, small franchise systems in the initial recruitment stages. Stanworth and Purdy (1998b), Kirby and Watson (1999) and Watson and Kirby (2000) also found that some franchisors under-estimated the amount of support franchisees would require in the early stages of operation and this was one of the factors that led some firms to withdraw from franchising.

A small number of studies have attempted to determine the factors which promote franchise success. First, success may depend upon a franchisor's ability to achieve rapid growth in the first two years of operation. According to Shane

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[12] A lack of suitability to franchising may be because the business concept is not easily replicated in operation or in different localities, for example.

[13] Pierre Victoire, the UK-based, French-style bistro is an example of this. The company expanded too rapidly from an inadequate capital base. A failed expansion into Europe also contributed to the company's demise.

(1995), Stanworth (1995) and Stanworth *et al.,* (1997) the speed of franchise system development in the first two years of operation is an indicator of success, with the:

> *"more successful franchise companies appearing to grow more rapidly than their less successful counter-parts in the first two years"* (Stanworth *et al.,* 1997, p25).

Franchisors that grow quickly and effectively will be able to reach a minimum geographical scale to efficiently promote the brand name and other competitive advantages of the franchise system (Shane, 1995). The ability to grow quickly has also been an indicator of success in other business forms:

> *"probably the most powerful influence on their survival [of young firms] is whether or not they grow within a short period after start-up"* (Storey, 1994, p109).

However, as it has already been discussed, rapid *over-expansion* (such as that illustrated by Pierre Victoire) from an inadequate financial or operational base can, conversely, be a cause of failure.

A second, and often critical, factor of success is recruiting the right franchisee (Shane, 1996a; Fenwick and Strombom, 1998). According to Shane (1996a) firms which minimise 'agency costs' (e.g. adverse selection, moral hazard) are more likely to survive than firms that do not. Therefore, franchisors may try to recruit franchisees with, for example, experience, management skills and knowledge of the local market, which may aid successful operation. Fenwick and Strombom (1998) and Price (1997) have argued that the more successful franchisees are individuals which exhibit few entrepreneurial tendencies and which have little previous experience of the sector of operation. Entrepreneurial tendencies may make it difficult for a franchisee to stick to a prescribed franchise format and previous experience of the sector of operation may mean a franchisee is stuck in bad working practices.[14] However, it must be noted that such assumptions by the authors have not been tested empirically and there is little evidence to substantiate such claims.

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[14] This issue is returned to and discussed more fully in Section 2.3.4 and Chapter 6.

A third factor, which may determine survival rates, is the level of investment in the franchise units. English and Williams (1994) tracked American franchises, corporate chains and independent restaurants over a four-year period and found that initial investment was the best predicative measure of success. Franchise outlets in the sample had a rate of investment almost eight times as high as the independent firms, whereas the corporate chains had a rate of investment thirteen times as high as the independents. Therefore the corporate chains survived more frequently than the franchise units, but franchises survived better than the independent firms. Shane (1998) also found support for this contention; the higher the level of franchisee investment in a franchise unit, the less likely it will be to fail.

In summary, the franchise failure debate has been fraught with difficulties for two main reasons. First, the franchise community (which has a vested interest in promoting a positive picture of franchising) has continually reported an inaccurately low rate of failure for franchise activity. Second, some academic surveys have also reinforced low rates of franchisor and franchisee failure compared to other business forms. However, such studies have often suffered from definitional and methodological problems and statistical inaccuracies (Price, 1997). Only recently has more rigorous debate concerning franchise failure occurred, with studies such as Bates (1995, 1998), Lafontaine and Shaw (1996) and Shane (1996a) in the US and Stanworth (1994), Stanworth *et al.*, (2001) and Price (1996, 1997) in the UK contributing to a more realistic picture of franchise failure rate. The research has also demonstrated that contrary to popular belief, the franchise business form does not operate in an economic vacuum and is subject to the same economic upturns and downturns as other economic activity (Price, 1997).

2.3 Geographical Dimensions of Franchising

2.3.1 Introduction

It was argued at the end of Chapter 1 and in the introduction to this chapter that franchising is inherently geographical, yet this disciplinary perspective has not been significantly acknowledged in the academic franchise literature. The first part of Chapter 2 has demonstrated the limited nature of much of the franchise literature: there has been only a narrow focus of themes and topics emanating from a minority of disciplinary perspectives. Hence, Price (1997) argues that future franchise research should be more rigorous in investigation with a wider topic focus which incorporates disciplinary perspectives from the fields of sociology, psychology and geography, for example.

Indeed, the role of geography is implicit in some of the literature themes examined in the first part of this chapter. The resource constraints and agency theories, which are used as explanations for why firms franchise, have implicit geographic inferences. According to the resource constraints perspective franchising can be used as a method to achieve rapid spatial expansion and the agency perspective argues that franchising is used as an effective way to monitor geographically distant units by aligning agent motivation and compensation. The internationalisation theme examined in the literature demonstrates that franchising is a strategy used to achieve geographical expansion across international and national markets. The potential for conflict in the franchise relationship theme highlighted two implicitly geographical issues: the management of system growth and development over time and the management of format standardisation and adaptation. For example, Chapter 1 highlighted that the growth of franchising has been fairly static throughout the 1990s, and with more systems reaching maturity unit concentration may become higher, as firms seek to maintain growth through new unit development. However, addition of new units to a network may lead to cannibalisation and encroachment and increase conflict between the franchisor and franchisee. Failure of a franchise unit/system or operational difficulties may be linked to inadequate expansion strategies, territory definition or siting of franchise units and format rigidity, for example. Therefore, there are legitimate geographical issues to be explored but which have to date, received little attention by academia. Thus, this second part of Chapter 2 demonstrates that a geographical perspective of franchise activity is a valuable line of academic inquiry, by arguing that issues of expansion, location, territory and local market environment are central to franchise activity. Three key geographical issues are identified for examination and a research agenda to address these issues are outlined more fully in the following sections (2.3.2-2.3.4).

2.3.2 The Spatial Expansion of Franchise Systems in the UK

The examination of franchising on an international scale, outlined in Section 2.2.3, is in stark contrast to the limited nature of the literature examining the spatial expansion of franchising at a *national and sub-national scale*. This neglect is surprising, particularly as according to Price (1997) most franchisors are *not* international operations. Therefore, little is understood about how franchise systems expand within *national* boundaries. In other areas of economic activity – manufacturing and other service based sectors – the expansion process has been well-documented (Chapman and Walker, 1991; Hamilton, 1979; Hayter, 1997; Jones, 1981; 1982; 1988; Jones and Simmons, 1990; Keeble, 1976; Laulajainen, 1987; Mercurio, 1984; Sparks, 1986; Taylor, 1975; Watts, 1980).

Research findings have indicated that in a manufacturing context, a firm's employment and production capacity are initially concentrated in a single region (normally the region where the enterprise originated). A first phase of expansion may occur in close geographical proximity of the initial plant in order to minimise risk, utilise linkages with customers and suppliers and to cut transportation costs, for example. Progressive dispersal of a firm's activity gradually occurs, and operations extend outwards from this core region into other regions. Expansion will be accompanied by a lagged development of new factories, warehouses and offices, resulting in a more widely dispersed multi-plant operation. Subsequently, successive development of market areas and expansion to different geographical scales, from local to regional to national and even international markets, may occur (Chapman and Walker, 1991; Hayter 1997).

Studies of the service sector suggest that spatial expansion is hierarchical in nature (Jones, 1981; 1982; 1988; Jones and Simmons, 1990; Laulajainen, 1987; Mercurio, 1984; Sparks, 1986). Initial expansion is also often related to the home base of the firm, with locations in close geographical proximity being entered first by a service firm. However, the spatial expansion of a manufacturing firm is likely to be different from the spatial expansion of a firm in the service sector. Service activity generally requires a large number of outlets, close to local markets, suggesting a need for a more extensive geographical distribution and different pattern of expansion to a manufacturing firm (Curran and Stanworth, 1983; Hoy *et al.*, 2000).

In contrast, our knowledge of the expansion process for firms that operate as franchise systems is far from clear. This is as a result of the limited research, in both the geographical and franchise literatures, which has examined franchise system expansion at the national level. There have been only two explicitly geographical studies that have examined the spatial expansion of franchise systems - KFC in the UK (Newby and Hardwick, 1979) and McDonalds in the US (Aspbury, 1985). Both studies employed spatial diffusion and central place theories as frameworks of analysis in which to understand the expansion process. Similar to the expansion patterns outlined by research which has examined other service-based activity, these studies also suggest that the two fast food systems expanded in a hierarchical manner, opening franchise units in cities and large towns, thereby colonising the main population centres first. Over time, franchise units were also opened and operated in smaller settlements. However, expansion did not occur in only a hierarchical manner and furthermore, expansion and the pattern of expansion was not determined solely by franchisors. Once established in a location, the local expansion of a franchise system was facilitated by a 'contagious' or 'neighbourhood effect' whereby interpersonal contact and communication spread the franchise concept to the market and to potential franchisees within an area, via existing franchisees. Existing franchisees were also responsible for determining the pattern of expansion in localised areas: Aspbury (1985) found that some of the more successful McDonald's franchisees became multi-unit franchisees and located additional outlets within their localised area.

Attempting to understand the spatial expansion of the KFC and McDonalds franchise systems through the framework of spatial diffusion and central place theories is a useful starting point for offering insights into the franchise expansion process. However, a major limitation of this approach, as

Aspbury (1985) concedes, is that spatial diffusion does not adequately address the question *why* the firms expanded in the way they did. The main weakness of both studies is that neither attempts to fully understand or explain the spatial patterns evident in both networks in terms of underlying *firm decision making processes* and *firm expansion strategies*. For example, Aspbury (1985) contends that the hierarchical expansion evident in the McDonald's network is related to market potential and demand, where the firm may have entered largest markets first because such markets would have proportionally more potential entrepreneurs than smaller markets. This availability of potential franchisees would have facilitated early growth of the system. However, it is difficult to know if a hierarchical strategy was what the firm originally intended, as the firm's underlying reasons and motivations were not addressed by the study.

A further limitation of the Newby and Hardwick (1979) and Aspbury (1985) studies is that both systems used in the research are in the fast food sector. As business format franchising is a heterogeneous activity (as the remainder of this thesis will highlight), the findings from these studies may not be applicable to other sectors. Our knowledge of how franchise systems achieve expansion is therefore limited in terms of its sector focus.

However, more recent research has attempted to examine the expansion strategies of franchisors in the UK (Forward and Fulop, 1995). Although the franchise expansion process was not the main focus of the research, the findings from this study suggest that firms had either site-led or franchisee-led strategies for achieving spatial expansion. With a franchisee driven strategy, franchisees were recruited to a network first and then suitable sites were found. With a site driven strategy sites in which to locate were found first and then suitable franchisees were recruited to a network. Although these findings are insightful and Forward and Fulop (1995) attempt to explain the decision making processes underlying franchise expansion the research was only conducted with a small number of franchise systems. Thus, such findings may not be in use in other UK based franchise operations.

Therefore, in light of the weaknesses of extant literature, there is a need to clearly understand how franchise systems achieve spatial expansion by examining the growth strategies that are used by firms. By an in-depth examination of this issue, theoretical comparisons of the expansion process with other types of economic activity will be possible and enable a contribution to organisational theories. It will also be possible to make observations of empirical regularities in franchise spatial expansion and from a practical perspective, this could help new firms embarking upon franchising assess and face the challenges and issues associated with the expansion process.

Thus, two main questions for investigation arise. In order to understand *how* firms expand, it is first necessary to examine *why* firms use franchising to achieve expansion, as this is the first decision making process undertaken by a potential franchisor. As section 2.2.2 of this chapter outlined, one of the dominant themes examined in the academic franchise literature is the question of why firms franchise. One of the main explanations - the resource constraints perspective - is implicitly geographical, as the theory explains the use of franchising as a way to achieve *rapid* spatial growth by accessing vital expansion resources of the franchisee. Therefore, the first question will assess whether firms in the current study use franchising to achieve rapid spatial growth or use franchising for other potential benefits by asking:

1.) Why do firms expand by using the franchise method?

The second question will address how firms achieve growth by examining the strategies which are used to achieve spatial expansion. In so doing, the study offers the first in-depth analysis of the spatial decision making processes of franchisors from across different sectors of franchise activity and from within the UK:

2.) How do franchisors achieve spatial expansion – what strategies are used to achieve growth within the UK?

These two questions will be the focus of in-depth examination in Chapter 4.

2.3.3 Franchise Network Allocation and Network Dynamics

One of the fundamental features of franchising is that the franchisee is given the right to trade within a specified geographical area – a franchise territory. However, not all firms will formally assign customers to franchisees through allocation of a territory. Instead, a franchisor will grant a licence to a franchisee for a unit and define a *market area* in which to locate that unit (Barrow *et al.*, 1999; The Midland Bank Guide to Franchising, 1999).

Although allocation of a territory or market area is one of the key operational aspects of business format franchising and is a component of the franchise contract (Mendelsohn, 1996; Stanworth and Smith, 1991) it is largely unknown how franchisors *define* a territory/market area, as very few academic studies have explored this issue. Successful territory/market area definition is a central task for the franchisor, the franchisee and the franchise system as a whole. If franchisors allocate territories that are too large, franchisees may not perform adequately or derive maximum returns. Leaving parts of a territory under-exploited could also result in a source of conflict between a franchisor and a franchisee (Micheal, 1996; Price, 1997; Pratt, 1997; Spinelli, 1994). Small territories or territories that lack market potential will make operation difficult for franchisees and long term survival may be jeopardised (Mendelsohn and Harris, 1991). Unit failure caused by poor territory definition or inadequate site location will be costly to the franchisor, could harm the reputation of the franchise system and could ultimately, affect franchisee recruitment. Clearly delineated territorial boundaries, which are stipulated in franchise contracts, will also be important to ensure effective operation of networks and assure franchisees of the areas in which they can operate and minimise any potential operational conflict (for example, an unethical franchisee may attempt to poach another's customers).

In view of this, it is not surprising that much of what Price (1997) calls the 'How To' literature[15] offers guidance for the potential franchisor and outlines the techniques and criteria franchisors can use to define franchise territories/market areas or locational analysis for site selection (e.g. demographic surveys, socio-economic profiling, visibility surveys). For potential franchisees,

[15] Advice that is given by franchise advisors and consultants, trade press and the high street banks.

such literature also outlines the necessary requirements of a viable territory or unit location. For example:

> *"you should ask yourself vital questions like: how many customers are there in the area?; how are the customers spread across the territory?; what competition is in the area?; and how good is travel and communication?"* (The United Kingdom Franchise Directory, 1999, p21)

> *"The rationale behind the territory assignment needs to be examined. Has the franchisor picked it out arbitrarily or has he conducted – as he should have done - market surveys to indicate that the franchise is likely to be viable in that territory? These should cover aspects like traffic flows, access, population mix by age and class, and so forth, and they should be made available to the franchisee"* (Barrow *et al.*, 1999, p26).

Given that territory/market area definition are important aspects of franchise operation, and the issue is given prime importance in the practical 'How To' literature, it is something of a paradox that franchise territory/market area definition has not been explored in more depth in the academic literature. In one of the few studies which does acknowledge how franchise territories are defined (although the observations are not the main focus of the paper) Zellar *et al.*, (1980) confirm that in the US, territories have either been defined by using predetermined geographical boundaries (such as a county boundary), using minimum distance between outlets, or by using market and population measurements. In another study, Bush *et al.*, (1976) confirm that the most important defining criteria of territory allocation for US operations is population. Such techniques are similar to the ones used to define retail trade areas (market measurements used to define a retail trade area include household data, consumer segments, level of income and degree and type of competition; Jones and Simmons, 1990). Spinelli (1994) also outlines some of the siting techniques and criteria that US franchisors use to locate franchise units (such as population estimates, patterns and volume of traffic, visibility and ingress and egress to a site). However, not all franchise systems are location or retail based operations which need to use siting techniques. As there has been little research, to date, examining how franchisors define franchise territories/market areas or locate franchise units, knowledge of how these key operational tasks are conducted is limited. Therefore, the question arises:

1) What techniques and criteria do franchisors in the UK use to define and delineate franchise territories/market areas and locate franchise units?

The difficulty of franchise territory/market area definition is that it is a *static* process undertaken by the franchisor or head office team at one point in space and time in the initial or roll out stages of growth. However, markets are dynamic not static. Shifting demographics, the success of the franchise system as the format becomes better known, changing business populations, competitive pressures, new roads or new shopping centre developments could all affect and alter the composition and market potential within a franchise territory (either positively or negatively). As Spinelli (1994, p367) observes: *"demographics are a constantly evolving factor and the market area will inevitably change."* Therefore, the allocation of customers between franchisees is on ongoing issue/challenge and franchisors may find that there are opportunities to establish additional units in a territory or market area because market potential has simply extended beyond the initial expectations and saturation points predicted by a franchisor at the initial and roll out stages of expansion. (Ghosh and Craig, 1991; Kaufmann, 1995; Stassen and Mittelstaedt, 1995; Zellar *et al.*, 1980).

The consequence of changes to market penetration is that the original allocation and definition of franchise territories and market areas determined by franchisors in the early stages of expansion may become out-dated and need to be altered and redefined to take account of this change. The dynamic, underlying the growth of a franchise network, may mean that a franchisor has to restructure the geographical basis of the network to take advantage of new market opportunities. New expansion opportunities may be geographically uneven and occur on just an individual basis of a few territories where demand has shown up over time (i.e. minor restructuring) or market demand may have increased so substantially that restructuring is necessary on a network-wide scale (i.e. major restructuring of the whole franchise network). Thus, the question arises:

2.) How common is it for franchise systems to undergo network restructuring?

If firms have experienced an increase in the level of market penetration and territory/market area delineations have become outdated and inadequate, the opportunities of new market potential pose two unique difficulties for franchisors. First, how a franchisor designs and allocates its network can have important consequences for the process of network restructuring. The discussion has already outlined two approaches to network allocation: networks allocated on the basis of territories and networks allocated on the basis of market areas. A further choice of network design, and one of the features specific to a franchise operation, is that a franchisor may grant *exclusive rights* to an operational area (Mendelsohn, 1991). In other words, the franchisee has contractual assurance that a new unit (either franchised or company-owned) will not be located within its territory. Offering exclusive territorial rights can be a way some franchisors attract and recruit franchisees, as the exclusivity status will signal to potential operators that intra-system competition will not be a threat within the network, an obvious attraction for the new franchisee (Bradach, 1995; Kaufmann and Rangan, 1990; Vincent, 1998; Zellar *et al.*, 1980). However, granting exclusive rights for the length of the contract (which in some cases could be for ten years or more) may mean a franchisor will be unable to restructure its network or individual territories.

If market demand has increased in a territory so that it is beyond the capabilities of the original unit to meet it and there is a need to add further unit(s) into the territory, legally a franchisor will be unable to do so with an exclusive territorial network allocation, as this will be in breach of the franchise contract. Firms with different network allocations that do not fix defined boundaries around an operational area may not face the same issues with restructuring. However, what effect different network allocations have on the restructuring process has not been rigorously examined by previous research. Thus, the question arises:

3) If original operational areas designated in the roll out stage become outdated by changes in the level of market penetration, does network design and allocation affect the restructuring process?

The second reason why the opportunities of new market potential pose unique difficulties for the franchisor is because of the dispersed ownership structure that exists in franchise networks. Unlike a corporate operation, where the ownership structure is the same, franchisors have to consider the effects of network restructuring on its *existing franchisees* and the businesses they own and operate (Bush *et al.*, 1976; Current and Storbeck, 1994; Ghosh and Craig, 1991; Kaufmann and Rangan, 1990; Spinelli and Bygrave, 1992; Vincent, 1998; Zellar *et al.*, 1980).

Whilst the franchisor's objective will be to develop new market potential this may be difficult to achieve, as the *franchisee's objective* will not necessarily coincide with that of the franchisor. As several authors observe (Bush *et al.*, 1976; Current and Storbeck, 1994; Ghosh and Craig, 1991; Kaufmann and Rangan, 1990; Spinelli and Bygrave, 1992; Zellar *et al.*, 1980), franchisor and franchisee goals rarely coincide and may even conflict when market development is accelerated. Whilst a franchisor will want to maximise system-wide sales a franchisee will be concerned with protecting their investment and maximising unit profit. For the franchisor, developing new market potential will be a way to maximise system-wide sales. Gaps which are left unexploited will be ultimately detrimental to the network as a whole. Therefore, developing new units would not only fill market gaps, making the network less open to competitive encroachment, but will increase system-wide revenue, achieve economies of scale and increase the level of awareness of the franchise system by making the operation more visible and the product/service more readily available. However, achieving optimal market penetration for the franchise network as a whole may not be in the interests of a franchisee. Adding extra units into the network may mean a franchisee loses part of its operational area with a new - and from the franchisee's perspective - competing unit, located near to its own unit, possibly causing cannibalisation of a franchisee's sales and profit (Mayfield, 1997; Ryans *et al.*, 1997). Franchisors may therefore have to deal with issues of encroachment and conflict:

> *"a system that does not franchise can expand its system in a particular area and increase its market share without hesitation or concern of a potential lawsuit being filed if sales of its surrounding units are adversely affected. However, a system that relies on franchising for its expansion faces the problem of encroachment with its existing franchisees as it opens more units in a particular area"* (Vincent, 1998, p29).

In the US, research has suggested that in some saturated markets, such as the fast food sector, encroachment and cannibalisation (and as a result, conflict and litigation) induced by changes to market penetration levels have increased (Barkoff and Garner, 1993; Fox and Su, 1995; Vincent, 1998). For example, research has highlighted encroachment disputes which have resulted in litigation between franchisors and franchisees from Burger King and McDonald's (Vincent, 1998), KFC (Hume, 1990), Subway (Marsh, 1992) and Taco Bell (Barret, 1992). Kaufmann and Rangan (1990) also found that one US franchisor spent 40% of its time on resolving group conflicts which had arisen from new unit openings. Three of the main specialist franchise lawyers in the UK concur that encroachment is a major problem for some of the large franchise systems in some sectors of the US franchise market (Abell, 1999, personal correspondence; Ishani, 1999, personal correspondence; Pratt, 1999, personal correspondence). However, it is less clear whether encroachment is a problem in the UK as little research has focused on the issues of intra-system spatial competition and encroachment within UK franchise systems.

Whilst the addition of new units to a network will generally be beneficial for a franchisor and a franchise system as a whole, it will be important that any benefit is not outweighed by the cost of conflict arising from new unit additions. A franchisor must keep conflicts and disputes at a minimal level otherwise the franchisor will have to expend valuable resources (time, money, effort) resolving disputes between old and new franchisees, (see Kaufmann and Rangan, 1990). Thus, existing franchisees must be a part of the franchisor's considerations when developing new market potential and continuing network development. A franchisor therefore has the task of balancing growth of the network from the first stages of expansion to subsequent stages with the interests of its franchisees. As Stassen and Mittelstaedt (1995) reiterate, one of the major challenges for a franchise system is to obtain *"a balance between system growth which assures that the franchisor maintains competitive advantage whilst maintaining a network of profitable outlets"* (Stassen and Mittelstaedt, 1995, p44*)*.

Although the literature has identified the problem franchisors face in balancing system growth over time with the effects of this on existing networks of franchisees, there has been little effort by the extant literature to examine in an empirical context how firms have attempted to *resolve* this problem. There has been some reference within the literature to how the method of franchising (i.e. multi-unit franchisees (see Bradach, 1995) and area franchisees (see Zellar *et al.*, 1980)) can be an effective solution to the problem of adding new units to a network over time. With both methods, existing franchisees establish and develop new units within their operational areas. This enables franchisors to minimise the financial and agency risk of recruiting a new operator as well as minimising the potential for conflict between the old and new franchisee with a new unit introduction. However, whilst the phenomena of multi-unit franchisees has begun to be examined more comprehensively by the literature (see for example, Kalnins and Lafontaine, 1996; Kaufmann and Dant, 1996; Kaufmann and Kim, 1995),[16] research which has addressed the potential for multi-unit franchisees to resolve the network restructuring issue is limited to the contributions of Bradach (1995) and Zellar *et al.*, (1980) although these authors' observations were not the central focus of their research.

Instead, the majority of previous research has largely been limited to developing mathematical models to assist the franchisor in its locational decision making process, rather than examining the resolution processes which are actually used by franchisors when adding new units to an existing network. Theoretically, locational models help the franchisor find optimal sites for new unit introductions, which will cause minimal cannibalisation to existing franchisees' sales and profit (see Current and Storbeck, 1994; Ghosh and Craig, 1991; Kaufmann and Rangan, 1990; Stassen and Mittelstaedt, 1995; Zellar *et al.*, 1980). However, whilst these models are potentially useful tools, they have limitations. Most importantly, as Elango and Fried (1998) point out, not one of the models developed in the academic literature has been tested in an empirical context. It is unlikely that a theoretical model will be as effective in a real environment as the literature portrays. Furthermore, the models are only applicable for retail or location based systems. Preceding chapters have illustrated the diverse sectors of business format franchising activity in both the US and UK and so it is unlikely that such models would be of use to non-location

[16] This research has focused on the characteristics of the multi-unit franchisee compared to the single unit operator, the role that multi-unit franchisees assume within the network and system growth rates in comparison with networks using single-unit franchisees to expand.

or non-retail based operations, as the different type of franchise systems face different locational decisions.

In summary, there has been little attempt in the academic literature to understand how franchisors, with different network allocations, continue network growth over time yet maintain profitable and successful networks of existing units. Neither has the issue of how franchisors attempt to resolve the challenges caused by new expansion been rigorously examined in an empirical context. Thus, a final question arises:

> ***4) How do franchisors resolve the network restructuring problem: what mechanisms or policies do franchisors in the UK use or have in place to facilitate the restructuring process?***

These four questions are the focus of in-depth inquiry in Chapter 5.

2.3.4 Franchise Formats and the Role of the Local Environment

Business format franchising operates on the principal of replicating a standardised tried and tested business format,[17] based around a tradename/trademark product or service, in different localities (Julian and Castrogiovanni, 1995; Kaufmann and Rangan, 1990; Stanworth *et al.,* 1996). The importance of standardisation is, as Falbe and Dandridge (1992, p48) observe: *"the cornerstone of franchising: customers expect the same product or service at every location."* Standardisation and uniformity are imperative to ensure not only the successful implementation of a franchise format, but to also ensure a franchise system's reputation and ability to attract and retain customers. It is a franchisor's responsibility to project an image of consistency and uniformity, which is essential for the integrity of the brand and mass promotion of the system (Dandridge and Falbe, 1994; Michael, 1996; Price, 1997).

Most franchise operations sell locally – are often territorially based – with units competing in geographically diverse local markets affected by variations in supply and demand (e.g. availability of labour and premises, different levels of

[17] Components of the franchise format are discussed more fully in Chapter 6. For the purposes of the discussion here, the franchise format encompasses the product or service deliverables, benefit communicators (intangible elements such as quality, cleanliness), system identifiers (e.g. tradename, logo) and system facilitators (such as operational manuals outlining procedures and guidelines).

disposable income, different consumer tastes and preferences). Yet individual unit operators (franchisees) attempt to compete in geographically diverse local markets by following international or national standardised business formats. Thus, because of the opportunities or constraints of local markets, adaptation and innovation of the format may be sought by franchisees to ensure successful and competitive local unit operation (Dandridge and Falbe, 1994; Michael, 1996; Stanworth *et al.*, 1996; Tuunanen and Hyrsky, 2001). Therein lies the paradox of business format franchising, as Kaufmann and Eroglu (1998, p70) observe:

> *"to succeed in its role as creator, builder and guardian of its business format...the [franchisor] must resolve the constant, yet evolving, tension between the two strategic imperatives of standardisation and adaptation."*

Operating to a standardised franchise format (which does not allow the flexibility to respond to the conditions of the local environment) could, for example, limit the franchisee's ability to meet the demands of local customers, act competitively (Ryans *et al.*, 1997), or constrain a franchisee from using their knowledge about local market conditions (Michael, 1996). A franchisee is in direct, daily contact with customers and could provide valuable feedback on the demands of the franchise system's customers and sense new trends and opportunities to introduce new products or services (Price, 1997). Franchisees maybe useful sources of new ideas and innovations for product/service development (Dandridge and Falbe, 1994; Falbe and Dandridge, 1992; Price, 1997).[18]

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[18] Innovations/adaptations can be either technical or administrative in nature, or focus on the product/service itself. To use McDonald's as an example, technical innovations include the McDonald's hand-held stainless steel pump dispenser used for dressings. As an example of administrative innovation, a McDonald's franchisee developed and used computer software to prepare employee work schedules, lowering costs and manning levels (Stanworth *et al.*, 1996; Price, 1997). Examples of product innovations/adaptations include McDonald's 'Big Mac' and 'Egg McMuffin', both introduced by franchisees (Love, 1986; Shook and Shook, 1993). Perhaps the most celebrated case of a franchisee adapting to its local market environment, is the McDonald's franchisee Lou Groen who owned a franchise in a predominantly Catholic neighbourhood in Cincinnati. Revenues at the restaurant were always satisfactory apart from on Friday's, where his normal clientele observed the religious practices of their faith. In order to maintain sales volume, Groen experimented with different products and innovatively developed a fish sandwich, to meet the demands of his local consumer market. After initial rejection, the innovation ('Fillet-of-Fish') was introduced system-wide (Shook and Shook, 1993; Stanworth *et al.*, 1996).

Franchisors do accept some degree of adaptation of the franchise format on an international scale. Host country factors, such as different socio-cultural and economic environments have to be taken into account (Hopkins, 1996; Falbe and Dandridge, 1992; Fladmoe-Lindquist, 1996; Stanworth *et al.,* 1996). Modifications and adaptations to the original product/service, marketing and operating system may be necessary otherwise the franchise system may not be successful (Forward and Fulop, 1995; 1997; Hoffman and Preble, 1990). For example, a franchisor may adapt a product to satisfy the international customer's preference by changing a recipe, portion size or packaging. More radically, new product innovations, which suit different tastes and preferences and compliment local products may be another strategy employed by the franchisor in adapting to an international market (Falbe and Dandridge, 1992).[19]

In the wider small firm literature, research has also shown a link between geographical environment and firm strategy. For example, North *et al.,* (1993), North and Smallbone, (1995), Vaessen and Weaver, (1993) and Vaessen and Keeble, (1995) found that differences in environmental conditions led firms to adapt to the opportunities and constraints of local markets. Firms changed, for example, recruitment and training policies if labour constraints or shortcomings in occupational skill structures existed in local markets by offering formal training programmes and having extra in-service training for local workers. However, such types of business operations are independent and do not operate to *standardised business formats* and can therefore adapt strategies accordingly. In business format franchise operations, differences in the nature of local markets across a national franchise system could result in *"franchisee requests for idiosyncratic adaptations in various aspects of the business"* (Kaufmann and Eroglu, 1998, p70) which could erode system uniformity.

Whilst the issue of format standardisation has been discussed on an international scale in the academic franchise literature, there has as yet, been

[19] McDonald's has even found the need to make local accommodations. For example, it has introduced a 'McDough' burger, a Phillipian-style hamburger, in its Manila location in order to compete with the local Jollibee chain (Ryans *et al.,* 1997). Hoy *et al.,* (1998) found that a Mexican franchisor, which expanded to the US, failed to take account of US tastes and

little acknowledgement of the role of *local* geographical environment as a factor which can instigate standardisation/adaptations tensions within business format franchise operations. Although Kaufmann and Eroglu (1998) point to market differences as an inhibitor of format standardisation, there is no empirical evidence to support the claim in their positional paper. Bradach (1998) does provide some empirical evidence in his study of five US fast food systems. The findings suggest that the local geographical environment affected format implementation in all five systems and local responses were sought. Although the findings from this study are insightful and demonstrate the importance of local market environment as a factor which may inhibit format standardisation, the results are American in origin and are concentrated in only one sector of operation. Thus, the findings may not be generalisable to other sectors of operation or applicable to the UK context. Therefore, as the effect of local geographical environment on format implementation has not been rigorously examined, the questions arise:

> ***1.) Does local geographical environment affect format implementation?***
>
> ***2.) To what extent will a franchisor permit local market responsiveness before format conformity is enforced?***

These two questions are the focus of in-depth inquiry in Chapter 6.

2.4 Summary

This chapter had three main aims. The first aim was to give an in-depth review of the key themes of the existing franchise literature and to summarise the main debates and focus of academic inquiry to date. This analysis has revealed the limited nature of much of the franchise literature in terms of its disciplinary and topic focus. Thus, the second aim of the chapter was to provide the rationale for the thesis by arguing that there are inherently geographical aspects to franchise activity. The third aim of the chapter was to outline therefore a research agenda to address three key geographical issues. The remainder of the thesis, for which this chapter has set the context, will address the research agenda and in so doing will not only help to broaden the disciplinary and topic focus of

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preferences (i.e. local consumer culture) and this was a contributing factor to the company's demise.

the franchise literature but provide an in-depth exploratory study of franchising from a geographical perspective. In the following chapter, a research methodology is proposed with which to carry out the study.

Chapter 3 Methodology

3.1 Introduction

Chapter 2 argued that the academic franchise literature is somewhat limited in disciplinary and topic focus and as a consequence, our understanding of this form of business organisation is far from complete. Thus, the chapter outlined the central aim of this thesis: to broaden the disciplinary and topic focus of franchise research by examining three key geographical issues, as it was argued that franchising is inherently geographical. The research questions outlined at the end Chapter 2 provides the research agenda which underpins this thesis. Chapter 3 will therefore examine how the research agenda was addressed by discussing the methodological approach that was used. Justification for the methodological approach, as well as the problems that were encountered and how they were overcome/minimised are also outlined. The chapter starts with a general background discussion of the methodologies that have been used in past/current franchise research and how this mirrors the wider social science methodological debate.

3.2 Existing Franchise Research - Methodological Considerations

Most franchise research is quantitative in methodological approach, as the majority of this research is American in origin, where quantitative methods have assumed predominance.[1] The reason quantitative methods occupy a dominant position in US research is underpinned by a theoretical, cultural and political value system of research in the US, where quantitative methods are valued as more scientific, rigorous and valid (Berg, 1989; Stanworth, 1998). Shane (1998)[2] has highlighted how qualitative methods are less accepted than quantitative methods and are perceived as subjective and unrigorous in the US

[1] Although the majority of franchise research is US in origin, there are a few key UK-based researchers working in the franchising field. Professor John Stanworth is the most prolific researcher in the franchising arena, and his research has covered topics such as franchisee motivation, franchise failure rates and understanding franchising from a broader theoretical and sociological perspective. Alan Felstead's work focused primarily on franchisee autonomy and independence within the franchise relationship. Stuart Price has focused on understanding and accessing a more accurate picture of the failure rate of franchise systems in the UK, and linking the failure issues to the degree and type of innovation within franchise systems to discern whether franchises are sustainable.

academic domain. Reflecting this epistemological position, franchise literature in the US has tended to be biased towards predominantly quantitative journals (such as Journal of Business Venturing) and this determines the methodological approach and the research that is conducted.[3]

Stanworth (1998, p107) suggests this elevated position afforded to quantitative research is also due to a more pragmatic reason:

> "*US academics [are] under tremendous pressure to publish, relying massively on secondary data often unsuitable for the purposes to which it is put and almost invariably, and somewhat tediously, run through endless statistical tests even when the samples are tiny. Much US literature in this area is insular, repetitive, overly reliant upon statistical treatment for 'padding' and ultimately, incredibly uncritical.*"

Therefore, the quantitative nature of franchise research has been criticised:

> "*[t]he empirical investigations undertaken to validate theoretical perspectives have often seemed to bear little relationship to franchising in practice. This divergence is attributed....to the* ***adoption of a methodology****, namely, the reliance predominantly in North America on large-scale statistical surveys based on inappropriate data collection and sampling bias. This has resulted in the* ***neglect or omission of factors and relationships, often crucial in franchise decision making****, and a failure to take account that franchising is more* ***heterogeneous*** *than might be first thought*" (Forward and Fulop, 1997, p619, emphasis added).

Thus, Forward and Fulop (1997) argue for a more qualitative approach to franchise research:

> "*In order to capture more detailed insights into franchising more emphasis should be placed on interactive methods of data collection to enable the acquisition of* ***qualitative data which would help to compliment and redress some of the weaknesses of the large-scale statistical survey*** (Forward and Fulop, 1997, p619, emphasis added).

Elango and Fried (1997) also reiterate the need for more qualitative studies in US franchise research and call for a more fine-grained approach to franchise research, as this would attempt to capture franchise phenomena more accurately:

> "*[w]hile a coarse-grained approach often results in generalisable findings with statistical significance, it often fails to capture the complexity and subtlety of actual business practice. The result can be research with limited practical relevance...we feel it is important for*

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[2] Speaking at the Babson-Kaufmann Doctoral Consortium, Gent, Belgium, May 1998.
[3] Appendix A, utilising special editions of the Journal of Business Venturing devoted to franchise research, between 1996-1999 illustrates the quantitative nature of much of the franchise literature.

> *some franchising research studies to use more fine-grained research methods. Fine-grained methods like case studies capture details of context by studying the phenomena in detail. These methodologies are well-suited to deal with complex situations"* (Elango and Fried, 1997, p18).

The methodological issues faced by franchise-based research echoes the wider methodological debate in the social sciences regarding the nature and constitution of 'science' and 'scientific method'. Traditionally, quantitative methodologies served a positivist ideal by statistically testing large aggregates of data and empirical hypotheses. This supposedly led to rigorous, reliable, verifiable (and more reportable) findings and conclusions (Berg, 1989; Curran and Blackburn, 2001; Schoenberger, 1991). This position exists because quantitative methods are seen as providing 'scientific truth' due to the privileged status and respect afforded to statistical analysis and manipulation in both the academic and public domains. However, many have argued that although quantitative methods maybe useful and appropriate in context, these procedures have often been used indiscriminately in application and have been reductionistic and inhuman, with the methods used at the expense of theory and substance (Berg, 1989). Clearly, certain experiences cannot be meaningfully expressed by numbers and statistical models, particularly where human activity and endeavour are involved. Since the late 1960s, a substantial critique of positivism has therefore ensued as several commentators in the social sciences became disillusioned with the quantitative tradition and methodological approach (Herod, 1993). Consequently, more humanistic approaches were sought (Cook and Crang, 1993).

Thus, the development of qualitative methodologies sought to derive greater depth of understanding and communication with the subjects and individual actors under research, instead of producing statistical descriptions and attempting to generalise, predict and control. Qualitative methods provided a means of accessing unquantifiable facts and processes, as the procedures enabled a researcher to gain an understanding of underlying reasons, decisions, thoughts and feelings of respondents, and so attempted to demonstrate causality (Curran and Blackburn, 2001; Herod, 1993). The approach could also aid in gaining insights into the complex nature of ongoing processes under research which may not be fixed in time or space but may be in a constant state of flux (Schoenberger, 1991; Cook and Crang, 1993).

However, qualitative methods are often time consuming and 'messy' in practice (Cook and Crang, 1993)[4]. Such methods are also not without criticism. The main criticism of qualitative approaches is that because they are labour intensive, they are typically limited in scale and this weakens generalisability (Curran and Blackburn, 2001). Therefore, qualitative methods are seen as subjective and non-scientific and thus devoid of validity. However, Cook and Crang (1993), among others, (see Herod, 1993; Jankowicz, 2000; McDowell, 1992; Schoenberger, 1992) have argued that recognising the embeddedness and subjectivity of the research process is the strength of qualitative methods and it is this very quality which gives the procedures reliability and validity from which more rigorous understandings may be built, as the methods are at least an 'honest attempt to engage with the real world' (Cook and Crang, 1993).

In sum, clearly quantitative and qualitative methodologies are both equally valid. The choice of methodology will be governed by the research agenda and the theoretical framework underpinning the research (Kumar, 1999; Curran and Blackburn, 2001). The majority of franchise research has tended to originate from the US and is mostly quantitative in nature, which reflects the epistemological, theoretical and cultural value system underpinning American research and demonstrates that research does not take place in a vacuum, but is also governed by external factors. Whilst quantitative studies can produce useful findings, as Forward and Fulop (1997) argue, such types of studies do not necessarily capture more detailed insights of franchise activity. As outlined at the end of Chapter 2, the research agenda for this thesis is to answer a number of 'why' questions, and it is this type of study which is best addressed through a qualitative methodology. Therefore, the following section (3.3) explains the research method that was used in this study and provides justification for this methodological approach.

[4] as quantitative methods can also be

3.3 Research Method

The methodology adopted for this thesis is a qualitative approach. As well as the theoretical and epistemological argument underpinning the methodological approach outlined in the preceding section, there is also a more plain and practical reason for the adoption of a qualitative approach for this thesis. The research questions which this thesis seeks to address requires access to underlying reasons, motivations and decision-making processes of key agents (directors/managers/owners) of franchise operations in order to understand a firm's behaviour and activities (Cook and Crang, 1993; Healey and Rawlinson, 1993; Herod, 1993; Schoenberger, 1991). This required interviews as the information was only available by direct contact with firms. As Healey and Rawlinson (1993, p340) observe, *"in many instances an interview survey of businesses is the only way to obtain the answers to the questions that researchers pose."* The nature of the information required was qualitative and in-depth interviews would enable the key actors to give an account of their individual motives, experiences and opinions. In-depth interviews were therefore used as the method of gathering information as this permitted a more thorough and direct examination of the ongoing strategic decision making processes of respondents. This allowed the reasons for individual and firm decisions, as well as causal factors, to be revealed rather than merely inferring causation from statistical generalisations (Fothergill and Guy, 1990; Schoenberger, 1991; Healey and Rawlinson, 1993) or deducing strategic behaviour from organisational and locational effects (Schoenberger, 1991). Thus, Schoenberger (1991) argues that in-depth interviews are more sensitive than other survey methods to historical, institutional and strategic complexity and a researcher can access and understand a firm's behaviour in light of its own history and circumstances.

There are also a number of other advantages to a qualitative approach and an interviewing method. First, interviews are a way of ensuring a better response rate within a research study, compared with postal questionnaires for example, which often have low response rates (Healey and Rawlinson, 1993). Second, interviews let respondents give the answers they want and not answers that have been stipulated by the researcher (as in a questionnaire survey). Interviews do not force respondents into specified categories as responses or topics have not been ruled out in advance. This allows for a wider ranging discussion to occur (Herod, 1993; Valentine, 1997). Interviews can thus let respondents open up and tell 'their story' and let experiences be described, if an interviewer has established a level of trust and rapport with an interviewee. This process can uncover truths that may remain hidden with other methods:

> *"the material generated in this way is rich, detailed and multi-layered, producing a 'deeper picture' than a questionnaire survey* (Valentine, 1997, p111)

> *"the richness of detail and historical complexity that can be derived from an interview-based approach allows one to reconstruct a coherent representation of how and why particular phenomena came to be...and can reveal underlying causal mechanisms and structures that lie behind observed behaviour"* (Schoenberger, 1991, p180)

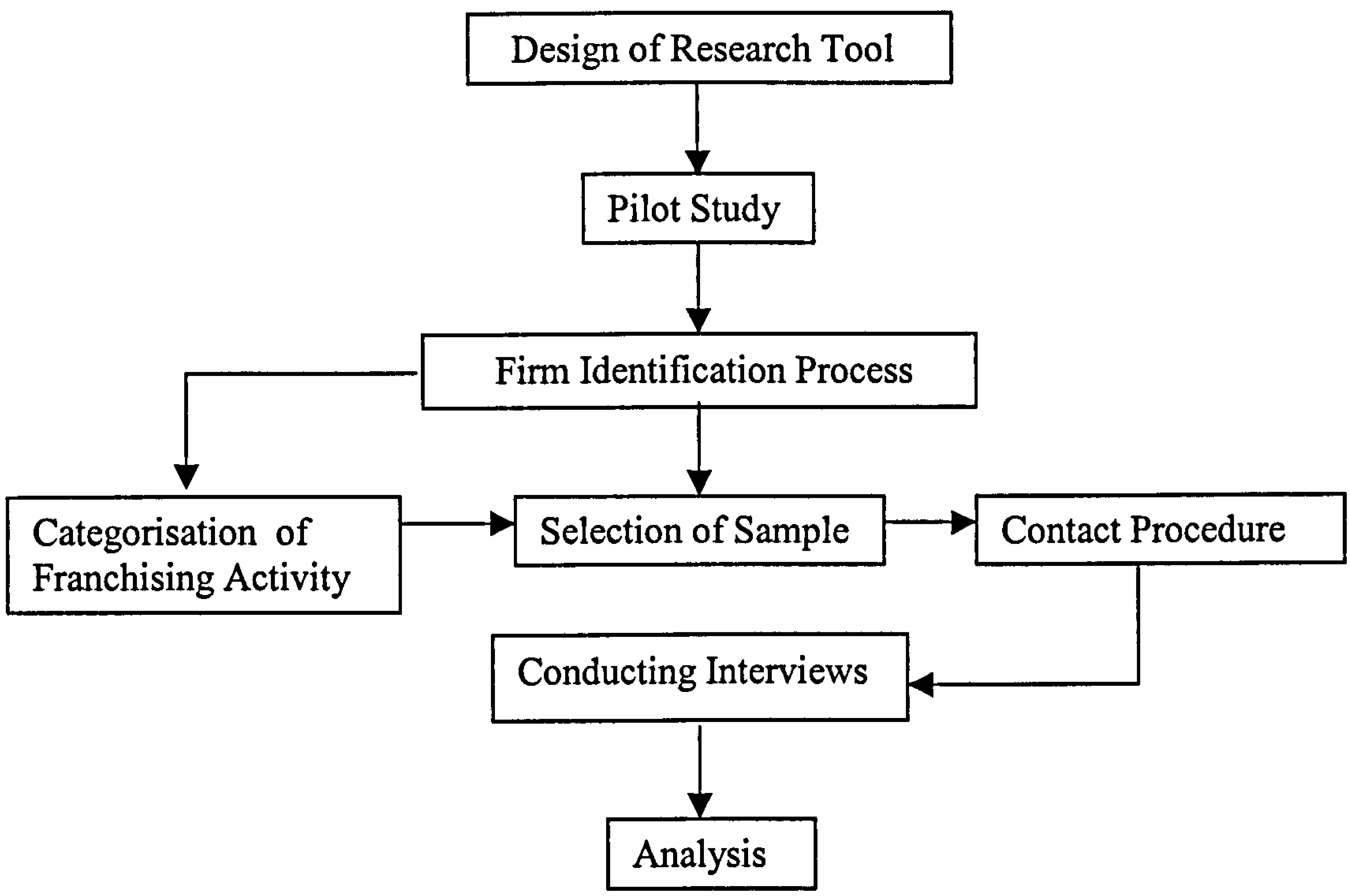
Third, as interviewing is an interactive process, questions which have not been understood can be explained to respondents or questions that respondents may have about the research can be answered directly by the interviewer, which is not possible through other non-direct approaches (Kumar, 1999). Thus, an interviewer can follow up issues more fully. Questions can be asked again in different forms and in different ways, so that issues are explored thoroughly. Interviewers and interviewees can explain complexities and clarify ambiguities and misunderstandings (for example, of meaning or terminology). Interviewers can also query discrepancies as well as probe for verification of too brief or non-specific answers. Interviewees may also raise points or questions the researcher is not necessarily aware of (Healey and Rawlinson, 1993; Valentine, 1997). By using an interviewing method, important non-verbal clues can also be read (e.g. body language) as well as allowing visual information to be collected (e.g. details about business premises). None of these benefits can be gained through a questionnaire based study, for example. Interviewing may also be somewhat beneficial to the respondent as the interview can provide the respondent with the opportunity to share their experiences and achievements with an interested listener (Oakley, 1981; Read, 1997).

3.4 Research Design and Data Collection: Practical and Conceptual Difficulties

3.4.1 Design of Research Tool

Having determined the methodological approach, the next step was to design the research tool (see Figure 3.1). An in-depth, semi-structured interview schedule was used for data collection.[5] The structured parts of the interview schedule focused on the factual questions, which were put to each respondent in a systematic and consistent order (Berg, 1989). This ensured reliability in the research tool (Kumar, 1999) and also allowed for an element of comparability and consistency across the interviews for the purpose of analysis.

Figure 3.1: Stages in the Research Design



The open-ended questions in the interview schedule were used for seeking access to opinions, experiences, perceptions and decision making and allowed for an examination of underlying processes and causal mechanisms, which Schoenberger (1991) argues are not always captured by structured questions. Thus, in this part of the interview schedule, although the topics and questioning remained the same, the specific answers of the respondents, and therefore the discussions that ensued, were necessarily different. As Schoenberger (1991) argues, the open-ended interview allows a certain amount of consistency across respondents as the same issues are addressed, if not necessarily in the same order or in precisely the same terms. Berg also argues (1989, p17) that this approach:

> *"allows the interviewer sufficient freedom to digress, that is the interviewer is permitted (in fact expected) to probe far beyond the answers to their prepared and standardised questions."*

Probing questions allows the interviewer to extract a more complete picture from a respondent as this encouraged elaboration and further clarification of a response already given (Jankowicz, 2000). Careful consideration must also be given to the sequencing, style, content and language of the questions. Questions have to be unambiguous and non-leading as well as using language that is suitable for the respondents. Thus the interview schedule was piloted with a small number of franchisors to test the applicability of the issues and to trial the ordering, language and meaning of questions. This enabled poorly worded and unimportant questions to be eliminated (See Appendix B for the Interview Schedule).

3.4.2 Firm Identification Process

Categorisation of Franchising Activity

A criticism that is made of existing franchise research is that there is a tendency to rely on secondary data derived from a single (often convenient) franchise system or sector of activity, namely the fast food sector (Stanworth, 1998). For example, studies by Hoy *et al.*, (1996, 1998); Kalnins and Lafontaine (1996); Kaufmann and Lafontaine (1994, 1996) and Price (1997) all have this narrow sector focus. Although many fast food firms are operated as franchises, and business format franchising roots are reputedly in the fast food sector (e.g.

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[5] Interviews may demonstrate facets of both structured and semi-structured approaches (Healey and Rawlinson, 1993). In this case, structured questions were complemented by open-ended questions.

Wimpy, McDonald's; Price, 1997), business format franchising activity is extremely heterogeneous, although existing literature and studies do not reflect this generally. It is therefore the aim of this thesis to take a far broader sectoral perspective in order to understand and capture the different processes that may operate in different sectors. Generalisations about franchising may breakdown because of its heterogeneity, but this heterogeneity has not necessarily been demonstrated in past research because of a narrow sector focus. Therefore, choosing a sample comprising different sectors was part of the explicit research design.

Thus, the next step in the research design was to categorise the diversity of franchise activity. This was somewhat problematic, as business format franchising encompasses a range of different economic activity (from, for example, fast food to educational and training services to industrial and domestic cleaning to printing to distribution services). There have been various attempts to classify franchising. Price (1997) for example, has defined and classified franchising activity according to Standard Industrial Classification (SIC) codes. However, it was felt that this approach did not adequately represent the service-orientation of franchising activity. Other classifications (such as Chaplin, 1996 and Macmillan, 1996) lacked theoretical underpinning. Thus, an alternative theoretical classification was sought to categorise business format franchises, which aimed to be more reflective of the service nature of franchising. Whilst definition of service sector activity is fraught with difficulties (Daniels, 1993; Marshall and Woods, 1995; Price and Blair, 1989), one classification has defined service activity into the groups of 'consumer' and 'producer' services.[6] Consumer services can be further sub-divided to include activities such as retailing, entertainment and personal services. Producer services are those which supply businesses and can be further sub-divided to include distribution, accountancy and management consultancy, for example (Marshall *et al.*, 1988). This classification of consumer and producer services (and the further sub-division within each category) was found to be the most fitting and appropriate way to categorise the diversity of business format franchising activity. Table 3.2

[6] This classification is still somewhat problematic as some services do not fit neatly into one group, but overlap both groupings, such as banking (Daniels, 1993).

shows this classification of business format franchises, as well as illustrating examples of firms which fit into each category.

Table 3.1 Business Format Franchising Sectors

Sector	Sub-Sector		Examples
Consumer Services			
Retail	Store Retail		The Body shop
Hospitality	Hotels		Holiday Inn
	Catering	- Fast Food	McDonald's
		- Restaurants	Pierre Victoire
Personal Services	Health and Beauty		The Tanning Shop
	Vehicle Services	- Repairs	Mr Clutch
		- Rental	Thrifty Car Rental
		- Driving Schools	BSM
	Property Services	- Estate Agents	Legal and General
		- Domestic Cleaners	Merry Maids
		- Home Care	Dyno Rod
	Leisure and Travel		UniGlobe Travel
Producer Services			
Distribution	Delivery		Card Connection
	Courier		Initial City Link
Professional Services	Financial Services		Auditel
	Training		Pitman Training
	Recruitment		Humana International
	Computer Services		Computer Kwik-Fix
	Legal Services		Legal Systems Ltd.
	Consultancy		FDS
Industrial and Commercial Services	Printing		Kall Kwik
	Commercial Cleaning		Jani-King

Selecting a sample

Once the categorisation of franchising was complete, suitable franchisors to interview were identified. One criteria which was imposed on the firms that were to be included in the sample was that a franchise must have at least 10 franchise outlets. This restriction was deemed necessary because of the issues under consideration. If a franchise was a relatively new operation with little experience of expanding, restructuring and operating a franchise network (which were the key issues under research) it was evident that the experiences of these firms were not yet relevant. With the exception of this one restriction it was intended to capture the full diversity of experiences and processes at work in different types of franchises, whether these firms were large or small, old or new, a well established brand name or relatively unknown name. This approach would also allow intra- and inter-sector comparisons. Consequently franchisors that were contacted were chosen from the six categories of business format franchising activity (outlined in Table 3.2) and a similar number of firms were sought from each sector.

Problems of Classification

One of the objectives of the study was to capture the full diversity of the different types of franchises and to be representative of the different *sectors* of franchise activity. However, as previous classifications of franchise activity were deemed insufficient, an alternative classification, using producer and consumer services was used (Table 3.2). One difficulty, which arose with this classification, was with the definition of the 'personal services' category. Firms classified under this sector were diverse in nature and included franchises such as, a car hire operation, domestic cleaning and estate agency franchises. It was somewhat difficult therefore to make comparative analyses of the firms contained within this sector. However, a greater number of firms classified under this sector were identified and selected in an attempt to include franchises that were similar in activity (such as domestic cleaning and maintenance operations). This was also a problem, although to a lesser extent, with the distribution sector. Although all firms categorised under this sector were based on distribution operations, the type of activity also varied (for example, from greetings card operations to courier services). Every effort was also made to identify and include firms that were similar in operation and activity in this category.

Thus, no claim is made that the selection of firms used in the sample was chosen in a random manner, as firms had to fulfil a certain size criteria and a balance between franchise sectors was also required. Firms were therefore subject to a two-stage sampling procedure. First, firms were identified and selected according to the number of outlets in a network. A minimum size was required (i.e. firms with more than 10 outlets in a network). There was also an attempt to include firms that were large, internationally known brand names and high profile franchise operations as well as smaller franchise operations in the sample. Second, stratified sampling was used to ensure the sample firms reflected the diversity of franchise activity.

Contact Procedure

The 1997 and 1998 editions of the UK Franchise Directory[7] were used to identify franchise operations which could be used for the survey. Experts in the field of franchising research, as well as some interviewees also made recommendations of firms to approach and passed on useful contacts.[8] Franchisors were approached with a letter outlining the researcher and institution details and the purpose of the survey. Letters were addressed to either the managing director or franchise director in most cases. This was to ensure that the letter would reach the person with the appropriate knowledge and history of the development of the franchise, as well as accessing the individual who would be either solely or partly responsible for the strategic decision making processes within the franchise. After the initial contact letter was sent, a follow-up telephone call to the firm (approximately 5-7 days later) was made to ensure receipt of the letter, and to request and arrange an interview.

As it has been argued in this chapter, it was inappropriate for this study – with an emphasis on qualitative issues – to undertake a large-scale survey. As there were constraints on resources (e.g. time, money) 80 firms were initially contacted and forty firms agreed to participate in the research (leading to a 50% response rate)[9]. A number of firms did not wish to participate in the study (n=31), seven firms were no longer franchising when contacted, even though their details were listed in the UK Franchise Directory and two firms only operated as franchises on an international scale. As the issues under consideration in this study concerned expansion on a *UK* scale, it was not appropriate to include these firms in the sample. Whilst the response rate is fairly successful, no claim is made that the results presented in this thesis are representative of the franchise population in general. However, the results presented in Chapters 4, 5 and 6 are fairly consistent and some generalisations are possible, suggesting that a larger sample would have been unlikely to alter the findings significantly.

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[7] The UK Franchise Directory is produced annually by Franchise Development. The directory was a very useful source for providing information, such as an address and phone number for a firm, and in most cases a contact name of either the managing director or the franchise director.
[8] Which was somewhat of a small scale 'snowballing' effect; although this was not the main and intended contact method, it still proved very useful in gaining access to some franchisors.

Problems of Gaining Access to Respondents

There were a number of difficulties that arose with gaining access to respondents. As Healey and Rawlinson (1993, p34) observe *"business organisations are bounded institutions to which the research worker has to seek, gain and negotiate access."* Therefore, the first difficulty of gaining access to respondents was reaching the managing director or franchise director. In a minority of cases, the contact details listed in the UK Franchise Directory were incorrect so the letter that was sent to a firm did not necessarily reach the right person. For example, in one case the contact name listed in the directory was for the franchise sales manager, but interview with the franchise director or managing director was required, as this individual is more likely to be involved in the decision making strategies of the firm, as well as having knowledge of the history and development of the firm. However, by contacting the individual listed, this at least allowed access to the firm. Requests could then be made to the firm that the letter be passed on internally to the appropriate person.

A second difficulty was getting past 'gatekeepers' (e.g. directors' secretaries). Once this had been negotiated, respondents were generally willing to participate. However, respondents are themselves gatekeepers to the information and data that are sought. A third difficulty, therefore, was persuading some franchisors to participate in the survey (reflected in the number of refusals). Unfortunately, franchisors suffer from 'respondent fatigue' (Stanworth, personal correspondence). Franchisors form a relatively small sector of SME activity, and as some globally recognised brand names are operated as franchises, franchisors are often the target of numerous undergraduate dissertations and other research projects. As a consequence some franchisors are wary of, and less willing to partake in research studies, because of previous demands and requests for their participation. Unfortunately, this was the experience in the present study and was particularly prevalent among some of the larger international franchises. Two such firms (McDonalds and Burger King) stated that it was their policy not to partake in research. In another case (The

[9] Current estimates from the NatWest/British Franchise Association Survey (2001) put the number of franchise systems in the UK at approximately 665 for 2000.

Body Shop), an interview was arranged with the assistant franchise manager of the firm, but a senior manager blocked the interview. This is likely to be because the approach was made at a commercially sensitive time, as the company was experiencing a process of buybacks, reorganisation and restructuring of its franchise operation. However, it was possible to gain access and include some of the larger, more established UK franchises, by exploiting 'industry' contacts and receiving referrals thus achieving a more balanced sample in terms of the size of organisations that were included.

3.4.3 Conducting the Interviews

As with most corporate interviews, the meetings took place on the business premises of the firms in the majority of cases. However, seven of the interviews were conducted at one of the major franchise exhibitions.[10] The advantage of conducting interviews at the exhibition was that several franchisors were accessible at one location, and it was therefore a very resource-efficient process. Two interviews were conducted on the premises of the research institution and three interviews were on the telephone. All face-to-face interviews were tape recorded and subsequently transcribed. As tape recording was difficult for the interviews that were conducted at the exhibition and over the telephone, note taking was necessary. Although the material collected in these interviews was not necessarily as rich, the main questions and issues were covered sufficiently.

Problems of Gaining Access to Reliable Data

Once interviews had been arranged with the franchisors, there were a number of problems to be negotiated in order to ensure reliable data were obtained. The first difficulty is that corporate interviews are power-laden. This can affect and shape the nature of the dialogue between the interviewer and respondent and subsequently the information gathered. Respondents can control access to knowledge, information and informants. Also, respondents may have rehearsed answers, deflect questions because of experience at dealing with interviewing, or withhold information if it is of a commercially sensitive nature (Cook and Crang, 1993; McDowell, 1992; Schoenberger, 1991; 1992).

[10] At the 1998 NEC Exhibition in Birmingham.

However, a number of measures were taken to combat the potential problems of the power-laden aspect of the interviews.

The first measure involved adopting a professional and knowledgeable attitude in order to be taken seriously, to encourage more detailed answers and to bypass rehearsed answers. This involved aiming to establish a good rapport with respondents and using language/jargon familiar to this group of individuals. The second measure involved a process of triangulation through utilising secondary documentary data sources. Therefore every effort was made to uncover firm reports, background information and trade articles to ensure a thorough examination of the secondary material available, in order to have specific background knowledge of each franchise operation before each interview took place. Thus, if it was felt that an issue had been deflected or 'glossed' over, the background preparation enabled a more thorough investigation through repeat questioning (Curran and Blackburn, 2001; Valentine, 1997). Third, any difficult or sensitive issues/questions (such as the rate of franchisee failure) were left to later in the interview schedule, after trust and rapport had time to be established with a respondent (as suggested by Healey and Rawlinson, 1993). Confidentiality was stressed throughout the interviewing process to also combat these difficulties.

A second problem of ensuring reliable data was collected was the difficulty of depending on a singular viewpoint. Healey and Rawlinson (1993) question whether a respondent will be inferring the motives and perspective of the firm as a whole, or just an individual perspective. However, the singular viewpoint sought was in most cases the perspective of the managing director or the franchise director. The positions that the respondents occupied meant that they were well placed to voice the perspective and motives of the franchise operation as a whole and not just an individual perspective. In addition, factual secondary sources were used to cross-reference and corroborate the consistency of the responses and the information gathered where possible. This also enabled new insights to be gained regarding the research issues (Berg, 1989; Cook and Crang, 1993; Curran and Blackburn, 2001).

A third problem linked to the difficulty of gaining only a singular viewpoint, is that certain parts of the interview schedule required respondents to comment on historical events and developments, which requires individuals to rely on recall. However, respondents can often forget past events or remember incidents differently to how they actually were. Therefore, where possible any inconsistencies, discrepancies or contradictions arising from relying on recall can be challenged and corrected if needed when conducting face-to-face interviews.

A fourth problem of data collection was the difficulty of respondents discussing issues which were of interest to them, but which were not of direct relevance to the study. Although such discussions may provide useful insights into the 'context' of the firm and can help to establish a good rapport between an interviewer and an interviewee, it was important to ensure that respondents did not stray too far off track by pursuing their own agenda, given the limited time that was available. This required tact and patience to redirect a respondent back to the issues under discussion. In addition, there were difficulties of distractions and interruptions during the course of the interviews (such as colleagues or phone calls). Whilst interruptions were not ideal, it was necessary to be sympathetic and appreciative of an individual respondent's situation and workload (Read, 1997).

A fifth problem which occurred with the collection of reliable data was that although the interview schedule was designed and piloted to avoid leading questions and ambiguities, understandings and interpretations inevitably varied to some extent (Kumar, 1999). However, questions were either repeated or worded in a different way and extra clarification was also provided where this occurred. Similarly there was the potential to misunderstand and misinterpret respondents' answers (Schoenberger, 1991). Thus, a clarification process of checking and reiterating responses at the end of appropriate sections was undertaken in order to ensure that responses had been understood correctly and an accurate representation of the discussion had been gained. Where possible this was also corroborated through secondary sources.

The Effect of the Interviewer on Data Collection

Traditional approaches to interviewing have advocated 'detached scientific behaviour' (Cook and Crang, 1993) through keeping social interaction between an interviewer and interviewee to a minimum. Apart from developing a rapport with interviewees to elucidate sufficient responses, this positivist stance instructed researchers to retain a 'social distance' to ensure the outcome of the interview was not 'biased' by the inputs (i.e. comments, opinions) of the interviewer (Cook and Crang, 1993; Herod, 1993).

However, in recent years, it has been acknowledged that trying to create socially sterile conditions in an interview situation is impossible, and the desire to create such conditions, is a normative ideal. Not to recognise that an interview is a fluid, interpersonal encounter between two or more individuals, and that both the interviewer and interviewee will impinge upon the research process and data collected in unrealistic and naïve (Curran and Blackburn, 2001; Healey and Rawlinson, 1993). Thus, it has become important for researchers to reflect upon their own identity (Valentine, 1997) and acknowledge how their 'positionality' can shape and influence the nature of the interactions between an interviewer and interviewee:

> "*we are people doing research and...questions of gender, class, race, nationality, politics, history and experience shape our research and our interpretations of the worlds, however much we are supposed to deny it. The task, then, is not to do away with these things, but to know them and learn from them* (Schoenberger, 1992, p218).

Similarly, it is also necessary to conceptualise the embeddedness of the individuals being researched and recognise that they are variously positioned by intersections of class, gender, ethnicity, age etc. (Cook and Crang, 1993). In so doing, Herod (1993) argues that researchers are not abandoning scientific concerns for validity, but rather this approach offers opportunities to collect richer insights into how factors such as gender, age and race can shape individuals' understanding of the world.

Thus, the social characteristics of the interviewer and interviewees are important dynamics, which may shape the nature of the interactions of the interviews (Herod, 1993). In the present study, gender and age were the most important characteristics which affected the fieldwork process. The effect of gender on the research process has been much debated (see for example, McDowell, 1992; Schoenberger, 1992; Herod, 1993). Herod (1993, p306) argues that *"interviewing does not take place in a gender vacuum"* and therefore, gender may affect not only the nature of the data obtained, but also how that data is interpreted. Research has shown that interviewees gave significantly different answers to male and female researchers, as well as male and female researchers understanding respondents' answers differently (Eagly and Carli, 1981). Power differentials may also be evident in the research context and particularly as Herod (1993) observes, there is a tendency towards the predominance of men in positions of economic power. This is significant for the sorts of information and insights interviewers can hope to produce in data collection, particularly if the interviewer is a young, female researcher. According to Easterday *et al.,* (1977, p334-5):

> *"being young and being female represent two ascribed criteria influencing social interaction in any setting and defines our opportunities and limitations as researchers."*

Thus, one of the main difficulties of the study was being a young, female researcher and the problem of not being taken seriously (Easterday *et al.,* 1977; Herod, 1993; Read, 1997). Franchising is dominated by males (The NatWest/BFA Annual Surveys; Dant *et al.,* 1996) and in the present study, the vast majority of respondents (95%: n=38) were male. Therefore, every effort was made to ensure that 'being taken seriously' occurred in interviews by presenting a knowledgeable attitude and adopting a professional dress code suitable for the respondents' environment. However, in a small minority of cases, respondents were occasionally either patronising, sceptical or paternalistic in parts of an interview. Although this was unfortunate, it was perhaps unavoidable and reflective of the positions these individuals occupy in a work environment, where they are *"likely to be accustomed to exercising power and exerting authority over others"* (McDowell, 1992, p213).

However, there are advantages to being a young, female researcher, as well as not being taken seriously. Schoenberger (1992, p217) argues that a male respondent may perceive a female researcher to be *"less threatening, more* *intriguing, or presumed to be a better audience for the recounting of exploits"* and will more readily confide in a female researcher (Read, 1997). This may have therefore helped in gaining access to some respondents, although this 'gender effect' is impossible to quantify.

3.4.4 Analysis of Research Material

After the completion of the data collection stage, there were a number of steps to undertake in the analysis of the material gathered from the interviews and other secondary data sources (firm reports, promotional literature, copies of franchise contracts/agreements for example). The first stage was to organise the primary material into a presentable and readable form. Thus, interviews were transcribed[11] and extra field notes that were collected were put into a legible form. Berg, (1989), Cook and Crang, (1993), Crang, (1997) and Curran and Blackburn (2001) argue that this is an important process for the researcher to undertake, as this allows a re-familiarisation of the material gathered. Some of the questions in the interview schedule were closed questions, (e.g. basic statistical questions; 'yes/no' questions), making it possible to quantify these responses.

However, the majority of questions were open-ended, therefore the second stage of analysis was a process of careful and fine-grained reading and marking up of the transcripts to note and annotate the transcripts with ideas/themes/issues that emerged about the topics in the material. This basic form of broad or 'open coding' is based on *"getting as close to the material as possible, both to get a feel for it all and to avoid missing anything"* (Crang, 1997, p186). This process is also necessary to help produce working ideas on how to interpret the events of the interview/transcript (i.e. understanding a firm's history or development process; Cook and Crang, 1993).

The third stage was to sift, sort and develop the ideas from this initial reading of the transcripts and open coding. This involved organising the notes/annotations/jottings into categories and topics (or more formal coding) as

[11] This was something of a lengthy process, as there were almost 40 interviews to transcribe, ranging from 45 minutes to 2 hours in length. An interview therefore took between 3-6 hours to transcribe, depending on length.

thoughts and issues developed. As Crang (1997) notes, this is a process that is intended to aid the researcher in making sense of the material, a process of 'analytical induction' which tended to involve going from the material, to ideas and back to the material to check, change or re-categorise in light of later, emerging thoughts and ideas. It is also a process that can occur many times. However, as Berg (1989, p42) contends: *"although analysis is without question the most difficult aspect of any qualitative research project, it is also the most creative."*

3.5 Sample Overview

The preceding discussion has outlined the methodological approach used for this study and the difficulties inherent in this type of research. The remainder of the chapter offers an overview of four key business characteristics (age, sector, size and location) of the sample of franchisors that took part in the survey. This section is intended merely to provide a general descriptive account of franchisor characteristics. Many of the points raised here will be more fully discussed and analysed in the context of the relevant chapters that follow. (Appendix C also outlines the characteristics of the sample firms in greater detail).

3.5.1 Age

Table 3.3 shows that the majority of franchises in the sample are between the 6-10 year age bracket (established between 1992-1996; 32.5%) and the 11-15 year age bracket (established between 1987-1991; 25%) and are, therefore, fairly well established franchise operations. The age distribution of franchisors in the present study is a reflection of the way the sample was selected. Because of the nature of the research issues, an active effort to include more established franchises was made, where there was some expectation that these firms would have experience of expansion phases and territorial restructuring. This will have biased the age of the sample upwards. An explanation for the predominance of franchises in this age bracket could also reflect the 'boom era' of franchising (i.e. the late 1980s and early 1990s) when the strategy was at its height in popularity, as awareness of franchising grew (through the franchise exhibitions, for example) and when banking finance also became more readily available (Financial Times, 1.10.88; Price, 1997). A final caveat is that although the emphasis is on the age of the franchise operation, it is important to acknowledge that some firms had been in operation before embarking on a franchise strategy. Therefore, for a number of firms (42.5%; n=17) there was a time delay between the year of establishment and the year when franchising was initiated.[12]

Table 3.2 Business Characteristics of Sample Franchisors

	n (total=40)	*%*
Franchise Age		
(Year of first franchise)		
0-5 years	0	0%
6-10 years	13	32.5%
11-15 years	10	25%
16-20 years	8	20%
21-25 years	4	10%
26 years or more	5	12.5%
Sector		
Retail	5	12.5%
Fast Food	5	12.5%
Personal Services	10	25%
Distribution	10	25%
Business-to-Business	5	12.5%
Industrial and Commercial	5	12.5%
Size		
Less than 10 (excluded from the sample)		
10-49 units	15	37.5%
50-99 units	14	35%
100-149 units	4	10%
150-199 units	3	7.5%
200+ units	4	10%
Location		
South East	30	75%
South West	5	12.5%
North	2	5%
Midlands	2	5%
East Anglia	1	2.5%

3.5.2 Sector

A methodological shortcoming of some previous research has been the tendency to examine franchise systems from only one sector of franchise activity. Therefore it was aimed to have a multi-sectoral approach in this study. A fairly even distribution across the six sectors of sample franchise firms was sought and achieved. However, because of the diversity of the 'personal services' and

[12] For example, in one extreme case, this delay was over 100 years, but in most cases, the delay amounted to a couple of years.

'distribution' sectors, these categories were larger than the other sectors because more franchises of similar activity were included in these sectors for comparative analysis purposes.

3.5.3 Size

The majority of franchisors had between 10-49 franchises (37.5%) or 50-99 franchises (35%). However, the difficulty with these figures is the hidden fact that some of the franchises may be run as area or master operations and subsequently more units are actually operated. For example, one retail franchise had 36 area franchises, but this encompassed approximately 1,500 units. Company-owned units may also increase the number of units operated. Therefore, the size of the franchise operations in the sample may be larger than the figures in Table 3.3 suggests, as this depends upon the method of franchising that is used and whether both franchise and corporate units are included in the figures.

3.5.4 Location

Three-quarters of franchisors' head offices were located in the South East (i.e. London and the Home Counties; 75%: n=30). The remaining franchisors were based in the North, Midlands, and East Anglian regions. Although the firms contacted were chosen in a random manner, this southern bias reflects the situation that the majority of UK franchise operations are located in the South East area (NatWest/BFA Annual Surveys). Therefore, this locational characteristic of the sample is reflective of the general population of franchise systems.

3.6 Conclusions

The majority of franchise research is based on quantitative approaches. However, some of this research has serious shortcomings notably in terms of a narrow methodological view and narrow sector focus. This chapter has made the case for the adoption of a qualitative methodology, for both epistemological and practical reasons. The research questions identified in Chapter 2, which are addressed by the remainder of this thesis, necessitated a rigorous investigation of underlying decision making and casual mechanisms of key actors. This was to gain a more thorough and in-depth understanding of the geographical issues and strategic processes under examination. Therefore, interviewing was the most appropriate technique to use for data collection. A case was also made for encompassing all types of franchise activity through a multi-sector perspective, so that the research would not be sector specific. However, there were some conceptual and practical difficulties in undertaking the survey (such as gaining access to respondents and gaining access to reliable data), although it was ensured that every measure was taken to minimise such difficulties.

Chapter 2 outlined that franchise activity is inherently geographical. Chapter 3 has argued that the adoption of a qualitative and multi-sectoral approach, using a sample of established and diverse franchise systems, will help to explore the geographical dimensions of franchising from a UK perspective. The remainder of this thesis seeks to analyse the findings of this study. The analysis begins in Chapter 4, where the spatial expansion strategies of franchisors are examined.

Chapter 4 The Spatial Expansion of Franchise Systems in the UK

4.1 Introduction

As franchising is used as a strategy for firms to achieve expansion, it is something of a paradox that *how* expansion is achieved has not been rigorously examined in the literature. As Chapter 2 outlined, the spatial expansion process has been well documented in other areas of economic activity (e.g. Chapman and Walker, 1991; Hayter, 1997; Jones and Simmons, 1990; Laulajainen, 1987) as well as at the international scale within the franchise context. However, very few studies have examined the expansion process of franchise firms at the *national* level. Existing literature on this issue (Newby and Hardwick, 1979 and Aspbury, 1985) found evidence of franchise expansion occurring in a hierarchical manner in the two fast food systems which were examined. In addition, expansion occurred at a local scale through a 'neighbourhood spread' effect, whereby the franchise was diffused to potential franchisees via interpersonal contact and communication by existing franchisees. However, whilst this literature is insightful, it is limited as it focuses only on *patterns* of expansion rather than the *processes* causing those patterns. In a more recent piece of research, which has attempted to examine the decision-making processes underlying franchise system expansion, Forward and Fulop (1995) found that a mixture of franchisee-led and site-led strategies were used to achieve expansion. However, there are also limitations to these findings, as they are based on only a small sample of franchisors and generalisations of the spatial expansion process are not possible.

As our knowledge of the expansion process is limited, more systematic evidence is needed in order to examine how franchise systems achieve spatial expansion. This chapter seeks to answer the two key research questions outlined in Chapter 2: 1.) Why do firms use franchising to achieve expansion? and 2.) How do franchisors achieve spatial expansion – what strategies and methods are used to achieve growth? In addressing these questions by means of a survey of a broad range of firms from across the different sectors of franchise activity, this chapter aims to understand the underlying firm decision making processes and expansion approaches that are used to embark upon and achieve franchise network growth within the UK. The discussion starts by outlining the reasons firms use franchising for achieving expansion.

4.2 Why Firms Franchise

4.2.1 Introduction

The reason why firms franchise has been one of the most dominant themes of the academic franchise literature (Elango and Fried, 1998). As Chapter 2 outlined there are two main theoretical explanations - the resource constraints perspective and the agency perspective - which attempt to explain why firms use franchising as a strategy for achieving growth. The following section therefore examines whether firms in the present sample conform to existing theoretical arguments and seeks to understand the advantages of franchising for these firms.[1] In addition, the section also outlines the disadvantages that the firms identify with using a franchising strategy.

4.2.2 Reasons for Franchising

The majority of firms (18) stated that the main reason for franchising their operations was because it enabled access to capital, which facilitated *rapid* organisational and spatial growth (see Exhibit 4.1). This finding provides support for the resource-constraints theory of franchising. As outlined in Chapter 2, the resource constraints perspective contends that franchising is used as a method to gain access to franchisee resources (financial capital, human capital and local market knowledge) which enable a firm to realise growth (Hoy *et al.*, 2000). The firms in the present sample identified financial capital as the most important resource to access.[2] Franchisee funds are an effective source of expansion capital as a franchisee provides capital not only through an initial fee for the franchise format, but also through ongoing royalty fees which can facilitate further expansion of the franchise network (Curran and Stanworth 1983; Dant, 1995). Rapid expansion is therefore

[1] A number of firms were international in origin (eleven from the US, two from Canada and two from Australia) and this was the reason why these firms operated as franchises in the UK. The franchises either operated through a master licence agreement or as wholly owned subsidiaries of parent companies in the UK. However, master franchisees were also asked the reasons why a franchising strategy had been used in the UK.

[2] A small number of firms also confirmed that franchising enabled access to *human* capital as well as financial capital (see Exhibit 4.2 - Distribution franchisors A and E). Local market knowledge was also identified by some firms as a useful resource to have access to.

Exhibit 4.1 Resource Constrained Explanations for Franchising - Sample Responses

"Why franchising? Well, if we were to have a national business and we did it through recruiting people and employing distributors and owing the vehicles ourselves it would have cost about £3 million to start. By doing it through a franchising route, where each individual distributor will have their own business, it has cost tens of thousands of pounds to start rather than millions...and you grow much quicker" (Distribution Sector, Firm E)

"That's why franchising – rapid expansion, nation-wide coverage" (Personal Services Sector, Firm I)

"Its an easier way to distribute your product and to get greater penetration in the market place in a smaller space of time" (Distribution Sector, Firm D)

"Franchising is, the cynics would say, a very cost effective method of getting a rapid distribution base, because obviously, the major cost of the distribution exercise is the staffing and we have 81 members of staff – our franchisees – who we don't pay salaries to" (Distribution Sector, Firm A)

"It was a quick way of getting up a system that was effective but without the hassle of employing X amount of people. It allowed us to be networked instantly and it was the owners way of doing it quickly" (Distribution Sector, Firm J)

"The reason for franchising was simple. You can use other people's money – the capital is provided by other people to expand. It allows much more rapid growth and much higher brand awareness" (Retail Sector, Firm D)

possible because a firm is not reliant on financial resources of retained profits or debt-secured finance, as company-owned chains can be for example (Kaufmann and Dant, 1996). As one franchisor also explained, the founder could maintain greater control over his business by using franchisee capital to expand rather than utilising other sources of expansion capital (such as bank loans, venture capital or investors):

> *"We first decided to franchise in 1984 as Sperrings. The reason why we decided to franchise at the time was that, here we had an entrepreneur owner, who wanted to expand but didn't want to lose control of his company. So he didn't want to go to venture capitalists, or to the banks to get money to expand and hence lose power and control, (and have to answer to investors), so rightly or wrongly, we thought that franchising was the way to go forward" (Retail Sector, Firm A).*

Kaufmann and Dant (1996) echo this sentiment. The authors point out that once bank credit has been tried or exhausted, start-up firms wishing to expand are left with two realistic alternatives: franchising and venture capital. However, venture capitalists will require a high return on their investment and demand a say in the running of the business: *"even though franchisees are sometimes hard to control, operating as a franchisor is easier than trying to control a board populated by heavily invested venture capitalists."* (Kaufmann and Dant, 1996, p345). Franchising may therefore be a more attractive option for entrepreneurs wishing to maintain a greater degree of control over their business, whilst also gaining access to sought after expansion capital.

As Chapter 2 also outlined, the alternative theoretical perspective to the resource-base explanation of franchising - agency theory - attempts to explain franchising as an effective way of addressing the classic problem between a principal (an owner of an outlet) and an agent (a manager of an outlet). Principals may not know if an agent is 'shirking' and insufficiently promoting an owner's interest without the aid of costly monitoring mechanisms. Agency theory argues that franchising effectively addresses the shirking problem as it aligns the interests of the agent (the franchisee) with those of the principal (the franchisor) by forging links between franchisee compensation and performance. As a franchisee has a financial interest in the business as an owner-operator of a unit, it is argued that they will be more motivated to make the business succeed. This will also lower the propensity to shirk, as any shirking will reduce profit and compensation for the franchisee. Subsequently, the need for supervision and monitoring are greatly reduced, although not eliminated (Kirby and Watson, 1998a; Shane, 1995).

Only a minority of firms (7) cited reasons associated with agency as the motivation for adopting a franchising strategy. According to these firms, franchisees were more highly motivated than managers/employees and offered higher levels of commitment and standard of service, which franchisors maintained, would have been less evident in manager-run company-owned units. Such benefits arose because a franchisee had invested their own capital in the business and were therefore more motivated to make it succeed (see Exhibit 4.2).

Exhibit 4.2 Agency Related Reasons for Franchising – Sample Responses

"As a franchisee has invested in the business, there is a greater motivation to make the business work as there is a greater level of commitment, there is a driving force in franchisees. We believe that franchisees will increase sales by 15-20% because of the motivation effect" (Retail Sector, Firm B)

"It's all about commitment, it's all about 'can do's' instead of 'can't do's'...employees - it's human nature - aren't going to perform in the same way as the people who own the business, because it's a one way operation. So that's the key to it, it's all about commitment" (Distribution Sector, Firm H)

"It is always the case of the person who has the franchise is totally dedicated to the business – in a financial sense. It is his life on the line" (Distribution Sector, Firm C)

"The attraction of franchising for me was the motivational aspect. Because franchisees are self-employed, they have greater motivation than employees. It's up to them to make it succeed and make their businesses profitable, which means we get better results" (Distribution Sector, Firm B)

"A good franchisee tends to be very passionate about the business and learns it exceptionally well and probably operates it at least as well - if not better - than a corporate entity because its their livelihood and their money. They will make sure they will spend all their time there" (Fast Food Sector, Firm C)

Indeed, six of the seven firms had tried company-based expansion before embarking on the franchise route.[3] These firms decided to use the franchise method as a means of overcoming the problem of agency in poor performing company-owned/manager-run outlets. For example:

> *"we tried managed units, we have a few managed units around. There is a noticeable difference in the performance of a managed site and a franchising site, and it's purely about delivery of service" (Personal Services Sector, Firm J).*
>
> *"the owner had around ten or eleven managed shops - which any managed chain, however big or small, - you always get some that are doing very well and stragglers. And once you put the stragglers right the others fall down a*

[3] Eleven firms used company-based expansion before using a franchising strategy (the remaining majority of the sample firms had intended to franchise their operations from the start). The remaining five firms, which had previously tried company-based expansion, were now using franchising as a strategy for achieving rapid organisational growth. For these firms, the attractions of franchising were resource based. For example, an estate agent franchisor could not afford to grow using its own capital and neither could it afford to take over a national chain. Its bank advised the firm to examine franchising as a means to financing expansion.

> *bit, and so he figured that franchising would be the best option" (Industrial and Commercial Sector, Firm B).*

Within the academic literature, the resource-constraints perspective has been largely disregarded following criticisms. For example, Rubin (1978) argued that franchising is an inefficient means of raising capital as profits have to be shared with franchisees. Substantial empirical support for agency theory (for example, Brickley and Dark, 1987; Brickley, Dark and Weisbach, 1991; Carney and Gedajlovic, 1991; Combs and Castrogiovanni, 1994; Lafontaine, 1992; Mathewson and Winter, 1985; Norton, 1988b; Rubin, 1978; Shane, 1995, 1996, 1997; Vaughn, 1979) also served to discredit the resource constraints perspective of franchising. Hence the agency-related perspective of franchising has assumed predominance as the main theoretical explanation within the literature (Kaufmann and Dant, 1996). As Kaufmann and Dant (1996, p343) note:

> *"although many entrepreneurs/franchisors confirm the relevance of the capital acquisition argument in their decision making, theoretical analysis has discounted its importance...researchers have, by and large, rejected the capital acquisition argument for franchising in favor [sic] of this incentive-based rationale"*

However, in the present study, the main reason for franchising was resource-related. The majority of firms in the present study used franchising as a way of overcoming financial constraints (18). Only a small number of firms (7) stated that franchising was used solely for agency-related reasons. The evidence from this study, as well as findings by Dant (1995), Kaufmann and Dant (1996) and Lafontaine (1992), confirm the importance of the resource-constraints perspective for explaining why firms use franchising to expand. It is therefore arguable that agency-related reasons have assumed too much theoretical prominence in the academic franchise literature.

However, the remaining 15 firms in the sample stated that their motivations for franchising were *both resource and agency related* (see Exhibit 4.3). As the quotes from the firms underline, it is evident that both resource and agency related factors are what makes franchising an advantageous method of expansion. Combining access to financial capital with highly motivated unit owner-operators were key benefits of the franchising method for these firms. Therefore, based on these findings, it is arguable that singular explanations of the motivations underpinning the use of a franchising strategy are inadequate: both theoretical perspectives in combination can provide insights into the reasons why franchising is used as a strategy to achieve growth.

Exhibit 4.3 Resource and Agency Related Reasons for Franchising – Sample Responses

"Its actually quite a cheap way to expand, because obviously other people are coming in and bringing the capital, so they expand the business for you. So it can save an awful lot of capital investment...you have access to limitless funds very few people have. Franchising definitely enables much quicker growth of the business because when franchisee come in they are effectively financing each new outlet - the franchisee effectively comes in and finances the growth and the company then builds their network using their ongoing fees on a larger scale from a bigger number of outlets, quicker. The only way you could do that quicker on your own, is if you have limitless funds to open 200 shops. That is one of the key issues. The other is that you have got owner-operators, so you have got people who are motivated running the businesses. And there are lots of benefits to that, because they go out and drive the business forward on an individual basis. Whereas if you are trying to manage shop managers (a) you have a huge cost of managing that whole operation and (b) they just have a job, so they haven't really got the motivation" (Industrial and Commercial Sector, Firm D)

"It is always the case of the person who has the franchise is totally dedicated to the business – in a financial sense. It is his life on the line...franchising also allows rapid growth without utilising your own capital, of course. If you consider that each of our franchises cost about £200, 000 and we have got 68, you can see how the capital would have been employed and without having so many" (Distribution Sector, Firm G)

"The individual can provide you with funding and hopefully they bring with them the dedication to the customer, that you do not find in managed operations" (Industrial and Commercial Sector, Firm C)

"Franchising has allowed us to grow the system, so it's all over the country. Certainly having worked for corporate estate agents in the past - I've worked in an independent estate agent as well - one of the problems perceived with corporates is that people always feel that they have the safety net of Halifax or the Woolwich or whoever paying their wages, so you know, you get 'do I really have to stay till half past seven and make that call, I'll do it tomorrow?' When its your own business, then you will work and do whatever's necessary to make that business work. So it's got to be better for them and it's got to be better for us." (Personal Services Sector, Firm A)

4.2.3 Disadvantages of Franchising

Whilst the main advantages of franchising were identified as resource and agency related by firms in the current study, franchisors acknowledged that there were also disadvantages to the franchising method. The firms identified two main disadvantages: profit sharing and managing franchisees.[4]

The first disadvantage firms highlighted was that compared to other forms of organisation, operating as a franchise returned lower profit margins. As section 4.2.2 outlined, Rubin (1978) has criticised the resource constrained perspective of franchising by arguing that franchising is an inefficient method of obtaining access to capital, as profits must be shared with franchisees. Therefore, whilst franchising allows access to capital in the short-term, long term returns/profit will be lower compared to corporate-owned operations. For example:

> *"the down side is that you don't make as much margin out of the profit that you would make if you were to sell it direct into the retail market" (Distribution Sector, Firm A).*
>
> *"undoubtedly, our profits would be higher if we were a wholly owned company" (Business-to-Business Sector, Firm E).*

Although lower levels of profits were a disadvantage, a number of firms noted the trade-offs that existed between lower levels of profit margin and the other benefits that were associated with the franchise method. For example, although franchisors expected long-term profits to be greater if companies were organised as wholly owned operations, firms acknowledged that achieving nation-wide company-owned networks would have been a far more costly and lengthy process if a franchise strategy had not been used:

> *"financially, long term, there is a school of thought which says the returns are going to be less from the franchise network. We have a turnover of £60 million, but we get effectively 10% of that - £6 million revenue from our franchisees. If we had gone through the pain of growth over the years and we owned the whole network it would be £60 million turnover rather than £6 million turnover. So, in the very long term, we could make more being the owner of a network, but there are lots of pitfalls to that" (Industrial and Commercial Sector, Firm D).*

[4] Nine firms identified profit sharing as their key disadvantage, 19 firms identified managing the franchisee network as their key disadvantage and 12 firms identified both disadvantages.

Firms also commented that by franchising, they were able to attract a higher calibre of business individuals to operate units. Arguably, without such individuals, profits generated by unit managers may not have been as high in a company-owned manager-run operation compared to a franchise operation because of the 'agency' effect.

The second disadvantage identified by firms centred on the difficulties of managing franchisees. The agency-based explanation of franchising argues that franchisees will be a source of highly motivated unit operators, but it is precisely this advantage, which can also act as a *disadvantage* for firms. As franchisees were independent business owners and not just unit managers or employees, some franchisees would behave autonomously and did not necessarily comply with franchisors' directions. Specifically, firms encountered difficulties with getting franchisees to implement changes to the system (such as introducing a new innovation or procedure) and ensuring that they followed the franchise format and did not mis-represent the brand at a local level.[5] Therefore, exerting and maintaining control over franchisees was sometimes problematic, confirming previous findings (Price, 1997; Spinelli and Birley, 1997). As Chapter 2 outlined, legally the balance of power and control in the franchise relationship resides with the franchisor (Felstead, 1993; Spinelli and Birley, 1996; 1998). However, in practice, exerting control over franchisees was a difficult task for these franchisors and involved learning management skills necessary for the purpose, such as how to direct and persuade franchisees rather than acting in an autocratic manner to achieve the results the firms wanted (Exhibit 4.4).

4.2.4 Summary

The preceding discussion has addressed why firms in the current sample use franchising as a strategy for achieving expansion and has assessed whether these firms conform to existing theoretical explanations. Whilst firms in the current sample confirm existing resource and agency theories, the resource–related perspective was identified as the prominant reason for using franchising by these firms. Implicit within the resource-based view of franchising is that the

[5] Chapter 6 discusses these issues more fully.

Exhibit 4.4 Disadvantages of Franchising: Managing a Franchise Network – Sample Responses

"The fundamental disadvantage is the lack of real control. Technically you have control - because the franchise agreement gives you all kinds of rights to say, 'do this, do that', but the reality is once they are up and running, you can't force them to go out and sell, for example...So the key is you have to cajole and persuade, rather than say 'I am you boss, do this, do that.' So it's a different set of skills really." (Industrial and Commercial Sector, Firm D)

"There are advantages to having a chain. The main advantages being that you can be dictatorial, which you can't be with franchisees. It is always a consensus to a degree, although it is not a democracy. There is a greater degree of consensus involved in making sure that the joint ends are realised and sometimes you have to be diplomatic and a bit persuasive to get the franchisees to see your point of view. What you can't do is tell them." (Distribution Sector, Firm G)

"Franchising is excellent as long as it is a system such as McDonald's. Everything that a franchisee does has to be so tightly controlled. If you can't do that, then it is a big problem, especially in a service sector like home cleaning, if you can't control what the franchisee is doing on a daily basis, then franchising can be problematic." (Personal Services Sector, Firm D)

"Franchising is much harder to manage, because we have a 100 plus network of small businesses and entrepreneurs. With a managed run/owned operation you can sack individuals if they don't do what you want – but you can't do that with a franchisee. You have to manipulate and massage and work with them, which can be very costly and time consuming" (Retail Sector, Firm D)

strategy can achieve rapid spatial expansion, and this was one of the key advantages identified by the firms, which used franchising for resource-related reasons. Although agency theory has assumed predominance in extant literature, the evidence from this study highlights the importance of the resource-constraints theory as an explanation for why firm franchise.

However, a significant number of firms argued that it was because of *both resource and agency* related reasons that the decision was taken to franchise. Therefore, the existing franchise literature, which only adopts singular theoretical explanations of franchising, is insufficient: both explanations in combination can provide more powerful insights into the reasons for franchising. Firms also identified some of the problems, which can occur with franchising. The main disadvantages were lower profit margins and the difficulties of maintaining control over franchisees. For firms in this sample, the disadvantages were a trade-off franchisors were willing to make, as these firms believed the advantages of the franchise method outweighed the disadvantages. In sum, this section has sought to examine why firms franchise. However, the decision to franchise is only the first stage in the expansion process. Therefore, the following section (4.3) addresses the second research question of the chapter, namely how firms expand and the strategies that are used to achieve growth.

4.3. The Life Cycle Model of Franchise Spatial Expansion

The second question this chapter seeks to address is 'How do firms achieve spatial expansion - what strategies are used for growth?' as current understanding of this issue is limited. Examining spatial expansion strategies has the potential to assist new firms about to embark on franchising with the expansion process and help them anticipate some of the problems and challenges of expansion. However, whilst the original research question proposed to examine expansion strategies, it becomes evident from the findings that spatial expansion needs to be considered in a 'life cycle' context. In other words, spatial expansion – and the strategies that are used for this - is not a static process (as Forward and Fulop (1995) demonstrated in their findings), but rather the expansion process is a dynamic one, occurring over several identifiable stages with strategies altering over time.

Applying life cycles models to business organisations first emerged in the 1960s and early 1970s (McGuire, 1963; Christensen and Scott, 1964; Steinmetz, 1969; Greiner, 1972). According to Bouchikhi and Tornikoski (2001, p382) life cycle theory is where *"each stage of an organisation's life is characterised by a particular managerial style and a set of management problems. As the key problems change, so should the firm's organisational design configuration."* Although there have been many different life cycle models proposed in the literature, the models all share some common assumptions. First, different stages in life cycles are sequential in nature; second, stages occur as a hierarchical progression that is not easily reversed; and third, each stage involves a broad range of life stage specific organisational activities and structures (Quinn and Cameron, 1983).

Indeed, life cycle or 'stage' models have been one of the most dominant frameworks describing the process of small business growth (Churchill and Lewis, 1983; O'Farrell and Hitchens, 1988; Stanworth and Curran, 1976). However, as Floyd and Fenwick (1999, p33) observe:

> *"there has been no attempt to apply such models to franchise system growth and development, nor has any model been developed specifically for franchising. Given the strong interest in franchising at academic and professional levels, a growth and development framework for franchises is urgently needed."*

Applying a stages model to franchising reveals that similar to small business growth, (and regardless of variation in firm sizes, sectors and capacities for growth), there is a sequence of identifiable stages common to the organisational development of most franchise systems in the sample used (Floyd and Fenwick, 1999). The five stages identified by Floyd and Fenwick (1999) for franchise system development were hatchling, nestling, fledging, adulthood and beyond adulthood (see Exhibit 4.5).

The evidence from the present study also suggests that firms undergo different stages in the process of achieving *spatial expansion* (see Figure 4.1). Like other life cycle models, the four stages of spatial expansion were generally characterised by key expansion processes.

Figure 4.1 – The Spatial Expansion Life Cycle of Franchise Networks

INITIAL STAGE$_{T1*}$
pilot and first franchises

↓

ROLL OUT STAGE$_{T2}$
main period of expansion determining
the strategies and methods used for growth

↓

CONSOLIDATION STAGE$_{T3}$
reinforcing and strengthening of networks
internationalisation

↓

MATURE STAGE$_{T4}$
management and maintenance of networks
internationalisation

*T1 = Time Phase 1

Exhibit 4.5 A Model of Franchise System Development

Stage 1 – Hatchling: Concept Development

- The first stage involved the decision to establish a business and formulation of a viable business concept.
- All businesses enter this stage.
- Some firms establish the business concept first and then franchise at a later stage. Other firms developed the business concept and decided to franchise from the start.
- The hatchling stage is one in which ideas are hatched and refined and the stage culminates with a business concept in operation.

Stage 2 – Nestling: Business Development

- This stage commenced with a commitment to franchising.
- Some firms operated corporate units whilst developing and testing the franchise format.
- Prospective franchisors should have tested the concept in another location before embarking on franchising fully (as some concepts are difficult to replicate and unit specific factors such as location or good staff may have been responsible for the original unit's success (Falbe and Dandridge, 1992)).
- One of the key aspects franchisors should have developed in this stage (or be able to demonstrate) is how franchisees will be supported. If franchisors have some existing corporate units, then some support infrastructure must exist. For franchisors with no trading history, franchisors had to demonstrate how support would be delivered during the system's early life.
- One of the main challenges to arise during this stage (and which continued into the next stage) was securing suitable premises in desirable locations.
- The stage was one where franchisors tested and refined the franchise format, developed support infrastructure, the management team and key documentation (the franchise contract, promotional literature and the franchise manual).

Stage 3 – Fledgling: Initial Franchisees

- Once the first franchisee begins trading, the franchise system enters the fledgling stage.
- Entering the fledgling stage was a critical step because the fledgling business embarked on the path to independent survival. Franchisees were required for fast growth to rapidly achieve economies of scale. Quality franchisees were required that could secure capable employees to run successful operations. Such a vital step also meant franchisee selection processes had to be evaluated and fine-tuned frequently.
- The main challenges for the franchisors in this stage were two-fold: finding suitable franchisees and securing strategic sites (for location based formats). Some firms found that recruiting the first 3-4 franchisees was difficult and therefore to overcome this, the firms waived fees. Others converted company-owned units to franchise units and employee-managers became franchisees. Securing good sites became increasingly important during the fledgling stage, so important that some founders participated in these decisions as well as with on-going negotiations with landlords. One franchisor's solution to the difficulty of securing good sites and franchisees was to establish company-owned units on every available and suitable site and recruit franchisees subsequently.

Stage 4 - Adult: Franchise Expansion

- The more mature systems in the sample were characterised by a head office with some degree of functional organisation, well-documented operating procedures for most aspects of franchisees' operations, established franchisee recruitment procedures.
- The primary focus of Adult franchisors tended to be more strategic: managing the franchisor-franchisee relationship, maintaining the franchise brand's competitive positioning, building and maintaining market share and gaining internal efficiencies.

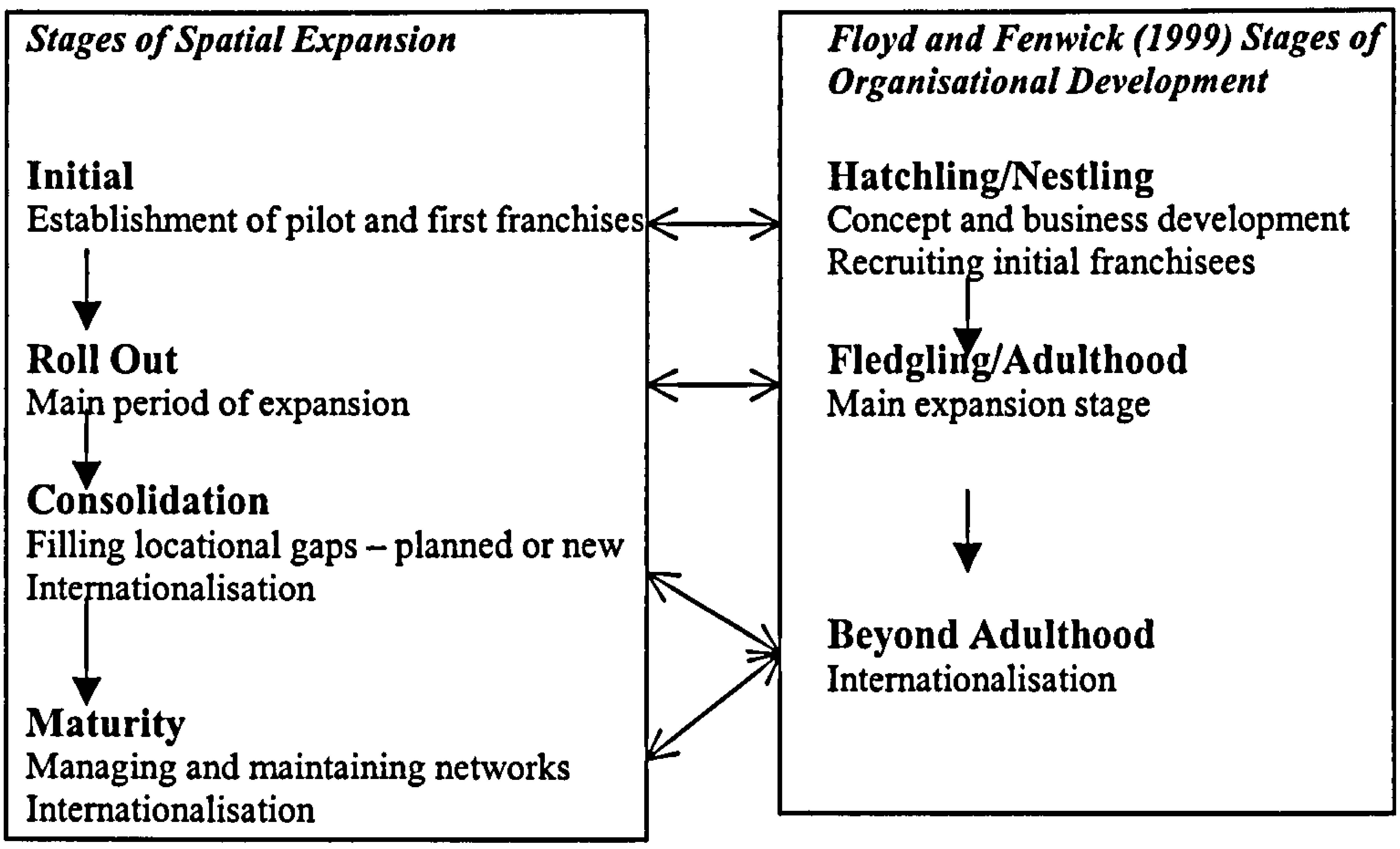
Beyond Adulthood

- Logical development beyond adulthood for very successful franchise systems is entry into one or more foreign markets (internationalisation).

SOURCE: Floyd, C and Fenwick, G, (1999), Towards a Model of franchise System Development, International Small Business Journal, 17, 4, pp32-48.

The first stage is the initial phase, where firms pilot the franchise concept and established the first franchises (time phase 1). The second stage is the main 'roll out' phase, where firms embark upon nation-wide expansion and determine the strategies and methods used to achieve growth (time phase 2). The third stage is a period of consolidation where firms strengthen and reinforce their networks (time phase 3). The fourth stage for firms is maturity, a process of managing and maintaining established franchise networks (time phase 4). Some firms also seek non-domestic expansion through internationalisation activities in the consolidation and maturity stages. Figure 4.2 therefore gives a comparison of the spatial expansion life cycle with Floyd and Fenwick's (1999) stages of organisational development and finds that organisational and expansion activities undertaken in each stage generally correspond across both life cycles.

Figure 4.2 A Comparison of the Spatial Expansion Life Cycle with Floyd and Fenwick's (1999) Stages Approach to Franchise System Development – Corresponding Activities/Processes



The spatial expansion life cycle, like other life cycle models, is sequential and linear in nature. Once the key process of each stage had been achieved (e.g. completion of the roll out process) this determines movement into the next stage (e.g. consolidation). However, the length of time spent in each stage varied from firm to firm with, for example, some firms taking 18 months to achieve roll out whilst for one firm the roll out process took 12 years. The length of time firms spent in a stage was dependent upon a number of internal and external factors.

First, it was dependent upon a franchisor's strategy and ambition. The reason some firms had slow growth rates (and therefore a lengthy period in one stage) was because franchisors' had decided that growth should be achieved at a manageable rate.[6] Second, this decision was often related to the size of the franchisor's head office operation. If management resources and infrastructure were limited this had implications for the number of franchisees that could be recruited each year as the amount of time and support new franchisees could be given by head office personnel would be limited. Head office support can therefore play a crucial role in the early development stages of franchise networks (Mendelsohn, personal correspondence, 1999). Third, time spent in a stage was also dependent upon a firm's market positioning and competition. For example, the four greetings card distribution franchisors in the sample all developed around the same period (1992-1994). However, two of the firms grew rapidly within two-three years in an attempt to establish their systems as market leaders. When these firms entered the consolidation stage, the other two greetings card franchisors were still rolling out their networks.

The structure of the following sections (4.3.1-4.3.4) discusses each of the four stages in the spatial expansion life cycle and examines the expansion characteristics of each stage and the growth strategies which are used. This will answer the second research question set out in the introduction to this chapter: 'How do firms achieve spatial expansion and what strategies are used?'

4.3.1 Initial Stage of Expansion

The initial stage was the first phase of the expansion life cycle, where firms set up a pilot operation for the franchise system and embarked upon establishing the first franchises within networks. Previous industrial location literature (including both the manufacturing and service sectors) has shown that the initial stage of spatial

[6] Franchising is often perceived to be a strategy used by firms to obtain *rapid* organisational growth. However, as section 4.2 outlined, firms in the present survey found franchising attractive for reasons other than gaining access to franchisee capital to finance rapid growth.

expansion is characterised by growth occurring either in, or locationally near to, the home base or home territory of a firm (see for example, Chapman and Walker, 1991; Jones, 1988; Jones and Simmons, 1990; Watts, 1975). Therefore, the question arises whether similar geographical clustering in the early stages of expansion is replicated in franchise operations. Locating a pilot operation and the first few franchises near to a firm's home base may enable a franchisor to closely monitor progress in the early test phase as well as minimise travel costs. Indeed, Newby and Hardwick (1979) found that in the case of KFC, the early test stage and the location of the first four to five units in the mid-late 1960s *did* occur near to the home base of the franchisor. However, initial locational clustering of an operation may negate one of the key benefits of franchising which is the ability to achieve rapid growth and brand dissemination on a national scale. Therefore, the following section will examine whether locational clustering in the initial stages of expansion is something that occurred in the current sample of franchise firms. The discussion first outlines whether the firms established pilot operations, the reasons for this and where pilot operations were located. The section then moves on to discuss the establishment and location of the first few franchises.

Pilot Operation

It has been argued that one of the most vital components in the organisational development stage of a franchise network is the operation of one or more pilot units as this will determine whether the franchise format has the potential for success (Falbe and Dandridge, 1992; Felstead, 1993; Forward and Fulop, 1997; Mendelsohn, 1990; Price, 1997; Stanworth, Purdy and Price, 1997).

However, Price (1997) argues that because a pilot operation can substantially add to the time and financial costs of developing a franchise, only a minority of franchisors will develop a pilot unit. Contrary to Price's (1997) contention, Silvester (1996) found from a sample of 146 franchisors in the UK that the majority established pilot units. This tendency is confirmed in the present study. Twenty-seven firms in the sample set up a pilot operation before fully embarking on the roll-out phase of franchise expansion. Most firms ran one outlet as a pilot (21), but six firms ran two outlets as their pilot operation. The majority of pilots (20) were company-run operations and the remaining seven were run as franchises.

In the present study, firms established a pilot operation for three reasons (see Exhibit 4.6). Firstly, to test the concept/product/service of the business in the market place. Secondly, to learn about operational aspects of running a franchising, such as managing the franchisor-franchisee relationship. Thirdly, to help in the process of recruiting franchisees. Operating an established pilot helped to prove to potential franchisees that the concept worked and had been fully tested in the market place.

The remaining 13 firms did not operate pilot units because the majority of them (8) already had existing company-run operations when the decision was taken to franchise. These firms therefore had previous experience of operating the business format and felt that a pilot operation was unnecessary. The three courier firms in the sample did not run pilot operations because the type of franchise meant that the networks had to be nation wide from the first day of operation. The remaining two firms that did not operate pilot units admitted that the first franchisees recruited to the networks took great risks as the product had not been tested in the market place and nor had operational aspects of the franchise been tested. For these firms the testing of the franchise concept and organisational learning occurred as the firm developed.

In the present sample pilot unit locations were determined by whether the pilot was company-run or franchise-run. The pilot operations that were company-run (20) were all located in the same city/town as franchisors' head office locations. The remaining seven franchise-run pilots were operated by franchisees and franchisees determined where the pilot operation would be located. Thus, in these cases, the pilots were not related to the location of the home base of the franchisor. In half the sample, therefore, an initial geographical clustering occurred with the location of pilot units. However, as Floyd and Fenwick (1999) observe:

> *"prospective franchisors should test the concept in another location before embarking on franchising because some concepts are difficult to replicate, and outlet specific factors, such as location or great staff may be responsible for the original business's success" (Floyd and Fenwick, 1999, p36).*

Half the firms in the present sample (20/40) had not tested the franchise concept in another geographical market as only one unit had been operated as the pilot, which was also corporate-run and not *franchise-run*. Additionally, a number of other firms (13) had not piloted the *franchise* operation but instead relied upon previous operating experience of running corporate units. For those firms that did run pilots operations, establishing test units in the same locations as head offices enabled them to be easily monitored and supported. However, whilst these firms had 'tested' the franchise concept, it is debatable whether they had truly 'tested' aspects of running a *franchise* operation. Firms that established pilots as franchises were the ones to comment that they had mostly learnt about operational aspects of franchising, such as managing the franchise relationship. For firms with company-run pilots, learning about running a franchise operation developed at a later stage when the first franchisees were recruited to networks. Whilst this did cause some initial 'teething' problems, it did not affect the long term viability of the firms.

Exhibit 4.6 – Reasons for Establishing Pilot Operations – Sample Responses

"We knew the method of distributing it through franchising would work. The main thing was to test the product and to see its performance in the market place." (Distribution Sector, Firm B)

"It is vital for every franchise to have a pilot to try it out, otherwise how are they going to know what is going on? Every franchisor should do it." (Distribution Sector, Firm G)

"The pilot taught the company a lot, in terms of how to the develop the process of delivering the service and how to market the business." (Personal Services Sector, Firm H)

"Managing the franchisor and franchisee relationship was the most important lesson that we learnt from the pilot." (Personal Service Sector, Firm B)

Locations of First Franchises

Half the sample of firms established pilot operation in the same locations as franchisors' head offices. The following section outlines whether initial expansion continued to occur within the home base of a franchisor with the development of the first few franchises (i.e. the first five-ten units established in a network) or whether initial expansion began to occur on a larger geographical scale.

Over half of the firms in the sample (24) stated that there was no clustering of the first franchises in the network. In other words, expansion was not related to the home base of the franchisor after the pilot operation was established. There are two possible explanations why locational clusters did not occur in these networks. The first reason is because of the approach used to achieve growth (the subject of more in-depth discussion in section 4.3.2). The majority of the 24 firms had franchisee-led strategies to growth. In other words, the location of the franchisee determined when and where the franchise developed. With such an approach, it is unlikely that an initial cluster of units would occur. The second reason why locational clustering did not occur was related to the sector and type of operation. Three distribution firms were courier franchises, and as it has already been noted, such operations need to be nation-wide from the first day of operation. However, these are not complete explanations for the absence of clustering because some firms in the sample which also have a franchisee-led strategy to growth and/or were distribution operations did develop their initial franchises in clusters near to home bases. It is therefore difficult to discern the reasons why some firms had clusters in the initial phase of growth and others did not.

The remaining firms (16/40) commented that the first franchises to be established *were clustered* around head office locations. This finding supports the previous expansion literature, which contends that there is strong emphasis on expansion occurring near to a firm's home base in the early phases of growth. Three reasons can be identified for this initial clustering effect. The first reason, for the majority of firms, was because the franchise system and brand name had become well known in the areas where franchisors had initially started the operation. Franchisors believed that through a process of contact and communication, potential franchisees had come into contact with existing franchisees and observed the franchise in operation (a diffusion process similar to that identified by Newby and Hardwick, 1979). A second cause of the clustering effect can be attributed to franchise exhibitions, where the primary function is to enable franchisors to recruit potential franchisees.[7] Some franchisors stated that the cause of the clustering of franchisees in their initial phase of growth was because they had attended a franchise exhibition. As a consequence the franchisees that were recruited tended to come from around the area where the exhibition was held, which was also near to the head office locations of the franchisors. The third reason for initial clustering applies to just one franchisor. This firm had constrained and controlled expansion within an area, thereby causing a deliberate pattern of locational clustering. Its initial expansion occurred only within the locational boundaries of the M25 (the franchisor's head office is located in Isleworth in Middlesex). Franchise units (and also corporate units) were all located within this parameter as the franchisor was clear that its locational objective would be to control growth in the initial phase so the firm could monitor and control the development of the franchise:

> *"when we first started, we kept all the franchise shops, all the shops in fact within the M25 so that we could monitor and control it far easier. And in fact at that time, we were approached by the people from Bolton – that was 5/6 years ago – and were asked for a franchise, and we turned them down. We said, we're sorry, we are keeping it within the M25 and we are monitoring it. And they approached us again a year ago and they now have a shop in Bolton. So they have waited that long for us to get out of the M25. But it was the obvious thing to do, because it was easier to monitor. Because when you are setting up a new franchise operation, there are mistakes, but if you are on top of them, you can correct them. If you are miles away, you can't. So it was kept within that area for that very reason, to control it basically." (Retail Sector, Firm C).*

There are a number of *operational considerations*, which might be expected to encourage close geographical proximity to the home base of the franchisor for the establishment of the first franchises (Macmillan, 1996). Indeed, some of the franchisors (including those that *did not* have initial growth clusters) acknowledged that locational clustering can have advantages. Locational clustering can ensure close monitoring and support of franchisees in the early (and often difficult) phase of franchise network and system development. If the first few franchises are located in

[7] The exhibitions are held quarterly at four major locations in the UK: London, Birmingham,

close proximity, this may facilitate a franchisor in the early days of expansion, particularly if the management infrastructure is limited, as it is likely to be in the early stages of franchise network development (Forward and Fulop, 1995; Mendelsohn, personal correspondence, 1999; Price, 1997). Clustering of franchise units can also allow for greater collaboration between franchisor and franchisee if both are geographically close. Any 'teething' problems may be detected and acted upon more promptly. With geographically dispersed franchises, the distance factor may mean that these problems are not necessarily dealt with so quickly. A number of firms did admit to the organisational and logistical difficulties of managing a dispersed network of franchisees in the early stages of growth. This was made more difficult as managerial and financial resources were relatively scarce at this stage. Some firms did intend to have a more focused strategy in its early stages of growth. However, because they had embarked upon national marketing campaigns in the early stages, they were approached by potential franchisees that were from geographically dispersed locations. As the objectives of these franchisors was to be *national* chains, potential development opportunities were taken up regardless of location. However, this posed franchisors with some logistical difficulties, as the firms had to manage the demands of developing and promoting new franchise concepts as well as manage franchise networks dispersed across the UK.

In sum, for the majority of firms in the sample, the first few franchises that were established in networks did not occur in clusters around the home base of franchisors. Instead, initial expansion occurred on a wider geographical scale. This finding does not, therefore, support existing literature which has examined the expansion process in the manufacturing sector and other types of service activity (Chapman and Walker, 1991; Jones, 1988; Jones and Simmonds, 1990; Watts, 1975). However, the lack of initial growth clusters in franchise operations can be explained by two possible factors. First, as section 4.2 confirmed, franchising is often used by firms as a strategy to achieve rapid growth. If expansion is constrained to one area, this is perhaps counter-active to achieving growth *rapidly*. Expanding and operating a more dispersed network can achieve greater and more rapid brand dissemination in the early stages of growth and allow a franchise to become established and known on

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Manchester and Glasgow.

a broader geographical scale and 'seed' localised geographical markets. Second, in the manufacturing sector or other service activity the expansion process will not necessarily be determined by a second party (the franchisee) and this factor can also explain why expansion did not occur in an initial cluster for the majority of firms. However, the franchisors did admit that an initial expansion strategy which occurred on a wider geographical basis sometimes caused operational difficulties with, for example, managing and supporting franchisees if they were located across the UK.

However, there were a number of firms in the sample (16) in which initial expansion did occur in a cluster around the home base of the franchisor. Although these firms identified a number of operational advantages to locational clustering or controlling growth within an area there were also trade-offs to this initial expansion approach. Restricting expansion to a specific geographic area could potentially discourage potential franchisees attracted to the system, and franchisors sometimes lost opportunities to develop a territory or a location because of this.

4.3.2 Strategies for the Roll Out Stage of Expansion

After establishing the pilot operation and the first few franchises, the sample firms entered the roll out stage – the main period of expansion. Only ten firms were currently in the main roll out stage; all the remaining firms in the sample (30) had passed through this stage. Roll out was the stage where firms determined the strategies and methods that were used to achieve expansion. Three types of strategies could be identified: proactive, franchisor-led strategies, where firms pre-determined territories or expanded through both the corporate and franchise route (Strategy 1); reactive, franchisee-led strategies where firms waited for franchisees to determine franchise development (Strategy 2); or a mixture of both (Strategy 3). Single unit operators was the main *method* facilitating expansion in this stage. However, a small minority of firms used the area, or master, franchise method.

Strategy 1 – Franchisor-Led

Strategy 1 was a franchisor-led approach to growth with franchisors determining the roll out process and deciding where the franchise will develop (see Figure 4.3). Under this approach, franchisors either predetermined the territorial basis of a network (Strategy 1a) or expanded through both the corporate and franchise route (Strategy 1b).

Figure 4.3: Strategy 1 (Time Phase 2)

Strategy 1 is determined by the franchisor

FRANCHISOR-LED (Total Number=18)

1a predetermined territories (n=17) → area franchises (n=4/17)

1b corporate and franchise expansion (n=1)

1a defined as: the franchisor will predetermine the territorial basis of the franchise network at the outset deciding where the franchise will develop before franchisee are recruited to the network. Territories will be either large scale area territories or small scale territories
1b defined as: the franchisor expands through both the corporate and franchise route

Strategy 1a – Franchisor-Led: Predetermined territories

Seventeen of the sample firms predetermined the territorial allocation of their networks before recruiting franchisees in the main roll out phase of expansion. These firms divided the UK into a master distribution plan of territories, with franchisors determining locations/areas where they wished to establish units. Small-scale territories were then allocated around locations/areas where units would be established and based on operational requirements.[8]

The majority of this group of firms (13/17) were mobile operations. Therefore, it was a necessary operational requirement for franchisors to allocate franchisees with clearly defined areas in which to work. All four greetings card distribution franchisors (Distribution Sector, Firms A - D) and all three parcel courier franchisors (Distribution Sector, Firms H - J) in the sample expanded with Strategy 1a. Five Personal Services Sector firms (C, D, E, F, and I) also predetermined territorial allocation before recruiting franchisees. These were all mobile operations.

[8] How territories are allocated and the techniques used for this task is discussed in Chapter 5.

Area Franchises

The remaining four firms (4/17) that used strategy 1a were locationally based firms and not mobile operations. These firms pre-determined the territorial allocation of their networks because of the *method used to franchise*. The method used to franchise was an integral part of the expansion approach used in the roll out phase of growth, as all four firms used area franchising. Therefore, pre-determining the territorial basis of a network was necessary for the establishment of area/regional master licences, which were granted to franchisees. Territories were also large-scale geographical areas compared to the other firms that pre-determined territories. Three of the firms (Retail Sector, Firm A, Fast Food Sector, Firm A, and Industrial and Commercial Sector, Firm A) granted areas franchises to franchisees. Franchisees would be given the development rights to a territory and have an agreement to open 'X' number of units over a certain period of time. However, the number of units that area franchisees established varied across the three firms (from 40 down to only four units). This may reflect the different types of operation of these firms. For example, the fast print franchisor (Industrial and Commercial Sector, Firm A) needed to develop only a small number of units compared to the convenience retailer (Retail Sector, Firm A) and fast food operation (Fast Food Sector, Firm A) because of lower levels of market penetration and larger catchment areas. However, the convenience retailer and fast food operator needed to have higher levels of market penetration and smaller catchment areas and therefore a larger number of units. The fourth firm which used area franchises (a virtual office support system – Personal Services Sector, Firm J) had a different organisational structure to the three other firms. It sold regional master licences to area franchisees, which then sold units to sub-franchisees, thereby creating an extra tier of franchisees (see Exhibit Box 4.7 for more in-depth explanation).

Ishani (1999) has estimated that less than one per cent of UK franchisors utilise area franchising. The very small number of firms in the present survey using area franchises provides further support for this notion. Explanations within the academic franchise literature examining area franchising are somewhat limited. However, Kaufmann and Dant (1996) and Ishani (1999) offer some insights into the *perceived* advantages of area franchising. These authors identified the advantages of area franchising as an ability to achieve a more rapid rate of growth, greater financial gain and access to large blocks of funds as well as the ability to keep consistency within an area.

The four firms in the sample confirmed that the reasons for using area franchising as the method in which to expand was for the predominantly resource constrained view outlined by Kaufmann *et al.*, in section 4.2 (see Exhibit Box 4.8). However, two of the firms also explained that area franchising was effective for agency related reasons. Kaufmann and Dant (1996, pp348-349) have argued that:

> *"in franchise systems using area development agreements...entire territories are licensed from the outset. Recruiting, screening and training economies are present, but because all units are committed from the outset, there is no ability to directly observe the franchisee's skills ex ante. Adverse selection in this context is still problematic."*

However, contrary to Kaufmann and Dant's (1996) proposition, these firms claimed that area franchisees did not suffer from motivational and incentive problems as the 'adverse selection' contention suggests. One of the firms (Retail Sector, Firm A) argued that because of substantial levels of investment (i.e. £100,000), area franchisees were perhaps more motivated than single unit operators[9] because franchisee losses would be considerable if area territories were not successful. For Personal Services Sector, Firm J using area *and* sub-area franchisees (and not using managers in units) ensured that both levels of unit owners had the same incentives not to 'shirk' but to work for mutual benefit.

In addition to the agency problem highlighted by Kaufmann and Dant (1996), Ishani (1999) has put forward a number of reason why area franchising has not been implemented in the UK, with these reasons confirmed by the remainder of firms (36/40) in the sample. First, geographical scale was noted as an important factor by firms as it is not necessarily feasible to allocate large area territories in a country the size of the UK. In the US or Canada, for example, where area franchising works very successfully, whole states are often allocated as territories. However, both countries are of a significantly different geographical scale to the UK.

[9] which the franchisor had used in the past in a previous attempt at franchising its operation

Exhibit 4.7 Area and Sub-Area Franchising An Example: Personal Services Sector, Firm J – a virtual office support system

Regulatory Background
Personal Services Sector, Firm J was the first franchise operation in the UK to be structured as an area and sub-area franchise. The introduction of the Trading Schemes Act in 1996 and the Trading Schemes Regulations in 1997 was aimed at curbing pyramid selling schemes and multi-level marketing schemes which franchising, and especially area franchising, could be considered to be examples of. However, franchising has been exempt from such regulations in two ways. First, all single tier-trading schemes are automatically exempt from the Trading Schemes Act, which includes the majority of UK franchise operations, although it *does not* exclude two-tiered area and sub-franchises. Therefore, the second way firms can be exempt from the Trading Schemes Act is if all franchisees in a network are registered for VAT (Ishani, 1999; Pratt, 1997). It is this exemption which has allowed Firm J to be organised through regional master licences and area and sub-area franchising, as the turnover of franchisees means that sales exceed VAT thresholds and franchisees are therefore, obliged to register for VAT.

Reasons for Using Area and Sub-Area Franchising
The firm's reasons for choosing the method of area franchising are two-fold. Firstly, the firm is a US concept in origin, and area and sub-area franchising is how the firm is organised in the US and other countries. Therefore, the UK franchisor believes that the area franchise structure has been a key factor in the firm's growth to 3,500 units worldwide and has allowed a rapid growth rate of 500 units a year. Secondly, because of the type of service the firm offers - a virtual office support system - the nature of the operation means that catchment areas for each centre have to be small to adequately penetrate target markets. Due to the potential number of units the firm could operate within the UK, (an estimated chain of 800 units), the franchisor argued that managing a large chain of units would be difficult to do from one central head office. Therefore, it was necessary to have some form of area management to ensure the effective operation of all units across each region. However, by introducing a middle layer of management, the franchisor believed that a clash of organisational culture would occur, as area management would not have the same agenda as franchisees. By making the middle layer of management a franchisee (the area franchisee) a commonality of culture occurs, as both area franchisees and sub-area franchisees have similar goals and agendas.

Network and Organisational Structure
The franchisor had divided the UK into 27 area franchises by defining key target markets for its operation:

> *"we have defined our market...we have concentrated on certain key market factors for location strategy. Currently, we know that our market is heavily AB's in demographic terms, it is very much dominated by people that are working from home or in small offices. It is dominated by people who I call 'early acquirers', people who tend to change their habits according to their needs very quickly...people who tend to be on the move a lot, often internationals, ex-pats etc. So we concentrated our initial location strategy looking at those sorts of people, students, ex-pats, areas with lots of professional people, high income areas etc." (Personal Services Franchisor, Firm J).*

Area territories were then allocated around such locations for area franchisees to recruit sub-area franchisees for each unit within the area territory (although the franchisor still had the final decision on the location of each unit). Whilst the head office provided area and sub-area franchisees with formalised training, product development, purchasing and marketing, area franchisees were responsible for local logistical and operational support, on-site training and the monitoring of operational standards.

Exhibit 4.8 Reasons for Utilising Area Franchising- Resource and Agency Explanations

Resource Constraints Reasons:
"as it is an expensive franchise, to invest, the franchisee expects greater returns on their money and expects to be able to open more than one store. For us, it is more profitable with area franchises, we get greater returns and greater investment" (Industrial and Commercial Sector, Firm A)

"Area franchising is more profitable, the returns aren't enough from single operators. We also get a faster rate of growth as we have found the right people to develop the stores for us" (Fast Food Sector, Firm A)

"It's a quicker way of achieving growth, of getting national representation" (Retail Sector, Firm A)

Agency Reasons:
"The company took the view that 'Why do it this way? Why don't we do it ourselves?' But how on earth will I be able to recruit a team of property managers that would have the same level of focus and motivation and incentive that these people have. How on earth would I then manage those stores with store managers, area managers, regional managers etc. How would I be able to focus those guys, give them incentive and reward them like I can with a franchisee?" (Retail Sector, Firm A)

"If you have a chain of 100-200 stores you can actually control that from the centre, if you go much above that you need area coverage. Now if you put area management into place, you tend to have a clash of culture. You have a master licensee, who is a franchisee, so if you have a franchisee at the front end, you have a manager in the middle who has a totally different agenda to franchisees. By putting a franchisee in the middle, you've got a commonality of culture and it works very well" (Personal Services Sector, Firm J)

Second, loss of control was a concern for some franchisors regarding area franchising. Having to deal with area franchisees that are responsible for developing 40 or more units could entail devoting considerable management resources to advising, supporting and motivating area franchisees. If the franchisor does not provide this type of support and assistance, an area franchisee may not reach the number of units stipulated in the franchise agreement and development will falter. For example:

> *"Say I've given a franchisee the rights to the north east of Scotland, for example, and the franchisee signs a development agreement and pays me in the traditional way of a lump sum at the start for those development rights. Then the franchisee has to build 25 stores in five years – five stores a year. In the first year the franchisee has only built four stores, what do I do? I would probably say to the franchisee "well you are one short, we can catch*

that up" it will be tough on the franchisee to withdraw the agreement on that basis, but technically I could. Come the end of the second year and the franchisee has built another three and is on seven rather than ten stores. Maybe I am getting worried by now. So we have a chat about it, we would try to say come on, lets catch up. Maybe you come to the third year and the franchisee hasn't caught up, you are then in a position of saying, "okay you know that your contract is null and void, we will have to recruit someone else in". You have lost three years in development in a potential market. Meanwhile, your competitor has got 15 stores in there and you have lost it..." (Fast Food Sector, Firm C).

Third, area networks could face problems of consistency and uniformity across the whole network, as area franchisees may place different emphasis on different aspect of the business. For example, one area franchisee may place greater emphasis on training, whereas another area franchisee may place greater emphasis on the quality of work achieved. The service offered by a firm that should be a national network could differ from region to region, which is contrary to the very essence of business format franchising: uniformity and consistency. Similarly, one poor performing area franchisee could damage the brand name and reputation of the whole network. Whilst all of these issues are of concern to a network structured around individual single unit operators, the issues become somewhat more problematic when area franchisees could potentially be responsible for developing between 50-100 units. Franchisors that develop with area networks place a greater degree of power and control with area franchisees than is evident with single unit structured networks (Ishani, 1999).

Strategy 1b - Franchisor-Led: Corporate and Franchise Expansion

The last firm with a franchisor-led strategy to growth expanded through both the corporate and franchise route (Retail Sector, Firm B). This firm's franchising strategy grew out of a relationship that it had with small independent retailers which were licensed to sell the franchisor's product. Over time the relationship between the firm and the independent retailers became more than just a simple licensing arrangement, as the firm began to give, for example, financial support and help with property leasing agreements. Over time a more structured and formal franchise relationship and contract evolved out of the original relationship between the firm and the independent retailers. Most of the conversion franchise units that the firm operated tended to be situated peripherally in locations in smaller cities and towns, as this was where the smaller independent retailers were traditionally located.

Strategy 2 – Franchisee-Led

Strategy 2 was determined by the franchisee. The franchisee determined the 'roll out' process of franchise units, deciding when and where the franchise developed (see Figure 4.3). There were two types of franchisee-led strategies. The first strategy was locationally/territorially dependent (Strategy 2a) whereas, the less common second type of approach did not entail franchisee being locationally/territorially dependent (Strategy 2b).

Figure 4.4: Strategy 2 (Time Phase 2)

Strategy 2 is determined by the franchisee.

FRANCHISEE LED (Total Number=22)

2a bespoke (n=20)

2b locationally unconstrained (n=2)

2a defined as: a franchisee-led approach to growth, where a franchisor has a bespoke approach to locations/operational areas. The franchisee determines the locations where the franchise will develop and the franchisor determines the viability of the location after the initial enquiry for the franchise
2b defined as: a franchisee-led approach to growth that is locationally unconstrained. Franchisees are not territorially or locationally dependent.

Strategy 2a - Franchisee-Led: 'Bespoke' Approach

The majority of firms in the sample (20/40) had a 'bespoke' approach to growth in the roll out expansion stage. This confirms Forward and Fulop (1995) who found that most of the franchisors in their sample had franchisee-driven procedures for achieving expansion. The bespoke approach is a somewhat 'unplanned' way of achieving expansion, as franchisors relied on franchisees to determine when and where the franchised developed. The bespoke approach illustrates the differences between corporate expansion and franchise expansion. With corporate expansion, a firm determines when and where the firm will open units. Zellar *et al.*, (1980) questioned whether franchisees play any role in the locational decision making process of franchise expansion. For firms with this approach the franchisee initially determined the process of where the franchise will develop (see Exhibit 4.9).

However, whilst the approach was initially determined by the franchisee, franchisors had the ultimate decision determining whether the sites/locations where potential franchisees proposed to open franchise units were viable. If locations were not viable (for reasons such as insufficient population, lack of customers, too much competition) the franchisor did not allow the franchise to develop in such locations/areas. However, suitable alternative locations were sought with potential franchisees. In those cases where franchisors allocated territories (17/20) territories were then allocated around the location of the unit. In many cases, franchisors had informal plans of locations or areas where they thought there was potential for the franchise to develop. Thus, the two way decision making process of both franchisor and franchisee determined spatial expansion.

The types of firms that adopted this approach were not limited to any particular sector or type of operation (i.e. mobile or location based). In fact, the approach was used by firms across the six different sectors of activity and by both types of operation (see Table 4.1). The majority of firms were location-based operations (17) with no distribution element to the operation. For these firms there was little need to pre-determine networks on a territorial basis. If a franchise operation has a distribution element, it is often necessary to pre-determine the territorial basis of the network so franchisees have defined areas in which to operate in order to prevent poaching of customers. However, three of the firms that used the bespoke approach to achieve expansion were distribution franchise operations. These firms recruited franchisees to the network first and then allocated territories subsequently, in consultation with the franchisees. Thus, there were no clear trends in terms of sector or type of operation regarding which firms used a franchisee-led approach for achieving expansion.

Exhibit 4.9 – The Bespoke Approach for Achieving Expansion

"None of the locations have really been chosen, we wait for people to come to us...get interested in us, if they decide to go ahead, we would look at any area, and we would choose the area based on the merits we find" (Industrial and Commercial Sector, Firm B)

"We have had a 'scatter gun' approach to growth. It is very much 'as' and 'when' we have been approached by potential franchisees." (Personal Services Sector, Firm B)

"When we started, we had a plan to locate around the main city centres. However, it didn't work like that. The type of franchisees we were looking to recruit we people at the senior level and they were reluctant to move. So we fitted our locational strategy around the franchisees we recruited and adapted as much as we could to their locational needs." (Business-to-Business Sector Firm B)

"We have had a very reactive approach, it has been franchisee-led. We will look at an area to see if it is viable however." (Industrial and Commercial Sector, Firm E)

"Rather than have a plan and say 'this is Manchester' we would say 'wait and see' and do it by knocking locations off one by one." (Distribution Sector, Firm G)

"We haven't gone out and said, 'we've got a territory here that we want to sell', it has come the other way around. It has been franchisee-led, they dictate the strategy." (Fast Food Sector, Firm D)

Strategy 2b – Franchisee-led: Locationally Unconstrained Operations

Two business-to-business franchisors (a Utilities Cost Management Consultancy (Firm A) and an Executive Recruitment Agency (Firm E)) had a locationally unconstrained approach to growth. Both firms did not allocate defined territories for franchisees to operate in and nor were franchisees tied to specific locations. The franchisors did not allocate territories or sites as it was considered an unnecessary operational requirement which would have restricted business. As both franchises operated with franchisees being specialist experts in one area (e.g. energy-cost management or pharmaceutical recruitment) a franchisee's 'market' was not constrained to clients in one geographical area, but was instead spread throughout the country. Franchisees could therefore decide where they 'located' their businesses (i.e. geographically as well as home-based/office-based), which meant that franchisees could be located in the same city or town but working in different specialist fields. However, market overlapping or 'poaching' of customers did not occur within the networks because the franchise operations were structured so that this did not occur.

Table 4.1 – Firms Using A Bespoke Approach for Achieving Expansion

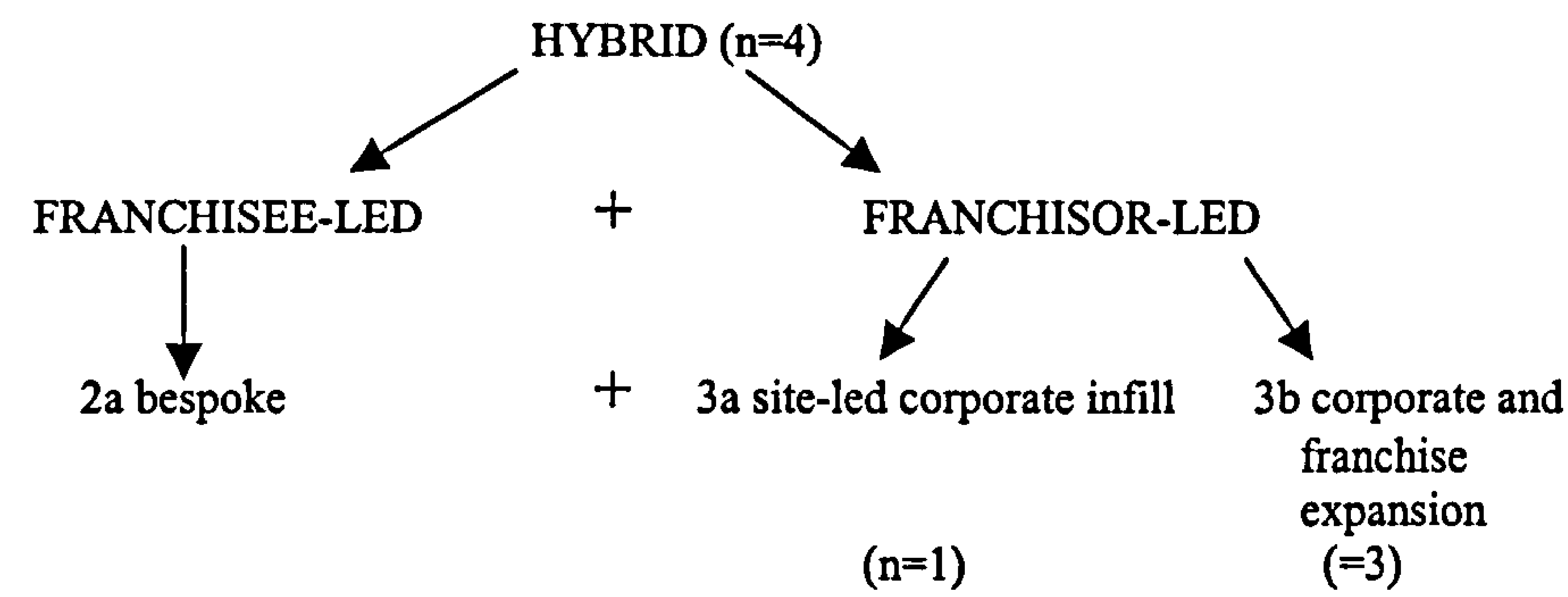
Sector	*Firm*	*Territorial Network*	*Type of Operation*
Retail	Bike Retailer (C)	Yes	Location based
	Second Hand Goods Retailer (D)	Yes	Location based
	Photographic Retailer (E)	No	Location based
Fast Food	Fast Food Pizza Delivery Franchisor (B)	Yes	Location based
	Fast Food Chicken Franchisor (C)	No	Location based
	Fast Food Chicken Franchisor (D)	Yes	Location based
	General Fast Food Franchisor (E)	Yes	Location based
Personal Services	Estate Agency Franchisor (A)	Yes	Location based
	Estate Agency Franchisor (B)	Yes	Location based
	Exclusive Health and Fitness Franchisor (H)	Yes	Location based
Distribution	Frozen Food Distributor (E)	Yes	Mobile
	Industrial Hose Distributor (G)	Yes	Mobile
	Pet Food Distributor (F)	Yes	Mobile
Business	Training and Consultancy Franchisor (B)	Yes	Mobile
	General Recruitment Agency (C)	Yes	Location based
	Driver Recruitment Agency (D)	Yes	Location based
Industrial	Fast Print Franchisor (B)	Yes	Location based
	Fast Print Franchisor (C)	No	Location based
	Fast Print Franchisor (D)	Yes	Location based
	Signage Franchisor (E)	Yes	Location based

Strategy3 – Hybrid: Franchisor and Franchisee-Led

As Forward and Fulop (1995) observe, empirical matters are rarely clear-cut. As with their sample, where franchisors had both franchisee and site driven strategies for achieving growth, so four firms in the present sample had a dual approach to achieving growth in roll out, which was determined by *both the franchisor and the franchisee.* The firms in this category first had a bespoke approach for achieving expansion, with franchisees determining the roll out process of franchise units (as outlined in Strategy 2a). However, these firms also had a more proactive approach to achieving growth than simply waiting for franchisees to be recruited to the network. Thus, the franchisors also determined growth by expanding through company owned and operated units. For these firms company expansion and a site driven policy for achieving growth was a solution to the difficulty of attracting and recruiting suitable potential franchisees, a strategy firms also used in the Forward and Fulop (1995) sample. Firms used corporate units in two different ways (see Figure 4.5). First, site-led corporate infill was transitory (Strategy 3a) and second, corporate expansion was an intentional part of achieving expansion (Strategy 3b).

Figure 4.5: Strategy 3 (Time Phase 2)

Strategy 3 is a 'hybrid' approach to growth, as both the *franchisor and the franchisee* determine the 'roll out' process of franchise units.



3a defined as: a franchisor will identify, open and operate suitable locations as company run units, until a franchisee is found for these locations

3b defined as: firms intend to expand through both corporate and franchise expansion

Strategy 3a – Hybrid: Site-Led Corporate Infill

For one firm, company-based expansion was transitional (Industrial and Commercial Sector, Firm C). The franchisor identified and bought company-owned shops with the intention of franchising these units when suitable franchisees were found in such locations. The firm's approach is somewhat unusual because in the early phases of expansion most franchise firms do not have the financial resources to be able to take on a site/property in the hope that they will be able to attract a franchisee to the site.[10] Indeed, the franchisor admitted that this was a risky approach because there was no guarantee that the locations would be taken on by franchisees. However, this was not the case as locations that were secured by the franchisor were taken on by franchisees after only a short space of time:

> *"I took on the Exeter property on speculation, I didn't have a franchisee for that location when I did this. I was lucky because I sold it fairly quickly...but I had to take risks in those early days." (Fast Print Franchisor, Industrial and Commercial Sector, Firm C).*

[10] The franchisor was able to implement this approach because the firm had private backing, and therefore had more financial equity at their disposal than perhaps most franchise firms would experience in the early stages of expansion.

Strategy 3b – Hybrid: Corporate and Franchise Expansion

The three other firms achieved growth through both the corporate and the franchise route in the roll out phase of expansion, and the approach - to grow through both types of expansion - was intentional in all three cases (Retail Sector, Firm C; Fast Food Sector, Firm C; Business-to-Business Sector, Firm C). The resource-constraints explanation (outlined in section 4.2) contends that franchising is an effective way to achieve growth as firms have access to franchisee finance, which funds expansion. However, for these three firms, gaining access to expansion finance was not the main priority for utilising franchising, as they all had access to other sources of finance (i.e. corporate funding and venture capital funding).[11] Rather gaining access to highly motivated unit operators was the main advantage of establishing franchise units (supporting the agency perspective of franchising). Agency theory also argues that a franchise network is likely to comprise both franchised and company owned units. Where units are peripherally located or difficult to monitor, agency theory suggests that they will be franchised because of the incentive advantages: owner-operators are less likely to shirk than employee-managers and more likely to work harder at making the unit a success because a franchisee's compensation is linked to performance (Forward and Fulop, 1997; Shane, 1995, 1996). However, unlike one of the retail firms outlined in Strategy 1b (Retail Sector, Firm B) the locations established as franchise units in the roll out stage of growth for the other three firms were not peripheral sites. In fact the franchise units and company-owned units that were established in this stage were interspersed throughout the country.

The first reason firms used company-owned stores was as a response to the difficulty of recruiting potential franchisees for locations identified as suitable sites for development. This confers with previous findings, which also suggests that franchisors open company units if franchisees cannot be found at the time desirable locations are identified (Floyd and Fenwick 1999; Forward and Fulop, 1995; Kaufmann and Dant, 1996; Knight, 1986). One of the franchisors (Retail Sector, Firm C) did not want to miss opportunities to take on locations thought to be suitable

[11] According to Forward and Fulop (1997) and confirmed by these three firms, the amount of capital resources available to support additional company owned outlets is one of the most important factors affecting the balance of the two types of units (franchised and company-owned) in a network.

for development if potential franchisees for sites could not be found at the time. Rather than letting a competitor take a site and achieve market representation in a city/town first, the franchisor took on the site as a company-owned unit. However, rather than turn these sites into franchise units when suitable franchisees were recruited, the franchisor intended to keep the sites as company-run stores. Company units were also used by another franchisor (Fast Food Sector, Firm C) to help the firm 'seed' markets where the firm had little representation (for example in Scotland). Using company units in underdeveloped or undeveloped markets helped attract potential entrepreneurs/franchisees who were able to witness the business format in operation (Newby and Hardwick, 1979).

A second reason that firms operated company units as well as franchise units was so that they could access two profit streams. Profit that franchisors gain from a franchise operation will be lower than the profit generated from a company owned operation (Rubin, 1978). Therefore, to enable access to greater profit, firms owned and operated company units. A third reason for operating company-owned units was to use such units as a vehicle for testing new ideas, concepts, and services before they were implemented in the franchised units, if successful (Forward and Fulop, 1997).

In sum, roll out was the main stage in the expansion life cycle for achieving growth. The firms in this sample had similar strategies to those identified by Forward and Fulop (1995), where firms had either franchisor of franchisee-led approaches for the expansion process. However, this study identifies a third strategy, a combination of both franchisor and franchisee-led approaches (hybrid). Single unit operators was the main method facilitating expansion, although a minority of firms used area franchises to expand.

4.3.3 Consolidation

Subsequent to the main roll out phase of expansion, firms entered a stage of consolidation. Thirty of the sample firms were currently in, or had undergone this expansion stage (21 firms were currently in consolidation, the remaining nine were in maturity). After the sample firms achieved a certain amount of geographic coverage, networks were strengthened and reinforced. Regardless of the expansion strategies and approaches used in the main roll out stage of development, strengthening and reinforcing networks involved the same issue for firms: filling network gaps that were planned at roll out where franchisors wished to locate and have unit representation.[12]

In addition to infilling networks gaps, a second process also occurred for some firms in the consolidation stage.[13] This process helped firms achieve consolidated networks but arose because new market opportunities, which were not planned or predicted by firms at roll out, arose over time. Shifting demographics, competitive pressures and factors internal and external to the system make it difficult for a franchisor to predict the saturation point of a franchise system. Therefore, the second process, which occurred in the consolidation stage, was to fill new market opportunities that arose in networks over time. For some firms, changing levels of market potential and opportunities to develop new units meant that networks had to be restructured and territories altered to accommodate new and existing franchisees/units. How such network and territorial restructuring is undertaken is the focus of in-depth inquiry in Chapter 5, as there are a number of contractual and operational implications to this process which warrant a more thorough examination (as argued in Chapter 2). Therefore, the following section only outlines the approaches that were used by the firms for the process of infilling planned locational and network gaps.

There was one further expansion process that occurred with some firms in this stage. Whilst the majority of franchisors when in this stage attempted to achieve consolidated networks on a UK scale, a number of firms (9) additionally took the opportunity to develop and expand internationally and establish master licences in European countries in the consolidation stage. For some of these firms this was a reactive strategy to potential master franchisee enquiries, but for other firms internationalisation was an intentional franchisor-led strategy, where new

[12] Incidentally, all firms in the sample wished to achieve nation wide coverage of their systems and firms experienced few barriers to developing nationally. Therefore, this is contrary to Dawson *et al's.*, (1984) contention that barriers (e.g. lack of franchisees, lack of concentrated population) limited the development of franchising in Scotland.

[13] This also continued into the maturity stage for a number of firms.

international expansion opportunities were sought. However, as the aim of this research was to examine expansion on a *national* scale this issue is not discussed further.

Strategy 4 – Franchisee-Led Infilling

With Strategy 4, all 30 firms which were either currently in or had passed through the consolidation phase, were predominantly franchisee-led in their approach to achieving consolidated networks: franchisees determined the process of filling locational gaps. The approach was therefore a reactive one, as franchisors were dependent on new franchisees recruited to the network to determine not only the order in which specified locations/territories were filled but also how quickly gaps were filled. The approach is described as 'locationally constrained' because firms had to work around existing franchisees or territories that were already established in the network (see Figure 4.6).

Using a franchisee-led approach for achieving consolidated networks was therefore sometimes problematic. Firms identified two main difficulties. First, some commented that they had key territories or locations which they would have *preferred* to be developed as a priority over other locational gaps. However, because the infilling process was determined by franchisees, priority

Figure 4.6: Strategy 4, (Time Phase 3)

FRANCHISEE-LED

↓

locationally constrained

↓

infilling
(n=30)

4) defined as: A franchisee-led approach to filling network gaps.
After significant coverage has been achieved, firms may have locational 'gaps' in their networks (either virgin areas/locations or resales) and will fill such gaps by working around existing territories/franchisees.

territories or locations were not necessarily developed first. Second, firms sometimes found that they were in a position of being able to sell/develop particular operational areas several times over and having to reject potential operators:

> *"we are having to turn away potential franchisees, because they want to open an outlet or they want the same territory in areas where we already have franchise representation" (Personal Services Sector, Firm B).*

> *"this is the difficult bit now, because you can sell one territory ten times over, but filling in the gaps is the tricky bit" (Distribution Sector, Firm B).*

As a first response, 14 firms altered their advertising and marketing policies to facilitate the process of filling network and locational gaps. After initially having national marketing campaigns, through advertising in national newspapers and franchise trade press as well as exhibiting at the main franchise shows, advertising became more locationally focused in an attempt to target franchisees for gaps in networks. For example:

> *"we have gaps around Manchester, Leeds...we haven't tackled Wales...we have a problem with Norfolk. We want to fill in those gaps and to do that we will change our advertising. Whereas we had a 'scattergun' approach before I can see that we will have to have a 'rifle' approach and point to a local area and advertise there" (Distribution Sector, Firm F).*

> *"as we are now targeting specific areas - the South East and London - where we have poor development, we have done some local advertising" (Business-to-Business Sector, Firm C).*

> *"as we had more coverage, we had to target specific areas to fill the gaps...the last one filled was mid-Wales, so when you are down to your last one you have got to be pretty specific in your targeting. Now of course, we are doing re-sales, so advertising is targeted specifically at those areas." (Distribution Sector, Firm B).*

However, other franchisors which were in, or had passed through, the consolidation stage had tried targeted advertising but in their experience, an overly focused advertising strategy was too costly and was not successful at recruiting franchisees for network gaps:

> *"we don't focus – we have tried to say that we are looking for franchisees in Woking or Surrey for example - but we find that it doesn't work very well. It is too over focused, so just having a general trawl – we get 50 enquiries a week." (Distribution Sector, Firm E).*

> *"I don't think that there is a regional marketing strategy that works with franchising. The cost of advertising is so horrendously high that you have to*

> *have a balance which means that if you were targeting a region, it would not be cost effective…I think that the franchise market is a national market, it's marketed by the service organisations and support organisations like the British Franchise Association and they have a national approach" (Retail Sector, Firm D).*

Therefore, targeting advertising and recruitment policies to find potential operators for network gaps achieved varying degrees of success for the current sample of firms.

The second response to overcome the difficulty of filling locational gaps, although used by only a minority of franchisors (9), was to attempt to recruit franchisees who were locationally mobile (i.e. franchisees that were willing to move to start up their franchise). However, this policy was not necessarily a successful solution for filling network gaps, as new franchisees were not always willing to move to set up a franchise because of lifestyle issues and family commitments. Therefore, as with targeted advertising, recruiting locationally mobile franchisees for filling network gaps had variable levels of success. Indeed, the majority of franchisors (21) argued that if franchisees were mobile this had the potential to negate some of the advantages of a franchisee establishing a business in an area/territory in which the individual had in-depth local market knowledge and that they were familiar with. For example, a franchisee may have established business and personal contacts in an area which could aid the development of a franchise unit. If a franchisee was to move away from their local or home territory, the benefits of local contacts or local market knowledge could diminish. This finding therefore empirically confirms the resource-based view of franchising as the franchisee's local market knowledge was identified by the majority of firms in this sample as one of the key advantages of franchising. Some franchisors (particularly the mobile-based operators) also preferred that their franchisees actually lived on, or in, their territory to reduce costs and travelling times so as to provide a higher level of service to customers.

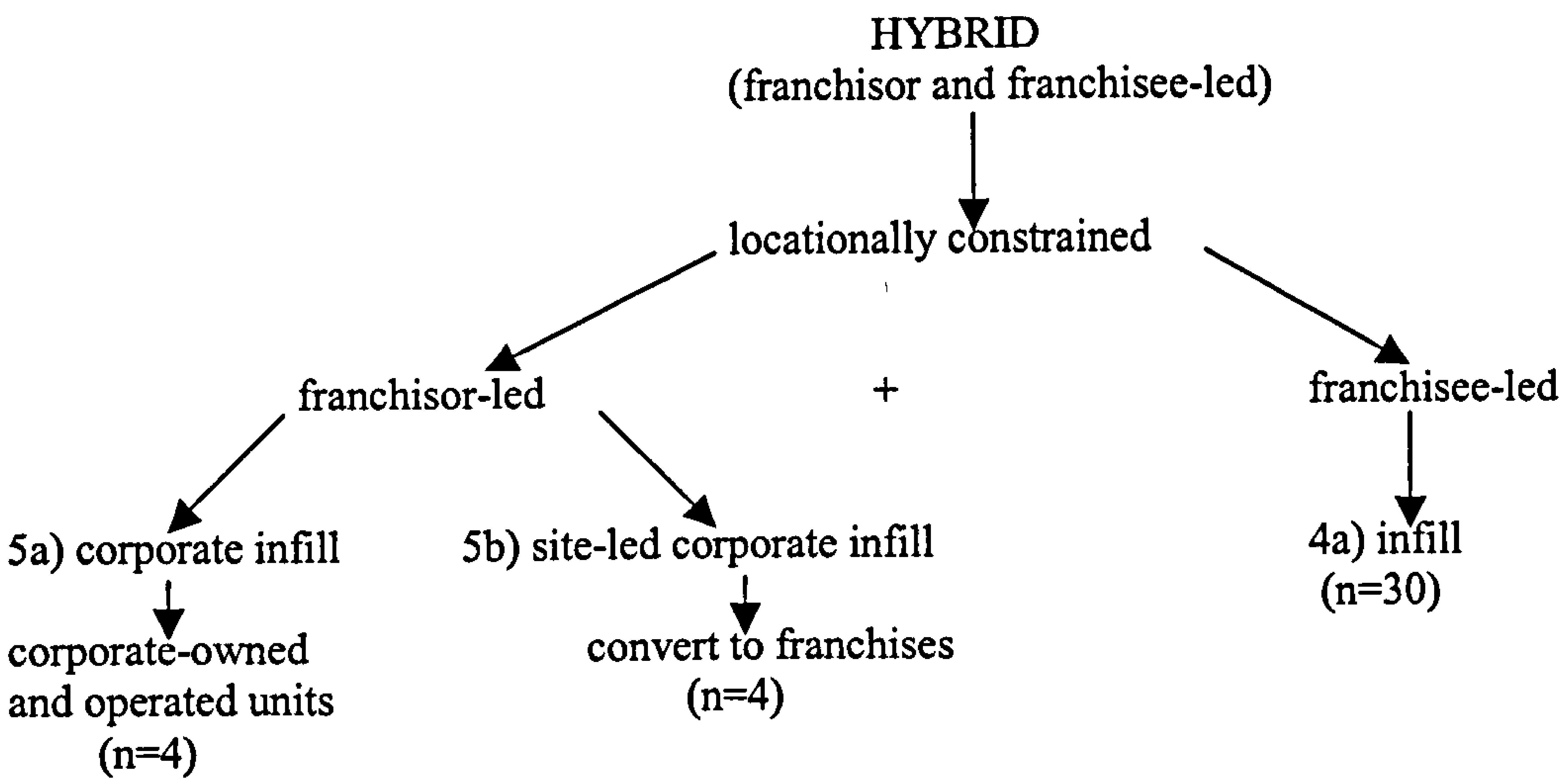
Strategy 5 – A Hybrid Strategy for Infilling Network Gaps

In response to the difficulties of filling locational gaps, eight firms in the sample used a more proactive approach to attempt to resolve this problem by opening and operating corporate units in network gaps. These firms continued to be dependent on franchisees to fill the majority of gaps but used corporate infill in locations which the franchisors perceived to be key markets for priority development: thus, the approach was hybrid as it was determined by *both the franchisee and the franchisor*. The firms used corporate infill in two different ways (see Figure 4.7).

First, firms used this approach with the intention of keeping units as corporately owned and operated units (Strategy 5a). For three firms (Fast Food Sector, Firm C; Retail Sector, Firm B; Business-to-Business Sector, Firm C) the corporate infill strategy was a continuation of the approach used in the roll out phase of expansion, where firms used both corporate and franchise expansion. As with the roll-out phase, if firms had identified locational gaps in which to open franchises, but as finding and recruiting suitable franchisees for the locations gaps had proved unsuccessful, corporate units were established in these locations. For the remaining firm (Fast Food Sector, Firm B) which had not expanded through both corporate and franchise expansion in roll out, corporate units were also used as a strategy to infill locational gaps. With greater equity, financed from franchisee expansion in the roll out phase of development, the firm had the opportunity to establish corporate units. By no longer being wholly dependent on franchisees for determining expansion, the firm had greater locational choice for system development.

Second, four firms (Retail Sector, Firm E; Personal Services Sector, Firms A and B; Industrial and Commercial Sector, Firm C) used the corporate infill approach with the intention of converting corporate units to franchise operations once suitable franchisees had been recruited to networks (Strategy 5b). Unlike firms using Strategy 5a, for these firms corporate infill was transitional (see Exhibit 4.10). For one firm (Industrial and Commercial Sector, Firm C) this was the same approach used in roll out. For the remaining three firms, the development of corporate units was a new policy made possible through greater availability to capital (funded through franchise fees and royalties, for example).

Figure 4.7: Strategy 5 (Time Phase 3)



Strategy 5a) defined as: a firm will continue to be franchisee-led in their approach to growth. However, with maturity of the system and increased resources, a firm may also have an approach of corporate infilling. A franchisor will own and operate corporate units in undeveloped areas, with the aim of maintaining these units as corporate entities.
Strategy 5b) defined as: a firm will continue to be franchisee-led in their approach to growth. However, with maturity of the system and increased resources, a firm may also have an approach of corporate infilling. A franchisor will operate corporate units in undeveloped areas with a view to developing these sites as franchises in the future, when suitable franchisees have been recruited.

Exhibit 4.10 Reasons for using Corporate Infill - Sample Responses

"We are still doing a franchisee led approach. If the right person says we want to be in Oxford, we will find a site in Oxford. What we are also doing now – hence the corporate stores - is when a good location comes our way, whereas before we would have had to turn it down because we would've had to wait for a good franchisee to come our way, we would now say okay, we will take it on. We will set it up...under the corporate banner and then go and find a franchisee for it. So it is now a franchisee and location driven strategy." (Retail Sector, Firm E)

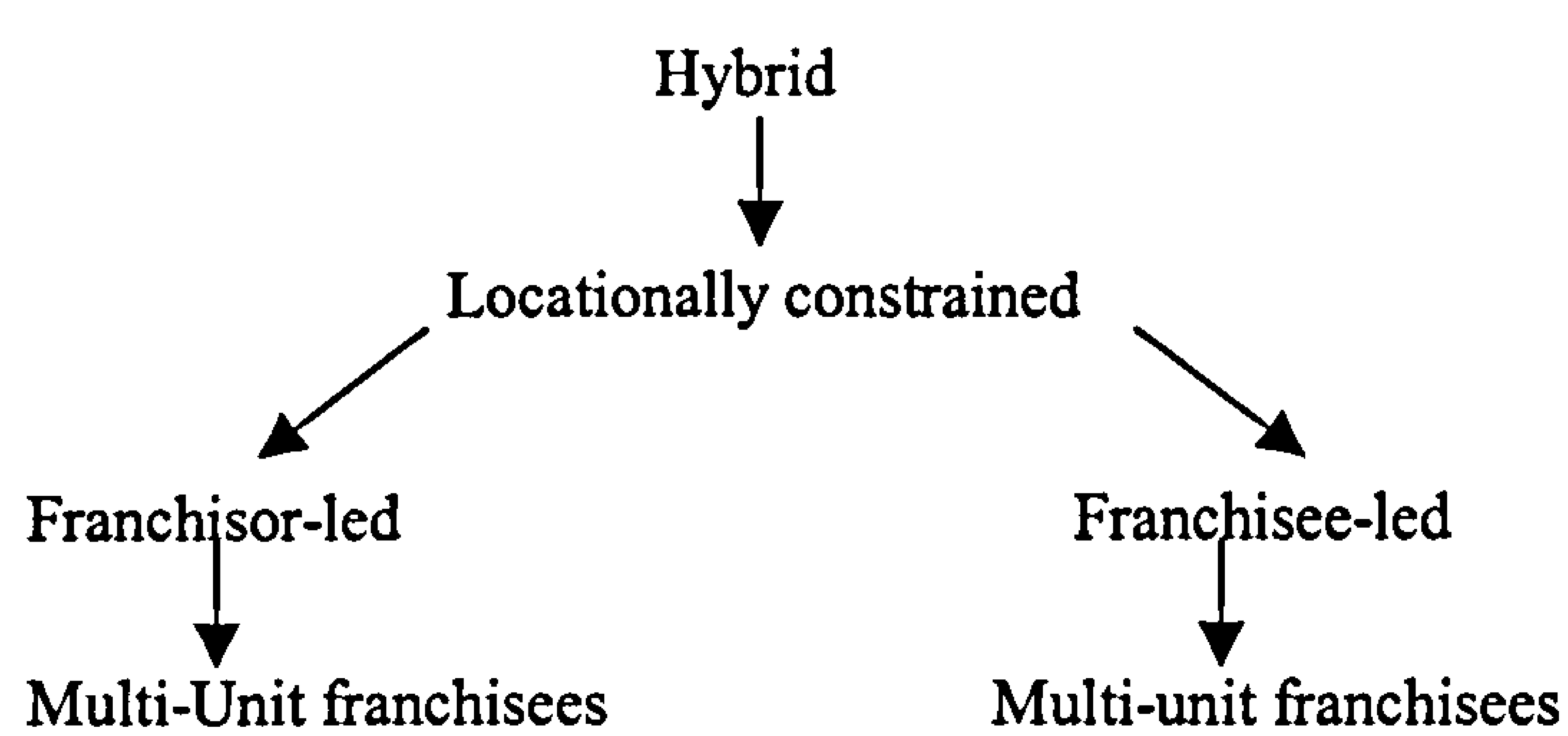
"If the company sees a good locational opportunity, but we can't find the right franchisee for that location, the company will take on that location" (Personal Services Sector, Firm B)

"the way we are working now, more so recently than in the past, is we will identify an area that we feel we can be successful in, or want to fill a gap - we've got an office here and a office there - so it makes sense to put one here. We'll identify that location and then we will go out to open there either by converting an existing business or by highlighting a premise. And in some circumstances, what we'll do in the future, is take those premises anyway and brand them as [firm name] and then find a franchisee for it. So we will do it the opposite way around." (Personal Services Sector, Firm A).

Strategy 6: Multi-Unit Franchisees

A fourth solution to the difficulty of filling locational gaps and achieving a consolidated network was to alter the method used to franchise (Figure 4.8). By getting existing franchisees to establish additional units and become multi-unit franchisees, firms were able to fill gaps that existed in their networks. A total of 15 firms altered their method of franchising in the consolidation phase. With the exception of three firms, utilising multi-unit franchisees was not the intended method of franchising, as in the main roll out phase of expansion firms expanded using single unit franchisees. Thus, unlike the 4 firms in the roll out phase, which expanded with area franchises, the multi-unit franchisee method of franchising was not an integral part of firms' expansion strategies. Rather, the method evolved over time with network development. Franchisors therefore approached existing franchisees to take on new or established units. Where virgin or resale territories/locations were available, proven, capable franchisees were an extremely useful asset to have access to in order to fill locational gaps.

Figure 4.8 Strategy 6 (Time Phase 3)



Strategy 6 defined as: A firm shifts in the consolidation stage from the single-unit method of franchising to utilising multi-unit franchisees to fill networks gaps.

In some instances, franchisees already operating in networks approached franchisors in the sample with an aim of taking on new or existing units. As Luxenberg (1985) and Price (1997) point out, some franchisees pursue expansionist policies from the outset and aim to achieve further expansion and increase their investment by becoming multi-unit franchisees. According to Price (1997) exhausted territories, slow unit growth or competitive pressures in a franchisee's local market environment may lead a franchisee to seek further expansion opportunities. Although not all franchisees in the present sample pursued multi-unit growth from the *outset*, an interest in taking on additional units developed over time, as franchisees became keen to achieve growth and increase their investment. This is further illustration that unlike corporate expansion, franchise expansion involves the locational decision making of not only the franchisor, but also the franchisee.

Regardless of whether sequential multi-unit franchisees resulted from either a franchisor or franchisee-led approach, franchisors had the ultimate decision regarding whether franchisees were proven business people capable of running additional units. As the academic literature has noted, not all franchisees have the ability to operate more than one unit (Kaufmann, 1992; Price, 1997). Franchisors in this sample confirmed that they had to assess whether existing single unit franchisees had the necessary skills, experience and finance to make further expansion successful. If franchisors did not allocate new units to existing franchisors the firms faced the alternative option of recruiting and training new franchisees, whose skills and capabilities were unobservable and unknown. Therefore, as Kalnins and Lafontaine (1996) and Kaufmann and Dant (1996) argue, operators that become multi-unit franchisees can reduce the risk of adverse selection for the franchisor. Allocating new or established (if a resale) units to existing franchisees can also reduce the costs of recruiting high quality franchisees to a network. As the franchisors in this sample confirmed, knowing the capabilities and experience of existing franchisees is a key advantage for new unit development and can be a less risky strategy than if a new/existing unit is allocated to a new, 'untested' franchisee. For example:

> *"if you have a good franchisee who knows the system, works the system well and will invest and grow with you, there is a lot less risk in going with an existing franchisee than going outside and recruiting someone else (Fast Food Sector, Firm C).*
>
> *"if one of my franchisees opens a new unit, at least I know what they can do. If I recruit a new franchisee - although our recruitment polices are fairly stringent – I could still end up with someone that is not right for the system" (Personal Services Sector, Firm H).*

However, one difficulty that can arise with multi-unit franchisees is that not all agency costs are reduced. Agency theory argues that franchising is an effective solution to the problem of overcoming 'shirking', as franchisee performance and compensation are linked. However, when multi-unit franchisees install managers in their units the problem of moral hazard can increase. Unit managers do not have the same incentives as franchisees thus, shirking can still potentially be a problem for both the multi-unit franchisee and the franchisor:

> *"multi-unit franchisees face a similar problem to franchisors in franchisor-owned units: they hire managers with contracts that give them relatively low-powered incentives. Monitoring the behavior [sic] of these managers will thus be particularly important to the success of the mini-chain. As a result, the multi-unit franchisee would want to own units that are close enough to their monitoring headquarters, and/or close enough to each other, to make this monitoring less costly" (Kalnins and Lafontaine, 1996, p5).*

Kalnins and Lafontaine (1996) found that in their sample of US franchise systems, the location of multi-unit franchisee units were geographically close, being contiguous and sharing market boundaries to minimise monitoring and agency costs.

Firms in the present study confirm Kalnins and Lafontaine's (1996) findings. For the current sample of franchisors, the solution to ensuring managers worked efficiently to promote a franchisee's interest, was to make sure units were located in close geographical proximity. The spatial consequence was that the majority of multi-unit franchisees were responsible for growth within a localised area. This enabled multi-unit franchisees to monitor units more effectively. However, for some firms ensuring a franchisee located its units close together was only something which was only learnt over time. Some franchisors initially let franchisees establish additional units which were geographically dispersed. Inevitably this led to problems with managing units. For example:

> *"one of our franchisee's initially had territories in London, Exeter and Plymouth as it was logistically crazy. We since re-organised that situation and we have learnt our lesson on that, as it just makes sense if franchisees have units that are territorially adjacent" (Distribution Sector, Firm G).*

Kaufmann & Dant (1996) observe that in the US, some franchisors control the number of units a franchisee can establish and run, as:

> *"unfettered franchisee expansion produces wide spans of control (in some cases reaching into the hundreds), too wide to assume that franchisee*

> *monitoring can efficiently solve store level incentive problems. In those cases franchisee holdings take on all the trappings of a company-owned chains" (Kaufmann and Dant, 1996, p347).*

The current sample of firms also confirm Kaufmann and Dant's (1996) findings. All the firms, which operated with multi-unit franchisees in this sample limited the number of units a franchisee could own and run (the maximum was 13 units but most multi-unit franchisees had between two and six units). Firms would also not allow existing franchisees to take on further units until such franchisees had been operating in a system for at least two years. Franchisors limited the number of units a franchisee could operate and specified a set period of operating experience because regardless of a franchisee's *perceived* capabilities, running a large number of units could sometimes be too demanding for a franchisee. Indeed some franchisors initially allocated a second unit/territory to franchisees, but it became evident that running a second unit was too difficult for particular operators. Consequently the second units were sold. As the franchisors observed, franchisees needed different skills to make the transition from owning and operating a single unit to multiple units, which was not always a successful process. For example:

> "as *soon as you move a franchisee from a one shop business to a two shop business, his role in life changes. He cannot be in two places at the same time. So his expertise has to be managing a manager in one shop and managing another manager in a second shop - and he may be absolutely terrible at managing people - but he may have lots of energy. So he needs different skills." (Retail Sector, Firm B).*

In sum, the academic franchise literature often assumes that the most frequent form of franchising is the single unit operation. The findings from the present sample, where almost half of the sample firms use multi-unit franchising, contradicts this stereotype. As Kaufmann and Dant (1996) also confirm, 88% of the franchisors surveyed in their sample had multi-unit franchisees within their systems. Similar percentages of multi-unit franchisees have also been found in samples by Kaufmann (1995), Kaufmann and Lafontaine, (1994) and Bradach (1995). However, all four studies have been based on the fast food sector alone. The current findings are based across a diverse range of sectors of franchise activity and the sample includes some of the most prominent UK franchise operations. Within each sector, at least half of the firms had multi-unit franchisees within their systems. Whilst US literature argues that multi-unit franchising is ubiquitous in the American context, this is the first survey to give some indication of the scale of multi-unit franchising in the UK. The embryonic literature on multi-unit franchising also provides some reasons why multi-unit franchising is used by some franchisors. Kaufmann and Dant (1996) argue that the benefit of multi-unit franchising is that it allows a franchisor access to capital from existing established franchisees and that it facilitates more rapid organisational growth. Bradach (1995) argues that franchisors found multi-unit franchisees better than single unit franchisees in terms of adding units, maintaining uniformity within the system and in making system wide adaptation to changes in the firm's competitive environment. Whilst the findings of the present survey confirm Bradach's (1995) argument that multi-unit franchisees can be more effective than single-unit franchisees in terms of adding units, the current findings also suggest that multi-unit franchising has been used by firms to overcome the problem of filling locational gaps in networks which is a major challenge encountered at the consolidation stage.

As in the roll out phase, the strategies and approaches used to consolidate networks differed. However, as with the previous phase of spatial development, expansion was determined by the franchisor, the franchisee or a combination of both. The majority of firms continued to be reactive and wait for franchisees to approach the system (a franchisee-led approach). However, marketing, promotion and advertising became more specific and proactive in response to greater locational constraints. Locationally mobile franchisees were also seen as a solution to overcoming the difficulty of infilling, although only in a minority of cases were franchisees willing to relocate. For a minority of firms, more proactive expansion strategies were used in the consolidation phase than were used in the roll out phase of development (a franchisor-led strategy) as they opened and established corporate units to overcome the infilling problem. Altering the method of franchising that was used in the roll out phase of expansion (i.e. developing existing single unit franchisees into multi-unit franchisees) was a way for firms to fill gaps in their networks (a franchisor and franchisee-led strategy).

4.3.4 Maturity

Nine firms in the sample had reached a mature stage of development. Not surprisingly, these firms were the oldest in the sample.[14] Having reached maturity, they had experienced a number of evolutionary phases in response to changing market positions, technological advances, changing levels of market penetration and competitive pressures, for example. Therefore, the focus of firms in this phase was strategic: to manage and maintain franchise networks (Figure 4.9). For the nine firms in this stage, managing and maintaining networks involved three processes: (i) restructuring and re-organisation; (ii) selling networks to larger corporations and (iii) seeking new expansion opportunities external to the franchise network.

Figure 4.9: Strategy 7 (Time Phase 4)

Franchisor-Led

↓

management of network

Strategy 6 defined as: An approach in which franchisors manage and maintain franchise networks. This process involved restructuring and re-organising networks (contract renewals, reselling units, new expansion and rationalisation), selling franchise networks and seeking new expansion opportunities on an international scale and with new franchise systems.

First, the maturity stage involved a process of restructuring and re-organising networks (a continuation of the process conducted in the consolidation stage). This entailed the renewal of franchise contracts or replacing franchisees with new recruits (if franchisees had sold their units, had retired or were poor performing franchisees[15]). Several firms were faced with succession issues, as some franchisees had operated with the networks since the roll out stage. These firms therefore had to recruit new franchisees to networks when original franchisees retired.

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[14] There were two other firms in the sample, (Fast Food Sector, Firm E and Industrial and Commercial Sector, Firm B) one started over 30 years ago and the other over 20 years ago. However, the firms were not yet in the mature stage, as both firms had deliberately maintained a slow rate of growth and were therefore currently in the consolidation phase of development.

For five firms, reorganisation and restructuring of networks occurred to maintain competitive positioning and market share. Four of the five franchisors maintained competitive positioning in their sectors of operation by adding new units into existing national networks (as in the consolidation stage), but the fifth firm (Retail Sector, Firm B) embarked upon a period of rationalisation in response to competitive pressures and the changing retail environment.[16]

A second process which three firms undertook in the maturity stage was to sell their networks to larger corporations. For these franchisors, selling off the franchises was for personal reasons as the franchisors wished to retire. Therefore, succession was an issue for *franchisors* as well as franchisees. Furthermore, it has been proposed by Oxenfeldt and Kelly (1969) that in a mature phase of development, franchisors will buy back franchise units and convert the network into a wholly owned and operated chain. Franchising is therefore used only as a short-term expansion strategy to achieve rapid market penetration and growth. However, this did not occur with the franchisors in this stage as all nine firms continued to operate networks as franchise organisations, findings which confirm Hoy *et al's*., (2000) contention that there is no widespread evidence of ownership redirection.[17] Networks were not converted into company owned and run operations because the franchisors felt this would not have been beneficial for their networks. The franchisors argued that putting inexperienced, less motivated unit managers into previously owned and operated franchise units would not have the same advantages as operating with franchisees. For these franchisors, franchising continued to be a highly effective form of organisation in latter development stages for agency related reasons.

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[15] If franchisees had continually failed to reach performance targets, contracts would not be renewed. This was also an issue faced by firms in the consolidation stage. (See Chapter 5 for more in-depth discussion of performance targets).

[16] The firm altered its locational strategy by opening larger units in 'new retail spaces': in shopping malls and out of town retail parks (see Wrigley and Lowe, 1996). For example, units were opened in Cribbs Causeway in Bristol, Bluewater in Essex and West Quay in Southampton, covering greater retail space and generating larger turnovers. As part of this new locational strategy, smaller units were closed.

[17] Indeed, only one firm (which was still in consolidation) intended to buy back franchise units and turn the franchise network into a wholly owned corporate operation. However, this was an aim that was several years away. All the remaining firms in the sample intended to continue operating their networks as franchise operations.

The third process undertaken in the maturity stage for three of the nine firms was to seek new expansion opportunities external to the existing franchise network. For two firms, this took the form of developing new franchise concepts and networks under the trade name of the franchisor group, as this was a way to maintain competitive positioning and increase market share. The firms (Personal Services Sector, Firms E and F) expanded and extended their range of services and sought opportunities to expand into new markets and achieve new growth in related activities.[18] The two firms had between 30-40 years operating experience, substantial head office development and network infrastructure and considerable equity to be able to develop, pilot and market each new franchise concept. As the franchisors argued, the reason for concept extensions was because:

> *"we want the ability to create new opportunities and new franchise types, we want more companies and more franchisees – that way we will continue to grow" (Personal Services Sector, Firm F)*
>
> *"in 2-3 years time, we will have got to optimum market share. So we have had to find additional services to increase our market and we therefore have more room to grow" (Personal Services Sector, Firm E).*

For the third firm (Distribution Sector, Firm I) the mature phase of development signified a period of expansion on an international scale. As the franchisor's domestic network was well established, the franchisor decided to expand into a European market in overnight freight. The franchisor established master franchise licences in several European countries as a way of continuing growth and development of the franchise system[19]. No other firm established international operations in the mature phase. As discussed in Section 4.3.3 the other nine firms, which internationalised their operations, did so earlier in their development, in the consolidation phase. As Floyd and Fenwick (1999) argue, internationalisation of operations is an activity which takes place beyond 'adulthood' (i.e. in the latter stages of franchise system development) when a firm has sufficient infrastructure and

[18] Both firms offered domestic and commercial maintenance services and both firms enlarged their groups to include three further services. One of the firms (Firm F) extended its service range by operating not only a commercial cleaning service but also a domestic cleaning service and two restoration services. The other firm (Firm E) originally operated a home maintenance service and extended this to include a security service, a roofing service and a pest control service.
[19] And was rolling out the franchise across Europe at the time of interview.

finance, and is successfully operating on a domestic scale, an observation confirmed by firms in the present sample.

In sum, for the nine firms in maturity, the stage was characterised by managing and maintaining franchise networks. This involved three activities. First, the majority of firms maintained networks by managing the renewal and resale of franchise units, with some firms additionally embarking upon new expansion phases within the UK. Thus, expansion was not restricted to only the initial stages of growth. Second, a minority of firms sold their networks to larger corporations and thirdly, some firms sought new expansion opportunities external to existing networks by developing new franchise concepts and systems or internationalising operations.

4.4 Conclusions

Franchising is a strategy which enables a firm to achieve rapid spatial and organisational growth. Paradoxically, *how* expansion is achieved has not been rigorously examined by extant research. Therefore, this chapter sought to understand the spatial expansion process of franchise systems in the UK in order to redress this neglect. Two key questions were addressed: why firms franchise and how firms achieve growth by the expansion strategies and methods that are used.

The first process of expansion is for a firm to decide to use franchising as a means to achieve growth. In examining this issue, the first part of this chapter has contributed to existing theoretical debates, which have sought to understand why firms franchise. Although agency theory has assumed predominance in extant literature, the evidence from the current study highlights the importance of the resource-constraints theory as an explanation for why firm franchise. A key advantage of franchising identified by this theory, and confirmed by the majority of firms in the present sample, is the ability to utilise the financial and human capital of the franchisee to realise rapid spatial expansion. Therefore, reiterating Kaufmann and Dant's (1996) contention, the first conclusion is that empirical analysis confirms that the resource constraints perspective should not be discounted by the academic literature in favour of alternative explanations.

However, a number of firms in the present sample also cited that it is because of *both* resource and agency related advantages that the decision to franchise was taken. Therefore, the second conclusion is that whilst separately, both the resource and agency perspectives can aid explanation of why firms franchise, it is a more balanced view - incorporating both perspectives - which can provide more detailed insights for understanding the reasons franchising is used as a strategy to achieve expansion. The academic franchise literature often only provides evidence for either the agency or the resource perspective, but not a combination of both.

The life cycle model is the conceptual framework – utilised in other areas of organisational literature – which has been developed in this chapter to understand the spatial expansion process of franchise systems. Through use of this model, the chapter has provided significant new insights into how franchise operations achieve expansion with the strategies and methods that are used to grow and develop over time.

Four key stages were identified in the life cycle. The first stage of the spatial expansion life cycle is the initial stage, characterised by the piloting of the franchise operation and the establishment of the first few franchises. The second stage of the spatial expansion life cycle is roll out, the main period of expansion, characterised by firms determining (or continuing from the initial stage) the strategies and methods used to achieve nation-wide expansion. The third stage of the expansion life cycle is consolidation, characterised by the strengthening and reinforcing of networks by filling locational gaps. The last stage of the spatial expansion life cycle, which only a few firms in the sample had reached, is maturity.

The third conclusion is that the four stages of the life cycle model demonstrate and enable insights into the generalisability and empirical regularities of the spatial expansion process. The firms in the current sample progressed through different stages of growth, characterised by key spatial developments. However, the strategies and methods used to achieve expansion varied inter- and intra-sectorally and few clear trends were evident within the sample. Whether a firm used a franchisor-led strategy, a franchisee-led strategy or a combination of both for achieving expansion was not sector specific nor determined by the type of operation (i.e. mobile/location-based).

The fourth conclusion is that the lack of clear trends regarding expansion strategies, whilst reflective of the broad sectoral range included in the current sample, demonstrates more significantly that franchising – despite often being treated as a homogenous economic activity (by the academic and practical literatures) – is heterogeneous in nature. The methodological approach used in this study has therefore enabled greater insights to be gained and given a more accurate representation of the nature of franchise activity.

The lack of distinction in understanding which strategy is used by a specific type of firm from a particular sector of activity demonstrates that other factors are responsible for determining the expansion process. Therefore, the fifth conclusion is that it is the *key actors* in a franchise system – both the franchisor and the franchisee – and their underlying decision-making processes that determine the strategies and methods used to achieve expansion. The franchisor may predetermine territories, open corporate units, or simply wait for a franchisee to determine when and where the franchise system will develop locationally. Indeed, it is this factor, that a second party (i.e. the franchisee) plays a key role in determining the expansion process, which distinguishes franchise expansion from manufacturing and other types of service based expansion.

Therefore, this chapter has argued that previous academic literature, which has examined the spatial expansion issue (Newby and Hardwick, 1979 and Aspbury, 1985) is limited, as its emphasis has been to describe patterns of franchise system expansion rather than the *processes* causing these patterns. It is evident from the findings in this chapter that it is the combined decision making processes of both the franchisor and the franchisee that determine spatial outcome. More recent academic literature (Forward and Fulop, 1995), which has examined the strategies franchise firms use for achieving growth, is also limited. This research focuses on only one stage (roll out) in franchise system development and does not take account of the dynamic nature of network development. However, the spatial expansion life cycle developed in this chapter captures the dynamic element of the expansion process, illustrating that strategies and methods alter over time according to the stage of development.

Reflecting the dynamic nature of the spatial development process, new expansion phases occurred for some firms in the sample in latter life cycle stages (i.e. consolidation and maturity). Thus, changing levels of market potential and new expansion opportunities, which arose over time, led to networks being restructured and altered to accommodate new franchisees/units. There are a number of contractual and operational implications to this process which warrant a more thorough inquiry. Chapter 5 examines the network restructuring issue in more depth. In so doing, the chapter is the first to offer some insights into the "*spatial and temporal statics and dynamics of business franchise growth and expansion...*" (Aspbury, 1985, p83).

Chapter 5 Franchise Network Allocation and Network Dynamics

5.1 Introduction

An inherently geographical aspect of franchising is for the franchisor to assign customers to the franchisee. As Chapter 4 outlined, part of the expansion strategy for some firms was to pre-determine territories at roll out. Thus, such franchisors assign customers to franchisees by allocating *territories* and franchisees service customers within a specified geographical area. However, not all firms will formally assign customers to franchisees through allocation of a territory. In some cases, a franchisor will grant a licence to a franchisee for a unit and define a *market area* in which to situate that unit (Barrow *et al.*, 1999; The Midland Bank Guide to Franchising, 1999).

Although the allocation of a territory/market area is a fundamental operational aspect of franchising and a key component of the franchise contract, knowledge of how franchisors define operational areas is largely limited to explanations in the 'How To' literature.[1] Few academic studies have examined this issue. This lack of academic investigation is an important omission as allocation and definition of territories/market areas is an important task for the franchisor to undertake. An enhanced understanding of this issue may therefore aid new franchise systems in successfully allocating and defining territories.

However, as Chapter 2 outlined, the difficulty with territory/market area definition is that it is a static process undertaken at one point in space, time and business development at the initial or roll out stages of expansion. However, markets are dynamic, not static, and original operational area delineations will be affected by shifting demographics and changes in market penetration, as over time a franchise format becomes better known. Consequently, there may be opportunities to establish additional units in a network if market potential extends beyond initial expectations and saturation points which may be predicted by the franchisor at the initial stages of expansion. The result is that original operational areas may need to be redefined and restructured. Moreover, as Chapter 4 indicates

[1] Defined by Price (1997) as advice given in the trade press or by franchise consultants and advisors.

restructuring may be necessary on more than one occasion, as new market potential can arise any number of times throughout the latter stages of the life cycle of a franchise network. Thus, the dynamic which underlies the growth of a franchise system may cause changes in the geographical basis of a network at any point from the first stage of expansion (roll out) to subsequent stages (consolidation and maturity).

New expansion opportunities which arise over time pose two unique difficulties for franchisors. First, how a franchisor designs and allocates its network at the initial stage of development can have important consequences for the process of network restructuring. The discussion has already established that a franchisor may allocate its network on either a territorial or market area basis (Barrow *et al.,* 1999). A further feature specific to a franchise operation - identified in both the academic and practical literatures - is that a franchisor may also grant *exclusive rights* to an operational area (Barrow *et al.*, 1999; Bradach, 1995; Kaufmann and Rangan, 1990; Mendelsohn, 1991; Vincent, 1998; Zellar *et al.*, 1980). However, granting a franchisee with exclusive rights can restrict a franchisor's contractual ability to restructure its network. If a franchisor does not fix defined boundaries around a territory or market area, the firm may not face the same problems with restructuring. However, the effect that different network allocations have on the restructuring process has not been rigorously examined by extant research.

The second reason why new expansion opportunities pose unique difficulties for a franchisor is because the effects of network restructuring on existing franchisees will have to be considered (Bush *et al.,* 1976; Current and Storbeck, 1994; Ghosh and Craig, 1991; Kaufmann and Rangan, 1990; Spinelli and Bygrave, 1992; Vincent, 1998; Zellar *et al.,* 1980). As the literature has identified, franchisor and franchisee goals rarely coincide and may even conflict regarding new market development. Whilst a franchisor will be concerned with developing new expansion opportunities to maximise system-wide sales a franchisee will be concerned with protecting their investment and maximising unit profit. Adding extra units into the network may mean that a franchisee loses part of its operational area with a new unit located near to its own, possibly causing cannibalisation of a franchisee's sales and profit (Mayfield, 1997; Ryans *et al.*, 1997).

Whilst the addition of new units to a network will generally be beneficial for the franchise system as a whole, it is important that any benefit is not outweighed by the cost of conflict arising from new unit additions. A franchisor must keep conflict at a minimal level otherwise the franchisor may have to expend valuable resources resolving disputes (Kaufmann and Rangan, 1990; Vincent, 1998). Thus, the franchisor must consider franchisees that are already operating in the network when developing new market potential and continuing network development.

Although the academic literature has identified the issues franchisors face in balancing system growth over time with the effects this can have on franchisees already operating in a network, there has been little attempt to understand how the network restructuring issue is *resolved* (see Chapter 2). Previous academic research has largely been restricted to developing theoretical models to assist the franchisor in its locational decision making to find optimal sites for new units which cause minimal conflict. Therefore, little is known about how franchisors with different network allocations continue network growth over time yet maintain profitable and successful networks of existing units. How franchisors attempt to resolve the issues caused by new expansion and network restructuring has also not been rigorously examined. Chapter 5 therefore seeks to answer the four main questions outlined below. In so doing, this chapter will be the first to comprehensively examine, in an empirical context, the dynamic nature of franchise system expansion and the network restructuring issue:

1) What techniques and criteria do franchisors in the UK use to define and delineate franchise territories/market areas and locate franchise units?
2) How common is it for franchise systems to undergo network restructuring?
3) If original operational areas designated in the roll out stage become outdated by changes in the level of market penetration, does network design and allocation affect the restructuring process?
4) How do franchisors resolve the network restructuring problem: what mechanisms or policies do franchisors in the UK use or have in place to facilitate the restructuring process?

5.2 Network Allocation and Definition

5.2.1 Territory/Market Area Allocation

Three forms of network allocation were used by the firms in this sample. (i) The majority of firms in the current sample (32) allocated territories to franchisees. (ii) Six firms licensed unit locations to its operators and did not, therefore, allocate territories but market areas in which to situate units. (iii) The remaining two firms allocated neither territories nor market areas to franchisees because the type of franchise operation was not spatially dependent. One firm (Business-to-Business Sector, Firm A) was a cost management consultancy and the other firm (Business-to-Business Sector, Firm E) was an executive recruitment agency. Thus, franchisees had an expertise in one particular area of utilities or recruitment and a franchisee's market was not tied to one geographical market, but was instead, spread throughout the country (and in the case of the recruitment franchise, some franchisees' markets were international). With this type of operation, it was impractical to set territorial boundaries and constrain franchisees geographically. In effect, franchisees operated across geographical boundaries and markets to service clients and were 'spaceless' franchisees.[2]

The key difference between allocating a territory and a market area is that market areas are not delineated or fixed by physical and contractual *boundaries.* For the firms which did allocate territories (n=32), the standard technique to delineate a territorial boundary was to use postal code districts (19). Other techniques included arbitrarily drawing territorial boundary lines on a map (8); using roads as physical boundaries (2); allocating city/town borders as physical boundaries (2); or using Yellow Pages classifications (1). These territorial delineations and boundaries were specified in the franchise contract: franchisors provided a franchisee with a map of its operational area and/or a list of postcodes, roads or addresses, which covered the franchisee's territory. However, some techniques were more effective at clearly delineating territorial boundaries. Whilst postcodes and city/town boundaries worked sufficiently in most cases, arbitrarily drawing boundary lines on maps or using roads as boundaries were techniques which could be problematic. Three firms (out of 32) experienced difficulties because of inadequate delineation of territorial boundaries (Fast Food Sector, Firm B; Distribution Sector, Firms G and J). This led to problems in operation and disputes between franchisees over customers. As the following quotes illustrate, a consequences of failing to accurately stipulate boundaries is that a franchisor may need to expend time, money and effort resolving territorial boundary disputes:

> *"In the early days, the maps were pretty broad brush and we would use a magic marker which was probably in itself about five hundred yards wide when you got it down to the size of a map. It became a problem at a later date, because that five hundred yards could have included a factory and suddenly one guy has got it and then the other guy has got it also"* (Distribution Sector, Firm G).

> *"There was a hospital on a road on a boundary and the same road was the boundary for two shops. An argument arose as to who could deliver to the hospital, because they were both entitled to it. They very nearly took each other to court -they very nearly took me to court - because the hospital was worth over £300 a week and they were both leafleting it and they both argued it was their delivery area"* (Fast Food Sector, Firm B).

A key trend that can be identified sectorally and in terms of the 'type of operation' (i.e. mobile/location-based operations) is that all distribution systems (n=10) and all mobile operations (n=16) in the sample allocated territories to franchisees. In such types of systems, it is necessary for the franchisee to have a clearly defined operational area, as the franchisee travels to the consumer (Current and Storbeck, 1994). In a location-based operation, in contrast, the consumer travels to the franchisee, and a clearly defined territory may not be such a necessary operational requirement. However, the trend is complicated by firms involved in the other five non-distribution sectors that are location-based operations, which also allocate territories for franchisees to operate in (n=17).[3] Allocating a territory is therefore not distinct to the distribution sector or mobile franchise operation. The network allocation decision is therefore based on factors other than franchise sector or type of operation and is discussed in greater depth in section 5.3.

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[2] Therefore, as neither territories nor market areas are allocated, the two firms are not included in the findings for the remainder of this section.

[3] One franchisor (Fast Food Sector, Firm B) was the only firm in the sample, which was both a retail *and* mobile operation, as it was a home delivery pizza ope rator.

5.2.2 Techniques Used to Define Territories/Market Areas

The techniques that franchisors used to define territories/market areas are outlined in Table 5.1. It is evident from this table that the basic criterion used by all 38 firms to define territories/market areas is population. However, the majority of firms used population alongside a combination of other definition criteria which incorporated further demographic and market information. For example:

> *"When the company was launched, because we had the right level of funding - which was a combination of the Chief Executive's own money and the 3i investment - we spent a lot of money researching the UK market and dividing the territories into territories that could deliver £10 million per annum of greetings cards sales. This was based on population, which was then broken down into socio-economic groups. So, for example, you could have a territory - and by the way, further broken down into postcodes – you could have a territory that might have three quarters of a million people, but a higher proportion of [socio-economic groups] D's and E's than another territory that might have 500,000 but higher proportion of A's and B's. So there was quite a lot of thinking in the design of the areas in the first place and no two areas are the same...but the underlying structure says that each territory can deliver a minimum of £10 million cards per annum* (Distribution Sector, Firm A).

Thus, several firms (e.g. Personal Services Sector, Firms C and D, Distribution Sector, Firm A) also used socio-economic groupings to help identify suitable customers. Almost half the sample (n=18) visited potential territories/market areas to assess the 'geography' of the area in terms of natural boundaries, accessibility and communication networks. In some instances franchisees provided useful knowledge to assist with territory/market area definition. A franchisee's local market knowledge was also incorporated into territory definition if the franchisee was local to the area and if a franchisor used a franchisee-led growth strategy (where a franchisee was recruited to a network first, and a territory was assigned around the franchisee: see Chapter 4). Other firms (e.g. Retail Sector, Firms A and C, Fast Food Sector, Firm D) took into account the degree of competition when defining a potential territory/market area. A few firms (e.g. Personal Services Sector, Firm D; Distribution Sector, Firm A and Business-to-Business Sector, Firm D) used the demographic, geographic and business community measures to estimate projected sales or customer base targets. The estimations were then used as further criteria for defining potential territories/market areas.

Irrespective of whether a territory or a market area was allocated, the definition techniques and criteria used by the current sample *were the same* for both types of network allocation. The only sectoral distinction was that firms which were producer orientated, (firms in the Distribution, Business-to-Business and Industrial and Commercial Sectors) tended, not surprisingly, to define territories/market areas using business community criteria rather than consumer orientated firms in the sample. However, there were no other clear sectoral or type of operation trends regarding the techniques used for territory/market area definition, further highlighting the heterogeneity of franchising.

Table 5.1 – Techniques and Criteria Used for Territory/Market Area Definition

Techniques/Criteria[4]	*Number of firms*[5]	*(%)*
Demographic Measurements		
Population	38	100%
Postal code data	18	47%
Socio-economic groupings	5	13%
Visual Assessment and Geographical Measurements		
Assessment of Competition	7	18%
Accessibility/Communication Networks	6	16%
Franchisee Local Market Knowledge	5	13%
Natural boundaries	2	5%
Business Community Measurements		
Business Counts	9	24%
Estimated Business Potential	9	24%
Predictive Measurements		
Projected Sales/Customer Base Targets	7	18%

5.2.3 Techniques Used to Locate Franchise Units

In addition to the techniques used to define the *macro* location of a territory or market area the *location-based* franchise systems in the sample (n=23) also used *micro* siting techniques and criteria to locate a unit within a territory or market area. The micro siting techniques that were used by the location-based firms in the sample were a combination of footfall and traffic flow measurements and site characteristic surveys, which included factors such as visibility, type of

[4] Categories are not mutually exclusive.

location (primary or secondary retail), ease of access, rental rates, and level of competition. These siting techniques and policies are similar to those used by non-franchised and other retail operations (Jones and Simmons, 1990).

5.2.4 Discussion

The techniques and criteria for territory/market area definition were the tools used by the franchisors in this sample to ensure that areas had sufficient levels of market potential necessary for a franchisee to effectively operate a unit. Similarly, the siting policies used to locate units were to help ensure that units were placed in suitable locations with sufficient levels of custom. As the 'How To' literature (e.g. Barrow *et al.*, 1999; Mendelsohn and Harris, 1991) contends most (ethical) franchisors will guarantee enough market potential within an area to deliver a suitable amount of customers/sales/profit.

However, the level of sophistication and attention given to territory/market area definition varied among the firms. For example, one firm (Distribution Sector, Firm A) tried to ensure that all territories, across the network were equal and theoretically able to deliver the same amount of sales and the firm employed a sophisticated range of techniques to achieve this. However, this firm was the exception and not every firm went to such lengths to ensure that all territories were equal. Indeed, some firms (although only a small minority (n=5)) gave considerably less attention to territory/market area design, with areas allocated using only a simple definition criterion (e.g. all territories were divided into areas of 600,000 population). In these systems, such basic levels of territory/market area definition, whilst less costly and time consuming for the franchisor to designate, inevitably gave rise to greater variation in market potential across operational areas.

The majority of firms in the sample used a range and combination of definition techniques although they were neither as elaborate as Distribution Sector, Firm A nor as basic as the five firms outlined above. These firms accepted that geographical variations were inevitable and regardless of the techniques and

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[5] Percentages have been calculated using a total of 38 firms, therefore excluding the two firms, which did not define territories or market areas.

criteria used some operational areas were unequal in market potential, despite efforts to adjust territories/market areas to take account of this. Therefore, some franchisees may be operating in territories/market areas that have different opportunities and constraints to other franchisees in a network.

Indeed, 15 firms did admit that, particularly in the early stages of expansion but also in latter stages, some territory definitions or unit locations were unsuitable and had either led to severe operational difficulties for the franchisee or unit failure. For example:

> *"When you are buying an existing convenience store you are normally paying extensive good will for that store, the thing you also know you are buying is the level of turnover and when you're buying a piece of land to put a store on you never know until you are up and running how much turn over you are going to get, so there are always risks, and no matter how good we say we are or think we are sometimes you get it wrong. What you have to do is understand what those reasons are and try and combat them in some way, shape or form, and if you can't, don't be too proud to say I've tried and its not going to work, the best thing you can do is get out. Now with a franchisee that is some times difficult because if its his only store and that is his livelihood then he can't afford to make that decision as easily as I have put it."* (Retail Sector, Firm A).

> *"There have been areas which have not produced the results we would have expected them to produce given a certain level of effort...there are differences in people in an area and there are differences in the economic wealth of an area"* (Distribution Sector, Firm E).

As outlined in the introduction (section 5.1) the practical 'How To' literature advises firms embarking on franchising that successful territory/market area definition and siting of unit locations are important processes. Inadequate territory definition (possibly leading to territories that are too small or too large) or poorly located units in difficult locations may affect successful operation, negatively impact a franchisee's business (as well as the franchisor's) and could ultimately lead the franchisee to fail. In the situations where franchisees had difficult operational areas, or poorly sited units, franchisors admitted that franchisees affected by this simply had to work harder. However, the majority of these franchisors also made concessions for what were considered to be difficult areas or poorly sited units by adjusting franchisee performance targets accordingly.

The remaining firms (25/40) stated that if a unit experienced operational difficulties or failed it was as a result of the *franchisee* rather than an inadequate area of operation or poor unit location. Indeed, the 15 firms, which commented that location could cause unit failure *also* acknowledged that failure could be as a result of franchisee under performance, a finding which confirms previous research on franchise failure (Fenwick and Strombom, 1998; Price, 1996; Shane, 1996). Whilst the agency explanation of franchising (see Chapter 2) maintains that franchising is an effective way to access highly motivated unit operators, critics of the theory (e.g. Levinthal, 1988) argue that there will be high and low quality agents (franchisees). A low quality franchisee may mis-represent their abilities as being of high quality to obtain employment and financial gain (the 'adverse selection' problem). Franchisors in this sample confirmed this and argued that whilst one franchisee could perform adequately in an area, another would perform badly. Therefore, franchisors believed that it was not the operational area or location that was a problem rather it was the quality of the franchisee and their performance.[6] For example:

> *"It is definitely a problem of the franchisee...why can one person rise to the occasion and another can't? We have had the situation where a different person comes in and takes over the business, same location, same equipment and sometimes with the same employees and they fly..."* (Industrial and Commercial Sector, Firm C).
>
> *"I think fundamentally, because it is a very proven concept...the difference between success and failure is down to the franchisee...you have to look and say what is the common denominator and the variable factor is the franchisee. So without wanting to say that we are never responsible in any way it is usually the franchisee's failure as a salesperson and business person that causes them to go under. Failure is not likely to be due to the actual area"* (Industrial and Commercial Sector, Firm D).
>
> *"The main reasons for a franchise failure comes down to the individual because of the market research we do...a lot of ground work goes into finding the right location. Once we have the right location, you can put a very good franchisee in a secondary location and still have a very good business. You can have a very good location and put an average business person in there and you can have a poor business"* (Retail Sector, Firm E).

[6] Even though franchisors had in place (or developed over time) stringent recruitment procedures, franchisors sometimes made mistakes and unsuitable or franchisees of low quality were recruited to networks.

For this reason, all the franchisors in the sample set performance targets to ensure franchisees met *at least minimum performance levels* (performance targets were generally 'X' amount of sales, turnover or customers) and to ensure adequate exploitation of an area. If a franchisee consistently failed to meet the minimum performance targets it would be in breach of contract and the franchisor could terminate the agreement (Abell, 1999, personal correspondence; Pratt, 1999, personal correspondence).

Only a small minority of firms (n=4) sought external advice to aid territory/market area definition and siting policies (Personal Services Sector, Firms C and D; Distribution Sector, Firms A and F). Advice was sought in three cases from CACI Information Services (which produces ACORN, a geodemographic profiling system) which provided the firms with socio-economic and demographic data. The fourth firm (Distribution sector, Firm A) received advice on territorial definition from 3*i*, because this organisation had partly funded the franchise operation.

The 15 international franchisors in the sample could have benefited from internal operational advice and experience of parent organisations/franchisors, and this can be an advantage of operating as a master franchise (Forward and Fulop, 1995), although this was not the case. Only one firm (Fast Food Sector, Firm B) received internal advice with territory/market area definition from its parent organisation when the operation was set up in the UK. However, the firm did not benefit from the operational advice given by the parent franchisor because territory definition techniques and siting criteria were not suitable for the UK market. Thus, both the techniques for territory definition and siting criteria were modified. Territories were defined on a much smaller population criterion than the US parent organisation had recommended. The siting criteria used to locate units was changed from retail and industrial parks (as suggested by the US parent) to primary and secondary retail locations. For the other international operations in the sample, parent organisations permitted the UK master franchisors to develop UK-focused territory/market area definition techniques and siting policies. As Fladmoe-Lindquist (1996) and McCosker and Walker (1992) observe (and the 14 remaining international franchisor in the current sample confirmed), the purpose of using a master franchisor when establishing a franchise operation in an international market is that a master franchisor will understand host country conditions better than if the parent franchise system was to enter the market itself.

Thus, the majority of firms in the sample (both domestic and international operations) did not seek either external or internal advice for territory/market area definition. Reasons for this were three-fold. First, some franchisors had previous experience as franchisees and the franchisors argued that first hand knowledge of how territories/market areas should be successfully defined had been gained through this experience. Second, cost and size of operation was sometimes a barrier to seeking external advice. Consultant advice can be costly for a small, young firm when first setting up in business. Indeed, many firms turn to franchising as a growth strategy precisely because it enables access to scarce financial resources and using scarce resources for territory/market area definition was not an option for some firms. For example, one firm (Fast Food Sector, Firm D) complained that as a small firm even if it could afford advice it did not know who to seek advice from and therefore, had to 'learn on its feet':

> *"Where do you go? We didn't know. We have read books on it and seen how other people have done it. But if you take a company like ourselves, we are the head office there is nowhere to go for advice. It is quite difficult to get detailed information from other franchisors because they may be competitors or in a similar field. Basically it is very difficult to find people in the same field that will give you that information, because that is how they are making their franchise successful. So the only way to really learn is to learn through experience"* (Fast Food Sector, Firm D).

Third, some firms had simply learnt the techniques and criteria that made territory/market area definition successful over time. Table 5.1 only outlines the techniques and criteria that were used for territory/market area definition *at the time of interview*. For many of the more mature, established firms in the sample techniques for territory/market area definition and siting policies evolved as demographic and market information improved and became more available, making it easier for a firm to assess a market more accurately (Stanworth and Smith, 1991). For example, some of the territorially based franchise systems in the sample have in the past defined and delineated territories using geographical regions, grid references or arbitrarily (i.e. choosing an area and drawing boundary lines around it). However, the development of postal codes and other market and demographic data allowed more sophisticated information to be incorporated into the latter stages of territorial definition. Whilst territory definition may not have been particularly sophisticated or sufficient in the early days of operation, franchisors had become better at defining territories by developing market information through operational experience. This experience could be put into practice if network re-organisation and restructuring became necessary.

5.2.5 Summary

In summary, firms in this sample defined either a territory or a market area for franchisees to operate in. The difference between the two types of operational areas was that territories were defined by set boundaries. Firms utilised a range of demographic data and market information to define operational areas and site units. The techniques that were used to define territories/market areas ensured viable operational areas, although a number of firms in the sample did admit that, particularly in the early stages of operation, territory/market area definition was not necessarily adequate and this led to operational difficulties for franchisees. Territory/market area definition improved over time with operational experience.

However, the difficulty of territory/market area definition is that it is a static process undertaken by the franchisor in the early stages of expansion. But, as the introduction to this chapter outlined, markets are dynamic and original operational areas will be affected by shifting demographics and changes in market penetration, as a franchise format becomes better known. There may be opportunities to establish new units in a network if new market potential arises over time and it therefore may be necessary to redefine and restructure original operational areas to take advantage of new market potential. Section 5.3 examines the frequency and process of network restructuring. Section 5.4 then outlines how firms attempt to resolve the network restructuring issue through the mechanisms that are used.

5.3 Network Dynamics

5.3.1 Changing Levels of Market Penetration

Twenty-three firms in the current sample (58%) experienced changes to levels of market penetration and took the opportunity to embark upon new expansion phases. This affected original territory/market area definitions allocated at roll out, and made territorial and network restructuring necessary for the majority of firms. The remaining 17 firms had not yet experienced changes to market penetration levels and market demand was matched by current territory/market area delineations. Ten firms were in roll out and therefore still in the early stages of growth. The remaining seven firms were in the *early stages* of consolidation as territorial gaps, planned at roll out, had yet to be filled.[7]

As the majority of firms in the sample experienced new expansion opportunities in latter development stages, predicting system saturation points is evidently a difficult task (see Exhibit 5.1). Predicting market penetration and system saturation levels will be dependent upon a number of factors, both internal and external to the franchise system (such as the quality of franchisees in generating business, managerial decision making, the level of competition and the operating environment). For this reason a number of firms (n=11) did not predict, or no longer predicted, system saturation points, as this factor was subject to change over time and firms did not want to limit potential growth opportunities. However, as market penetration levels altered and presented new growth opportunities for the majority of firms in the sample, the question arises: did network design and allocation affect the ability of a firm to act upon such growth opportunities?

[7] The ten firms had achieved less than 50% network coverage when predicted system saturation points and the number of units that had been established at the time of interview were considered. The seven firms were in consolidation as between 50-75% network coverage had been achieved.

Exhibit 5.1 Changes to Market Penetration Levels – Sample Responses

"How do you know what the ideal penetration is? Well the answer is, you don't know. I can put a mark in the sand and put various experienced people around the table and we will all disagree. And they will say no it's 1:50,000 population and another will say, no, it is 1:30,000 population, and you can make a case for any one of those. You won't know what it is and it will change over time" (Fast Food Sector, Firm C)

"We didn't know what the saturation point would be...we originally thought 50 depots and now we know that we can have 100 or more" (Distribution Sector, Firm G)

"Clearly, territories evolve...20-30 years ago, no one had heard of Milton Keynes. So obviously, territories themselves evolve upwards and outwards. Birmingham was a thriving manufacturing town 20 years ago and is a lot less so these days. So one's view of the optimum size of territory, business potential etc. moves." (Personal Services Sector, Firm E)

5.3.2 Network Allocations

For the 23 firms that experienced changes to market penetration levels there were three ways in which networks were designed and allocated. The first group allocated networks on the basis of exclusive territories (8). The second group allocated networks on the basis of non-exclusive territories (9). The third group did not grant territories or exclusivity. Instead, this group of firms allocated franchise units within market areas (6). As the following section outlines, the three network designs have different implications for the network restructuring process.

5.3.3 Group 1: Exclusive Territorial Networks

Eight of the 23 firms that experienced changes to optimal market penetration levels designed networks on the basis of exclusive territories (Distribution Sector, Firms A, B, C, D, H, I and J and Fast Food Sector, Firm B). All of these firms were mobile franchises or delivery based networks. Thus, the type of operation was the main reason these franchisors granted exclusive territories. The eight franchisors argued that exclusive territories were simply integral to ensuring successful operation of the networks, a finding which reiterates Current and Storbeck (1994). Franchisees serviced customers within their defined geographical territory but not outside and overlapping of customers should not, in theory, occur. Without exclusivity franchisees could potentially operate in any geographical market and the more proactive franchisees could 'poach' customers from neighbouring franchisees' territories or even travel farther afield and 'cherry pick' the more desirable customers from other territories.[8]

There were two further reasons why this group of franchisors granted exclusive territories. First, it was a way to *avoid potential conflict with franchisees* regarding changes to market penetration levels (as suggested by Kaufmann and Rangan, 1990; Pratt, 1997 and Zellar *et al.*, 1980). Second, *exclusivity helped to attract and recruit franchisees* as it reassured potential operators that intra-system encroachment would not be a threat nor a source of potential conflict with future network development (see Exhibit 5.2).

Whilst there seems to be clear sectoral and 'type of operation' trends (as seven of the eight firms in this group were in the distribution sector and all eight were mobile operations) not every firm from the distribution sector nor all the mobile franchises in the sample allocated their networks on the basis of exclusive territories.[9] Taking into consideration firms which had not yet experienced changes to market penetration level (17), 13 also granted franchisees with exclusive territories. These firms were involved in the six sectors of franchise activity (not just the distribution sector) and were both mobile *and retail* operations. The reason these franchisors granted exclusive territories was to attract and retain franchisees: exclusivity was a successful mechanism for reassuring franchisees of territorial protection (see Exhibit 5.2). Clearly, the

[8] The eight franchisors *reported* few and only minor incidences of 'poaching', which were, in the franchisors' opinions, generally accidental or due to misunderstandings (although it is obviously difficult to assess poaching incidences objectively from just the franchisor's perspective). The franchisors argued, however, that such competitive behaviour was discouraged as it was against the ethos of franchising; and franchisees generally worked together for the good of the network as a whole (see Exhibit 5.2). If disputes did occur, franchisors resolved them by arbitrating between the franchisees concerned, issuing official warnings or by fining franchisees.

[9] Distribution Sector, Firm G was the only distribution firm to allocate its network on the basis of non-exclusive territories. All other nine distribution firms in the sample granted exclusive territories. Five firms in the sample of a total of 16 mobile operations did not grant exclusivity. The firms' reasons for not granting exclusivity are outlined in the following section. The other 11

decision of network allocation is based on factors other than sector of activity or type of operation.

Exhibit 5.2 Sample Responses for Group 1 – Reasons for Allocating Exclusive Territories

Firms in Consolidation
"the reason for granting exclusive territories is that it is the basic strategy of running this business. We want our franchisees to operate within defined territories. The thought of them going into other franchisees' territories would be a minefield, and it could not work if you follow it through – where do you draw the boundary? A franchisee in Glasgow could operate in Manchester, it would be an absolute nightmare" (Distribution Sector, Firm A)

"although the franchisees have the same product, they are assured that their territory is theirs, there is no competition from other franchisees or the company within their territory. Exclusivity allows that." (Distribution Sector, Firm C)

"it's the way the business works – we couldn't have franchisees going into other franchisees' territories and poaching customers" (Distribution Sector, Firm D)

"it's the ultimate 'no-no' out type of business had to be a non-competitive business, otherwise it won't work" (Distribution Sector, Firm I)

Firms in Roll Out
"exclusivity is attractive for the franchisees entering into franchising – it offers them protection for their units" (Personal Services Sector, Firm B)

"exclusivity is important because it gives potential franchisees the reassurance that they will be protected and that encroachment is not an issue with us..." (Retail Sector, Firm C)

The exclusive territorial network design affected the ability of a firm to take advantage of new market potential and therefore the restructuring process. For the eight firms, the original territory definition had become outdated by the opportunities of new market potential (on either a network-wide basis or across a number of territories). Although *all* firms in this group wished to embark upon various restructuring schemes (see Table 5.2) they were *contractually unable to restructure.* Having granted franchisees with exclusive territorial rights for the length of the franchise contract, restructuring or placing new units into franchisees' territories during the term of existing contracts was prohibited. Altering franchise territories may have been possible for the franchisors when contracts were at an end or due for renewal. However, in some cases, this was not a satisfactory solution as, for example, contracts lasted for a period of ten years or

mobile operators all granted exclusivity (8 are the firms discussed here and the remaining 3 firms more, but restructuring had become necessary after five years of operation. Even at renewal, restructuring was not always a straightforward process as all eight firms' contracts contained, or had previously contained, a 'roll over' renewal clause.[10] This entitled the franchisee to operate with the franchise for an additional set period, such as a further five years, after the original length of the contract had transpired provided that the terms and requirements of the contract were met (Abell, 1999, personal correspondence; Ishani, 1999, personal correspondence; Mendelsohn, 1999, personal correspondence and Pratt, 1999, personal correspondence). Thus, the only way a franchisor with this network location would be able to alter the boundaries of a franchisee's territory is if the franchisee was consistently under-exploiting its territory and not meeting the minimum performance targets set by the franchisor. For this reason franchise lawyers advise that if networks are to be allocated on the basis of exclusive territories performance criteria must be set, which all eight firms in this group had done. If a franchisee under-performs and under-exploits the territory to such an extent there would be little a franchisor could do in contractual terms if a performance target had not been stipulated (Able; 1999, personal correspondence; Ishani; 1999, personal correspondence; Mendelsohn 1999, personal correspondence; and Pratt, 1999, personal correspondence). Even if a franchisee was under-exploiting its territory, restructuring would only be possible on an individual territorial basis and this would not be sufficient if restructuring was necessary on a network wide basis. Having to wait for contracts to end or come up for renewal meant that in some cases opportunities to exploit new market

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are in the roll-out stage).

[10] Such generous clauses are often part of franchisors' early contracts for recruitment purposes, as a potential franchisee should find a roll-over clause an attractive benefit of a system (Abell, 1999, personal correspondence). However, as Felstead (1993) discovered, franchise contracts vary not only from system to system but also *within* a system. The findings of the present survey are no different: franchisees within the same system had different contracts in terms of length and clauses. For example, a common feature of the sub-sample of eight franchisors was that franchisees were granted contracts of different duration and with different clauses. One franchisor (Distribution Sector, Firm H) granted original franchisees with contracts, which lasted 25 years, with an option to renew. New franchisees' recruited to the network have contracts, which last just five years with an option of a five-year roll over period. In another Distribution franchise (Firm A) the original franchisees were granted seven year contracts with a roll-over clause and the option to renew on the terms of the franchisor's then current contract, but new franchisees are granted only five year contracts with no roll-over renewal clause. Clearly, roll over clauses were designed to attract the first franchisees into a system as a 'reward' mechanism. It could be argued that the original franchisees take on a greater degree of risk than subsequent franchisees, which are brought into the system, as the franchise will at first be largely unproven in the market and the first franchisees are the key actors of brand and system development.

potential could not be acted upon by franchisors with exclusive territorial network allocations. If roll over clauses also existed, some degree of negotiation was also necessary at the contract renewal stage to enable network restructuring.

This is the cost that these firms paid for securing franchisees. The firms initially wanted to be able to attract and recruit franchisees and ensure successful operation in the early stages of growth and development. Allocating exclusivity was the mechanism to ensure this occurred. However, by granting exclusivity franchisors were contractually unable to alter franchise territories in latter development stages, if new market potential had arisen and franchisors wished to act upon this. Thus, the implementation of exclusivity within a network can inhibit the restructuring process. As section 5.4 discusses, the franchisors in this group implement a number of mechanisms to try to enable network restructuring *during* the term of existing franchisees' contracts.

5.3.4 Group 2: Non-Exclusive Territorial Networks

Nine of the 23 firms which had experienced changes to optimal market penetration levels designed networks on the basis of *non-exclusive* territories (Retail Sector, Firm A, Personal Services Sector, Firms D, E, F and I, Distribution Sector, Firm G, Business-to-Business Sector, Firm D, Industrial and Commercial Sector, Firms B and D). Territories were allocated in this way for two reasons. First, they were granted because this was integral to how six of the franchises operated. Five of the six firms were mobile operations. As a franchisee does not have a fixed location for its business and travels to the customer, franchisors must assign customers to an individual franchisee by means of a territory to delineate an area of operation. The sixth firm was an area franchise and therefore territories were also a necessary mechanism to assign customers to the franchisee but in such operations, territories are granted on a *large scale* in which to develop *several units*.

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The three remaining firms in this group were location-based franchises and therefore territories were not integral to effective operation (Business-to-Business Sector, Firm D and Industrial and Commercial Sector, Firms B and D). In these cases the reason for granting territories was as a tool to carve up the country to ensure key market areas were covered. The franchisors also believed that granting territories helped to attract and recruit franchisees. As defined areas to operate in were offered franchisors claimed prospective franchisees found this to be one of the attractions of the systems.

Territories were granted on a non-exclusive basis because the franchisors believed that this allowed greater flexibility in operation and facilitated greater control over the development of the franchise network (Exhibit 5.3). For example, with non-exclusive territories, franchisors could operate national contracts across several territories or the whole of the franchise network (Personal Services Sector, Firm D, Business-to-Business Sector, Firm D, Industrial and Commercial Sector, Firm B and D). Indeed, this was the principal reason the two firms in roll out and early consolidation, also with this network allocation, did not grant exclusivity (Business-to-Business Sector, Firm B and Industrial and Commercial Sector, Firm E).[11] Also in one of the networks (Business-to-Business Sector, Firm B) franchisees that had personal contacts situated in another franchisee's territory were able to develop such contacts into business opportunities. However, the franchisor operated a profit sharing scheme so that any revenue generated by one franchisee operating in another's territory was shared equally between the two franchisees. In the area system (Retail Sector, Firm A) the non-exclusivity clause allowed the franchisor to negotiate for prime retail sites on either a regional or

[11] In these systems, franchisors (or even franchisees) obtained national contracts or accounts, which could be major sources of revenue. Thus, franchisees in a region or across the network would have to fulfil each account or contract. For example, one franchisor (Business-to-Business Sector, Firm D) won an account to provide a distribution company with drivers across the UK and franchisees had to recruit drivers within their individual territory for this account. However, if a franchisee did not wish to take on a particular account - the franchisors argued that this rarely happened, as it was not in a franchisee's interest to decline business - another franchisee or the franchisor could take over the contract. It was for this reason that the franchisors did not grant exclusive territories, as exclusivity would not allow a franchisee to work in another's territory. Thus, operating with non-exclusivity ensured that national accounts could be maintained. Thus, operating national contracts was a major reason for not granting exclusivity.

national basis.[12] In the absence of exclusivity none of these arrangements would be possible. Therefore, non-exclusive clauses allowed firms to retain a greater degree of 'spatial flexibility' to operate such policies than if exclusivity was in place in networks.[13]

> ***Exhibit 5.3 Sample Responses for Group 2 –***
> ***Reasons for Allocating Territorial Networks as Non-Exclusive***
>
> *"One of the reasons why we are non-exclusive is that it gives us the ability to negotiate on a national basis" (Retail Sector, Firm A) [an area franchisor which would sometimes negotiate for retail sites on behalf of its franchisees].*
>
> *"Territories are not exclusive as a franchisee may have a personal contact in another's territory and they may be better at accessing the contact than the franchisee in the territory, as they may be of a more senior level, for example. So franchisees come to an arrangement for the good of the network as whole" (Business-to-Business Sector, Firm B).*
>
> *"I don't see how any service based franchise can offer exclusivity because that denies the franchisor the power to put other resources in if the prime resource plays up in some way" (Personal Services Sector, Firm E).*
>
> *"It is not in the interest of the franchisor to grant exclusive territories - because if push comes to shove we can say the agreement clearly states that it is a non-exclusive territory so therefore we will put a depot here - but that would be an extreme. But it is in the interest of the franchisor to keep everything together very much as a team, so it is very much a balancing act" (Distribution Sector, Firm G).*

Some of the franchisors in this group also argued that non-exclusive territories gave greater operational control over network growth and facilitated the process of network restructuring. This group of franchisors were able to add in extra resource to a network because territories were non-exclusive, unlike firms in

[12] On a number of occasions the franchisor had identified suitable retail chains which it wished to take over and redevelop the stores owned by the chains. However, the stores could be located across a number of franchisees' territories and the chain would have to negotiate on an individual basis with the franchisees concerned. Therefore, the franchisor undertook the negotiations on behalf of the franchisees, and if the negotiations were successful, the sites were offered to those franchisees.

[13] Although five of the nine firms in Group 2 were mobile systems and operated without exclusivity clauses, neighbouring franchisees poaching each others customers did not appear to be more prevalent in these networks compared to the mobile-based firms with exclusive territorial allocations in Group 1. While the franchisors reported minor incidents of franchisees crossing into another's territory to service customers, the franchisors maintained this rarely happened, as it went against the ethos of being part of a franchise network. For example: *"even the most aggressive ones have said that if they would stray out of territories in an organised way, it would not be very good for customers and that it would lead to a failure to scratch each other's backs...you can hardly say to your neighbouring franchisee 'here come and help me sort this one out' if you fear that your neighbouring franchisee will then nick the customer" (Personal Services Sector, Firm E).* However, if disputes did occur and the franchisor became aware of poaching the franchisor would arbitrate between disputing franchisees and resolve the issue through a number of mechanisms (such as verbal warnings, official warnings and fines).

the first group. With this method of territorial allocation, franchisors had the contractual ability to act upon new market opportunities by adding in extra units or franchisees to consolidate existing networks. All these franchisors argued that exclusivity could restrict network growth (Exhibit 5.3).

However, four of the franchisors in this group only learnt that exclusivity could restrict growth through organisational development. These firms (Personal Services Sector, Firms D, E and F, Industrial and Commercial Sector, Firm D) originally granted *exclusive* territories to franchisees at the roll-out stage, but over time the exclusivity status of territories was altered because they became aware that it constrained growth opportunities (as suggested by Zellar *et al.*, 1980). Whilst operating with exclusive networks the four franchisors could not add further units or franchisees into networks if new market opportunities occurred or if a franchisee was under-exploiting a territory. These firms therefore altered the exclusivity status of their networks at the contract renewal period, a point when it is possible for franchisors to alter the terms and conditions of the franchise agreement (Abell, 1999, personal correspondence and Mendelsohn, 1999, personal correspondence). Although these franchisors acknowledged this was sometimes a difficult process (as franchisees obviously did not want to lose the protection of the exclusivity status) they ultimately had the contractual power to alter the franchise contract and how the franchise network operated. Furthermore, all four firms were in a mature stage when the exclusivity status was altered and the firms had been successfully operating for a number of years (although not necessarily operating *efficiently* in terms of network design). The franchisors believed that it was unlikely they would lose existing franchisees because the exclusive right was to be taken away because many of their franchisees had established successful franchise units and so would be reluctant to leave the network. However, as the franchisors conceded, franchisees were not necessarily *satisfied* with the new conditions. Reflecting the power inherent in the franchise relationship (see Price, 1997), if franchisees did not accept the new terms of the contract, their licences were not renewed.

Whilst the four firms had to undergo a degree of organisational learning to appreciate exclusivity could constrain growth of networks, the remaining five firms in this group operated with this awareness from the start of roll-out. Such awareness had been gained from a variety of sources. Two firms had sought external advice from franchise consultants and lawyers (Retail Sector, Firm A and Business-to-Business Sector, Firm D). [14] The remaining three firms had previous operating experience of franchising as former franchisees in other franchise systems before embarking upon their own franchise operations (Distribution Sector, Firm G and Industrial and Commercial Sector, Firm B and D). Thus, the five firms established their franchises with the knowledge and understanding that non-exclusive territories can facilitate greater network control and operational flexibility whereas exclusivity clauses can hinder network restructuring and constrain further network growth.

As with Group 1 (exclusive territorial networks), firms in Group 2 were not sectorally distinctive in terms of allocating non-exclusive territories (the firms were from across five of the six sector classifications). The type of operation (i.e. mobile-based franchise systems) determined why some firms granted territories but did not explain why three retail based operations also granted territories to franchisees. The stage of development (i.e. maturity) provided some explanation in four cases as to why exclusivity was not granted. The four franchisors had originally operated with exclusive networks. With operational experience and organisational learning these franchisors realised that exclusivity could restrict franchisor control and hinder network growth and restructuring. Thus, in the maturity stage the firms altered the exclusivity status of their networks and operated with non-exclusive territories. However, there were firms in this group either currently in, or that had been through, the roll out stage, which did not allocate exclusivity from the start of operation. Thus, there are no clear sector, type of operation or stage of development distinctions that determine why this group of franchisors allocate networks on a territorial basis but do not grant exclusivity.

[14] The two firms in roll-out and early consolidation also had advice on network allocation (Business-to-Business Sector, Firm B and Industrial and Commercial Sector, Firm E), as both firms operated as master franchises in the UK, the firms had advice from parent franchisors. Through the parent organisations' operating experiences, the UK master franchisees were advised in network allocation and the effects of this on operation and development. These were two of the four firms, which operated national contracts. Following advice from parent organisations, the

Network Restructuring – At the Contract Renewal Stage

All nine firms in this group had embarked upon network restructuring at various stages throughout the consolidation and maturity stages to take advantage of new market development opportunities (see Table 5.3). As with the first group of firms with exclusive territorial allocation, there are examples of restructuring on both a major and minor scale. Three firms undertook major restructuring of territories on a network-wide basis (Distribution Sector, Firm G; Personal Services Sector, Firms D and I). Six firms undertook minor restructuring involving alteration of territories on an individual basis where new market potential had arisen (Retail Sector, Firm A; Personal Services Sector, Firms E and F; and Business-to-Business Sector, Firm D, Industrial and Commercial Sector, Firms B and D).[15]

As outlined in the preceding discussion, the reason for not granting exclusivity was because it gave a greater degree of control over the franchise network. Therefore, a non-exclusivity clause enabled the franchisor the contractual right to embark on a restructuring scheme, alter franchisees' territories and/or add in extra units to territories *during* the term of existing franchisees' contracts. However, only one firm (Personal Services Sector, Firm I) fully utilised its non-exclusivity clause. The remaining eight firms (as well as the two firms in roll-out and early consolidation) would not alter or restructure a territory until existing franchisees contracts had ceased or were due for renewal. Thus, in operation, the eight franchisors would not act upon the full contractual flexibility available to them; in effect the firms operated as though exclusivity were in place in the networks.

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master franchisees did not allocate exclusivity, as national contracts could not have operated effectively.

[15] Two of these firms had previously undertaken *major restructuring* schemes (Personal Services Sector, Firms E and F). However, both firms used to allocate their networks on the basis of *exclusive* territories. Although the exclusivity status of the two firms has since changed, the major phases of network restructuring took place when exclusivity was in operation. As with the other firms in the first group with exclusive territorial allocation, network restructuring was only possible if franchisees' gave their consent to territorial alteration. If not, the franchisors had to wait until franchise contracts were due for renewal or had ceased before territories could be altered. In some cases, (if, for example, roll over clauses were stipulated in the franchise contract) the two franchisors bought back such territories from the franchisees and altered and sub-divided

Indeed, the firms maintained that although exclusivity was not stipulated in franchise contracts, it was implied to franchisees through a 'gentlemen's agreement' that exclusivity was implicit within a network. In other words, franchisors would not alter nor encroach upon a franchisee's territory (Exhibit 5.4).[16]

Exhibit 5.4 Sample Responses for Group 2 - Moral Perspectives to Network Restructuring

"Our precedent is to our existing franchisees. It is not fair to say to them we have given you these postcodes, now we want to take part of them back when they have built up a good business with good established contracts. No we would not do that" (Business-to-Business Sector, Firm B).

"In the contract its states non-exclusivity, but it is exclusive in theory and we will not encroach upon a franchisee's territory" (Business-to-Business Sector, Firm D).

"Exclusivity isn't implicit in the contract, but it is implied to franchisees" (Industrial and Commercial Sector, Firm E).

"If a franchisee is performing legally you are in pretty hard water if you try to redefine the territory but morally it makes no sense. If the guy is performing why disturb him?" (Personal Services Sector, Firm E).

them subsequently. However, more recent restructuring phases for the two firms have been on the more minor scale of individual territories.

[16] However, if the territory is under exploited to such an extent – the franchisees only does business near to where they live or where they have the most customers, for example – so that the franchisee is consistently missing performance targets and is in breach of the agreement, the franchisor can legally terminate the contract (Abell, 1999, personal correspondence; Pratt, 1999, personal correspondence).

Table 5.3 Restructuring Schemes of Firms in Group 2 with Non-Exclusive Territorial Networks

Firm	*Restructuring Scheme*
Restructuring at the Contract Renewal Stage	
Retail Sector, Firm A	Minor Restructuring: New units were added to some territories during the term of existing franchisees' contracts. However, this firm had a different organisational structure to the other firms in this group, as it operated as an area franchise. The franchisor had established a property department to help franchisees identify and develop the 30-40 units needed to effectively develop an area territory. Existing retail units were therefore sometimes bought by the franchisor on behalf of the franchisees (through take-overs of small retail chains and individual retail units) if they were considered to be prime retail sites and suitable for development.
Personal Services Sector, Firm E	Major Restructuring Phase 1 Late 1970s: The 70 territories sold at roll out, which were large geographical areas, delineated by county boundaries were sub-divided creating a further 80 territories. The network therefore consisted of 150 territories of small geographic scope and delineated by postcodes. Major Restructuring Phase 2 Mid-Late 1980s: A period of rationalisation, as the corporate strategy shifted in emphasis towards a more comprehensive customer focused 'consultancy' service, so territories were restructured to reflect this. Thus, the number of territories decreased from 150 to 90 and incorporated larger geographical areas once more (territorial boundaries continued to be delineated by postal codes). A greater range of technical services was also offered to the customer. In this restructuring phase, the exclusivity status of the network was also altered at the contract renewal period, so territories became non-exclusive. Minor Restructuring: Territories are assessed when contracts are due for renewal or resale to ensure that a territory is still viable commercially and geographically. If this is not the case, territories are restructured.
Personal Services Sector, Firm F	Major Restructuring Phase 1 mid-late 1970s: Large territories defined in the roll-out stage in the early 1960s were restructured in the mid-late 1970s, as contracts came up for renewal. Territories were cut down into smaller geographical areas in response to new market potential and new franchisees were added into the network. Minor Restructuring Phase 2 late 1980s: The policy of cutting down territories down into smaller geographical areas continued, to make the network (and franchisees) operate more efficiently. At this stage, the exclusivity status of the network was also altered. Minor Restructuring: Territories are assessed when they are due for renewal to test viability and market changes. If a territory needs to be altered, this will continue to occur at the contract renewal stage.
Personal Services Sector, Firm D	Major Restructuring Phase 1997-2002: A process of re-evaluating and restructuring the original 70 territories defined at roll-out in 1971, as territories had ceased to operate efficiently through demographic evolvement, making some territories unviable. Restructuring would allow territories to be split into smaller geographical areas, which would operate more effectively and allow the franchisor to exploit new market potential with the establishment of between 100-130 new units. The exclusivity status of territories was also altered at the contract renewal stage.
Distribution Sector, Firm G	Major Restructuring: At the contract renewal period, territories will be re-negotiated and redefined in order to add extra units into the network. The franchisor had originally planned 50 units as the market saturation point, but market potential has increased to the extent the franchisor believes a further 50 units could be added to the network.
Business-to-Business Sector, Firm D	Minor Restructuring: The firm had begun the process of restructuring some of the territories in its network. The firm took the opportunity to look at the internal 'geography' of a territory to assess viability, as contracts came up for renewal. If territories were no longer deemed viable, (through demographic and/or market potential changes) the firm altered and spilt territories accordingly. Thus, the firm envisaged a potential increase in the number of franchise territories from 64 to 80 at the current contract renewal period as territories were split into smaller geographical areas.
Industrial and Commercial Sector, Firm B	Minor: Minimal territorial restructuring has been necessary for this firm, as when optimal market penetration levels have altered over the course of time, a new unit has been opened by an existing franchisee in its original territory to exploit with new market demand. Larger than average territories were allocated for this purpose.
Industrial and Commercial Sector, Firm D	Minor: Some alteration and restructuring of original territories as market potential changed over time and new franchisees were recruited to the network.
Restructuring During the Contractual Term	
Personal Services Sector, Firm I	Major Restructuring: New units were added to the network and existing territories *during* the term of franchisees' contracts. At the same time as adding further units to the network, the franchisors also took the opportunity to build a managerial infrastructure within the network.

Firms professed such an attitude and maintained such agreements because of the potential effect territorial encroachment (either real or perceived) could have on the franchise relationship. As discussed in section 5.2.1, operational areas and territorial boundaries were stipulated to franchisees in franchise contracts. Therefore, a franchisee had contractual rights (albeit non-exclusive rights) to operate in a defined geographical area. As one franchisor commented: *"a franchisee buys on trust and if a guy [sic] has bought a territory then he is quite entitled to keep that territory until his full term is finished and then to renegotiate when his term comes up again for renewal"* (Distribution Sector, Firm G).[17] A franchisee will want to protect its territory as time and effort will have been expended developing the market and building the business. The franchisee will obviously be concerned about the effect a new - and from the franchisee's perspective - 'competing' unit will have on its business. If a franchisor tried to add in another unit or alter the boundaries of an existing territory without the consent of the franchisee (although theoretically a contractual right for the franchisor) such an action could result in conflict between the two parties.

Trust is a highly integral part of the franchise relationship (Dahlstrom and Nygaard, 1995; Price, 1997). For this reason, the eight franchisors argued that a deliberate encroachment of a territory, or alteration to a territory's boundaries would not only be unethical but could also destroy the trust between franchisor and franchisee and therefore potentially result in dispute, which could be costly and time consuming to try to resolve. An action of deliberate encroachment could also damage the reputation of the franchisor and the franchise system as a whole, affecting potential franchisee recruitment. Franchisees may become disaffected and leave the network because of such actions or if they remain, conflict could emerge between the franchisee which is already established in the network and the new operator which is placed in an existing territory.

[17] This franchisor's contract lasted for a period of ten years, with a roll over renewal clause of the same duration. As with firms in the first group, all 11 firms with this network allocation granted franchisees with roll over renewal clauses. Thus, if territories needed to be altered because of new market opportunities, restructuring may not be a straightforward process if a roll over renewal clause is stipulated in the franchise contract. Therefore, it may be necessary to employ negotiation and other restructuring mechanisms at the contract renewal stage to facilitate network restructuring.

The decision of a franchisor to grant territories (which were considered necessary by the firms for effective recruitment and effective operation) therefore has important consequences for the restructuring process. Whilst the absence of exclusivity implied that a franchisor could, at least in theory, add extra resource into a network, in practice new unit introductions were difficult to implement because existing franchisees and existing territorial allocations had to be considered. Therefore the policy of the eight firms - and also two firms which had not yet needed to restructure - was that territories would not be altered or restructured until contracts were due for renewal or franchises were to be re-sold. At this point, it would be possible for franchisors to re-allocate and redefine territories to adjust to new levels of market penetration. Thus, allocating networks on a territorial basis alone can inhibit network restructuring. However, as section 5.4 outlines, to prevent the loss of development opportunities franchisors in this group implemented a number of mechanisms to try to enable network restructuring *during* the term of existing franchisees' contracts.

Network Restructuring During the Contractual Term

The remaining firm in this group had a distinctive attitude towards network restructuring (and indeed the franchise relationship) from the others in the group (Personal Services Sector, Firm I). Its policy was to fully utilised the contractual flexibility of a non-exclusive clause and add new units to its network *during* the term of franchisees' contracts. The franchisor had a more autocratic approach to controlling the growth of its network and managing its franchisees. Franchisees operated with only year long contracts (the shortest contract length in the total sample of firms) and the franchisor would not allow a network-wide franchisee association to be formed (although regional meetings were encouraged). For the franchisor, these actions were all part of the control process. If market gaps arose and the potential to add new units to consolidate the network occurred, the franchisor did so *during* the term of existing franchisees' contracts, and adjusted territorial boundaries and contracts accordingly. However, as section 5.4 outlines, adding new units to franchisees' territories was only possible for this franchisor as it used *financial compensation* to facilitate network restructuring.

5.3.5 Group 3: Non-Exclusive and Non-Territorially Based Networks

The remaining six firms out of the total of 23 which experienced changes to market penetration levels did not allocate either exclusivity or territories to franchisees (Retail Sector, Firms B, D, E; Fast Food Sector, Firm C; Personal Services Sector, Firm A; and Industrial and Commercial Sector, Firm C).[18] Instead, from the start of operation, the six firms simply defined 'market areas' in which to locate units. The operational areas were therefore not confined by exclusive agreements or delineated by territorial boundaries.

These six firms were all retail-based franchise networks. The franchisors argued that it was impractical and unnecessary for this type of operation to allocate exclusive territorial rights to franchisees. Consumer patronage of individual units could not be dictated and delineated by franchisors (unlike the mobile operations in the first two groups, where franchisors *had to allocate territories* as a means to divide consumers between different operators). Accordingly, territories were regarded as irrelevant or inappropriate for system operation by these franchisors.

However, other retail-based franchise networks in the sample *had* granted territories for franchisees to operate in (as outlined by firms in Groups 1 and 2). Consequently, the type of operation was not the sole factor explaining why the six franchisors did not allocate networks on a territorial basis. These firms did not grant territories because they believed that both exclusivity and allocation of territories *constrained growth* and made the process of taking advantage of new market potential contractually difficult (see Exhibit 5.5). Not assigning territories or exclusivity to franchisees they maintained a 'spatial flexibility' to develop new market potential as it arose over time and deal with changes to market penetration levels. By not granting restrictive agreements and giving away development rights to an area in a formal, legal way network restructuring could occur at any point in an existing franchisee's contractual period. As with Groups 1 and 2, network design was a result of managerial decision-making rather than purely related to sector or type of operation factors. This decision making process was influenced by advice from parent franchisors or by past operating experience of franchising.

All six firms had at various stages throughout their development embarked upon either major or minor restructuring schemes if original market area definitions became outdated by new opportunities (see Table 5.4). As neither territories nor exclusivity were contractual obligations, developing new units in a network during the term of existing franchisees' contracts was possible for a franchisor with this network allocation. However, the development of additional units in networks where franchisees do not have the protection of an exclusive agreement or a territory (as with firms in the first and second groups) could be a potential source of conflict between a franchisor and a franchisee as there is:

> *"...the increased potential for intra-system competition in the form of cannibalisation of sales of existing outlets as more are added to a market area"* (Stassen and Mittelstaedt, 1995, p28).

Following discussions with four of the leading UK franchise lawyers (Abell, Ishani, Mendelsohn and Pratt, 1999, personal correspondence), the consensus was that encroachment was not yet a widespread issue within the UK, although there have been cases where encroachment disputes have occurred (and two of the lawyers had dealt with such cases).[19] However, the lawyers agreed that encroachment could become an increasing problem for franchisors in the UK due to the number of systems reaching maturity.

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[18] No firms currently in the roll-out stage used this network allocation.

[19] For example, one of the lawyers (Mark Abell) had represented a group of Body Shop franchisees, which had raised a case against the franchisor when it embarked upon a new expansion strategy of setting up mobile franchisees, which would operate on existing retail franchisees' territories and would sell and market directly to the consumer's home. The retail based franchisees felt that if new franchisees could directly market into the consumer's home, this would encroach upon and impact their own businesses' sales and profits. Eventually, the Body
Shop bought out the franchisees that were in dispute, although this was a lengthy and costly process (Abell, 1999, personal correspondence).

Exhibit 5.5 Sample Responses for Group 3 - Reasons for not Granting Exclusivity or Territories

"My reasoning was because when I opened the second shop in London, the guy said to me [the first franchisee in London] 'you have taken half of my market away.' In Houston, Texas at the time, [where the US franchisor was based] with 2 million population, they had 80 Kall Kwiks. So I said 'why do I need to franchise an area?' It will probably allow us to do a higher density than maybe a franchisee might want...but a lower density is not necessarily in the interests of the franchisee because if you have strong brand awareness and strong brand attributes then I think you make more money and you can get more business" (Industrial and Commercial Sector, Firm C).

"We always reserve the right to put a store where we like" (Retail Sector, Firm D).

"We think there are a lot of opportunities out there and we don't want to miss an opportunity. We think that if you gave people – whilst we like to have areas of geographical clusters – we don't think that there is a lot of benefit in assigning territories to people. We think that if we gave territorial rights in development (and there are lots of other examples of people being given territorial rights in other markets) you can actually constrain your ability to grow. And what we want is to be able to grow at a maximum pace that is possible out there - profitably - and to develop the brand. It is easier to do that if you can avoid formal agreements" (Fast Food Sector, Firm C).

"We don't want to restrict ourselves to future opportunities. If you give people exclusive territories, then you do...we, as a company, don't see the sense in that as it is not necessarily for the good of the network in the long run" (Personal Services Sector, Firm A).

"It's a restrictive business. I believe it is a grey area anyway, does a franchisor or anyone have the right to say 'this is your business territory and you cannot go out of it.' Surely that is restricting business? So we never say to someone this is you business but you can only do business in this area and no where else. Why restrict it?" (Retail Sector, Firm E).

Although only a small sub-sample, and not portrayed as representative, the evidence from the current findings suggests that encroachment is not something that occurred within the six franchise systems.[20]

[20] Taking into consideration the other retail-based firms in the sample, the six franchise systems in this group are more likely to have encountered difficulties with encroachment, as unlike the other retail firms in Groups 1 and 2, the firms are non-territorial and non-exclusive operations. The six firms are also the most mature and established retail systems in the sample, with high levels of market penetration.

Table 5.4 Restructuring Schemes of Firms in Group 3 with Non-Exclusive and Non-Territorial Networks

Firm	*Restructuring Scheme*
Retail Sector, Firm D	Major Restructuring Scheme (1999-present): A first restructuring phase for the firm, where the franchisor intends to add a further 240 units to the existing 100 units to strengthen and consolidate the network, fill market gaps and protect the network from competitive encroachment. New 'Concept Stores' will be introduced to the network, which will be smaller, cheaper stores to establish and run, and will offer only a range of core services.
Retail Sector, Firm E	Addition of new units into the network (at a rate of 5-8 new units a year) where demand has arisen over time.
Fast Food Sector, Firm C	Major Restructuring Scheme (1999-2004): In response to a competitor's aggressive growth strategy, the firm intended to increase the number of units in the network from 450 units to around 1,000 units over a five year period. At least 60 units (both franchised and company owned) would be opened every year, with a target market penetration of 1:50,000. New units would be located not only in major urban areas, but also in smaller geographic markets to ensure the consumer had no more than a ten minute journey to the fast food firms' outlets. A new locational strategy was also used in conjunction with the restructuring scheme as new units were to be opened in 'new retail spaces' (i.e. people and place 'generators' such as leisure and entertainment complexes and universities).
Retail Sector, Firm B	Addition of new stores into the network where demand has arisen over time. Granting of licences to independent footwear retailers, which are run as both company and franchise units (3-5 conversions occur each year). However, the firm underwent a period of rationalisation in the late 1990s, with the number of units decreasing from 620 to 550. Thus, in addition to the small number of unit conversions each year, some of the less profitable, peripheral units will be closed, keeping the system saturation point at around 550. Also, some of the existing units will be relocated under the franchisor's new locational strategy, from small high street retail locations to large retail park warehouses.
Personal Services Sector, Firm A	Addition of new units into the network, where demand had arisen. The franchisor had put no limitation on system saturation point, and new units were being added to the network at a rate of ten per year.
Industrial and Commercial Sector Firm C	Addition of new units into the network, where market demand has arisen over time.

Whilst franchise contracts stipulated non-exclusivity and therefore, in legal terms the firms were able to add further units into a network, the franchisors argued that ethically and operationally, placing new units too close to existing ones was not a strategy that was deliberately embarked upon (see Exhibit 5.6).

Exhibit 5.6 Sample Responses for Group 3 – Ethical Perspectives of Network Restructuring

"Although there is nothing in writing to say that 'this is your territory', there is an unwritten law where we will not put franchisees close enough to impact. It is not viable for us, unlike a corporate company, where everything is going into one pot. For us, if we put stores so close, it would just dilute everything and therefore it is not beneficial for the franchisor, i.e. us, and it's not beneficial for the franchisees. It is better to have one strong business than two weak businesses" (Retail Sector, Firm E).

"I knew that we would be responsible franchisors, we would not franchise 'willy nilly'...I also thought that we would always have clever franchisees and they would not accept a system where you franchise willy nilly...I also believe it is better to have one successful franchisee and not two unsuccessful franchisees" (Industrial and Commercial Sector, Firm C).

"We do have a planned distribution policy where we don't open up against franchisees. At the end of the day we would put the franchisee out of business. In the long term we wouldn't gain anything, but we would just gain the reputation of being not a very responsible franchisor and in the long term the franchise would just die" (Retail Sector, Firm B).

"We don't benefit and they don't benefit if we open up a second one in the same town, unless the business is there - there is no way - because we may lose that franchisee for the sake of it and its to the detriment of the system. It doesn't make economic sense to do it" (Personal Services Sector, Firm A).

These franchisors reasoned that it is not in their commercial interests to place new units too close to existing ones. To encroach upon an existing unit would detrimentally affect a franchisee's business, causing conflict and dispute between not only the franchisee and the franchisor but also between the original and new franchisee. The franchisors would therefore have to expend time and effort in resolving such disputes and this could ultimately damage the reputation of the franchise system and the franchisor's ability to recruit new franchisees to the network. If a new unit was located too close to an old unit, it is also likely that neither unit would be fully profitable, and as a result this would affect the franchisor's business.

However, whilst franchisors' intentions were not to *deliberately encroach* upon existing franchisees' units, for three of the franchisors (Fast Food Sector, Firm C, Retail Sector, Firm D and Industrial and Commercial Sector, Firm C) situations arose where it was inevitable and unavoidable that new units caused an *initial* cannibalisation of some existing units' sales and profits, as development was accelerated to such an extent. Therefore, the three franchisors were faced with the challenge of continuing network growth with controlling conflict that arose from such expansion. Thus, in section 5.4 the discussion outlines the mechanisms and policies that the six franchisors used to facilitate new development opportunities whilst also minimising or avoiding conflict caused by new unit introductions.

5.4 Mechanisms for Facilitating Network Restructuring

5.4.1 Introduction

It is evident from the preceding discussion that all three network allocations affected the restructuring process. Firms in the first and second groups could not add new units to networks because of the contractual and 'ethical' obligations of exclusivity and/or the geographical constraints of franchise territories. Firms in the third group, which operated without exclusivity clauses or territorial allocations, did not have the same obligations as firms in the first and second groups and therefore had the contractual power to add units to networks as new market opportunities arose. However, in practice implementing new unit introductions could be difficult for this group of firms and the effect of new expansion on existing units had to be considered. In some cases, established units would initially be encroached upon and sales and profits cannibalised. However, for all three groups the consequences of not acting upon new market opportunities meant network gaps were open to exploitation by other franchised and non-franchised systems, enabling such firms to gain competitive advantage. The franchisors argued that this would ultimately be detrimental to the networks with the potential to affect system-wide sales and individual unit profit. Thus, it was important that firms filled market gaps and developed new market potential.

As Chapter 2 outlined, how firms resolve the issue of new unit development has not been rigorously examined by the academic literature. The literature has largely been aimed at developing theoretical and mathematical models to assist the franchisor in locational decision making processes as systems mature. However, the models are untested in an empirical setting. Moreover, how firms accomplish new unit additions has not been examined from the perspective of three different network allocation models. As outlined above, each of the allocations has different contractual and operational implications for the network restructuring process. Therefore the questions arise: First, what mechanisms do firms in Groups 1 and 2 use to facilitate the restructuring process so that new market potential can be acted upon during the term of existing franchisees' contracts? Second, what mechanisms do firms in Group 3 use to enable new unit development and minimise the potential conflict of new expansion (or at least maintain conflict at an optimal level)? In examining the mechanisms used by franchisors to facilitate the network restructuring process, this chapter will be the first to offer comprehensive empirical insights into how this issue is resolved by franchisors. The discussion starts with the mechanisms used by firms in Groups 1 and 2. Both groups faced the same problems with restructuring, as firms operated as territorially based networks and could not, or would not, restructure until the contract renewal period. The discussion then moves on to examine the mechanisms used by firms in Group 3. Firms, which were currently in the roll out or early consolidation stages are also discussed, examining whether such firms have considered the mechanisms and polices that will be used if market penetration levels alter in future.

5.4.2 Mechanisms Used to Restructure: Groups 1 and 2 - Firms with Exclusive and Non-Exclusive Territorial Networks

Multi-unit franchisees

The first mechanism which enabled new market opportunities to be taken advantage of *during* the term of existing franchisees' contracts and did not necessitate territorial restructuring was to offer new units to *existing franchisees,* thereby making them multi-unit operators. This mechanism was used by ten franchisors from the first and second groups (Retail Sector, Firm A; Fast Food Sector, Firm B; Personal Services Sector, Firm E; Distribution Sector, Firms C, F, G and I; Business-to-Business Sector, Firms B and C; Industrial and Commercial Sector, Firm B). Thus, new units were added into existing territories and franchisees already operating in the network ran the units. The multi-unit franchisee mechanisms were used in two different ways: first, as a 'built-on' mechanism and second as a 'built-in' mechanism.

This approach was used by eight of the firms as restructuring became necessary and was, in effect, a 'built-on' mechanism rather than being planned by the firms at the start of expansion (Fast Food Sector, Firm B; Personal Services Sector, Firm E; Distribution Sector, Firms C, F, G and I; Business-to-Business Sector, Firms B and C). Operating additional units may require a franchisee to develop new managerial skills and competencies. Therefore, the mechanism of using multi-unit franchisees was not appropriate in every situation where a market gap had arisen, as not every franchisee was capable of establishing an additional unit, nor was the multi-unit operator mechanism suitable for every type of franchise operation. For example, the four distribution franchisors argued that a single unit could be extremely demanding for franchisees to operate. Indeed, another distribution franchise (Firm A) had tried to implement the multi-unit mechanism but abandoned the plan as even the most capable franchisees in the system found it too difficult to run additional distribution units. However, this problem is perhaps specific to the distribution franchise. Thus, only in a small number of cases, where the franchisee had demonstrated exceptional potential, key competencies and willingness to develop a new unit, were additional units established by existing distribution franchisees.[21]

A further difficulty is that those franchisees who are capable of running additional units may not wish to do so as this may not fit with the individual's business objectives. As one franchisor commented, some franchisees reached a 'comfort level' where adequate levels of profitability and a satisfactory lifestyle

[21] The franchisors used this mechanism to a comparatively limited extent as all four franchise systems had less than 15 multi-unit operators.

had been achieved. Establishing another new unit would have been too costly and time consuming from the franchisee's point of view.[22] However, if the franchisor thought that a franchisee was capable (although reluctant) of running an additional unit and this overcame the difficulty of filling a market gap, the franchisor had the task of trying to persuade an existing franchisee to establish a new unit in order to take advantage of new market potential. The eight firms that used the multi-unit franchisee mechanism for filling market gaps therefore had varying degrees of success in filing market gaps, as this depended upon the skills-base, co-operation and motivations of existing franchisees to undertake new unit development.

In the second situation the multi-unit franchisee mechanism (used by the two remaining firms – Retail Sector, Firm A and Industrial and Commercial Sector, Firm B) was integral to the method used to expand. Both firms operated as area franchises and the mechanism was therefore a 'built-in' strategic mechanism as the franchisors had *intended from the start of roll-out* that existing franchisees would become sequential multi-unit franchisees. Therefore, these franchisees would not only have a set number of units to develop but if new market opportunities arose over time, the area franchisees would also be able to develop any new additional market potential. The franchisors had therefore allocated large-scale territories for this purpose.[23]

However, it is questionable whether *every* franchisee in both of the systems would be capable of running additional units, as the skills required for multi-unit operation were untested when franchisees were recruited to the networks. The firms, which did not plan to utilise multi-unit franchisees from the start of operation could at least observe the skills and capabilities of franchisees that had been operating with the network for some time to assess suitability for

[22] This finding is somewhat contrary to the dominant agency explanation of franchising, which argues that franchisees are a source of highly motivated unit operators compared with unit managers (Shane, 1995; Lafontaine, 1992). Whilst this theory may explain the motivations of a *single unit operator*, the agency perspective does not necessarily articulate the different motivations of a single-unit operator and a multi-unit operator and the attributes of a successful multi-unit operator (Bates, 1998).

[23] In one of the firms, franchisees were responsible for developing between 30-40 units within a single large-scale territory (which were geographical regions such as the south west, Scotland and London for example). However, it was intended that sequential multi-unit franchisees in the other firm would only operate no more than three units.

multi-unit operation. Furthermore, it is questionable whether franchisees adequately exploited the larger-than-average territory delineations, although the franchisors argued that to avoid large-scale under-exploitation, performance targets were set and these had been largely successful for keeping franchisees on track with unit development.

In sum, as suggested by Zellar *et al.*, (1980) and Bradach (1995), the mechanism of offering new units to existing franchisees (whether planned from the start of expansion or not) can be a solution to problem of adding new units to a network over time. However, as the discussion has highlighted, this mechanism does not necessarily work in every situation and with every franchisee. Thus, many of the firms in Groups 1 and 2 had to find other solutions to the network restructuring problem.

Buy-backs

A second mechanism was to buy-back from the franchisee all, or part, of the territory where new market potential had arisen and restructuring was necessary. Thirteen firms in the first and second groups had used this mechanism (Fast Food Sector, Firm B; Personal Services Sector, Firms D, E and F; Distribution Sector, Firms A, B, D, G, H, I and J; Business-to-Business Sector, Firm D, Industrial and Commercial Sector, Firm D).[24] Buying back part or all of the territory is the only restructuring option (after the multi-unit franchisee mechanism) unless a franchisor waits until contracts cease. These franchisors had either bought-back all or part of a territory which needed to be restructured or were in the process of doing so at the time of interview. Indeed, some of the more mature firms (Personal Services Sector, Firms E and F) had undergone a number of restructuring phases, with the original territories delineated at the roll-out stage bought back and restructured at the first contract renewal period. Over time, the firms continued the policy (albeit to a smaller extent and in conjunction with the multi-unit franchisee mechanism) of buying back territories if it became necessary. The remaining firms were either in the process of buying-back territories which needed to be redeveloped or had made plans to do so. Contrary

[24] Some firms used more than one mechanism in the restructuring process, therefore numbers overlap.

to Oxenfeldt and Kelly's (1969) contention, it was not the firms' intentions to make franchises into wholly owned corporate chains. Buying-back territories gave franchisors control over parts of the network where restructuring was necessary and was only for the purpose of sub-dividing original areas into smaller geographical territories to establish new units, which would be operated by franchisees.

Buying back all or part of a territory from a franchisee, which continued to operate with a network, entails a process of negotiation and compensation and so was not without cost to the franchisor. Negotiating territorial buy-backs with franchisees necessitated management time and effort, a process which could be time-consuming if the franchisor had to persuade franchisees to consent to selling sections of territory. For example:

> *"It is not a thing I am looking forward to doing because it will almost, or we will, almost end up in some degree of negotiation or conflict. And it might actually put the agreement to the test, which we don't particularly want to do...so it will be a matter of persuasion and commercial negotiation to get those places back that we know will have stand-alone-centres" (Distribution Sector, Firm G).*

Management time and effort were also used for activities such as advertising and recruiting new franchisees for new units, as well as amending existing franchisees' contracts with updated maps of territories.

Territorial negotiations were also generally only successful if franchisees were financially compensated for sections of territories that were bought back by the franchisor (see Exhibit Box 5.7). As Distribution Sector, Firm A admitted:

> *"it is going to be difficult to achieve our goal because we need the co-operation of a number of players to give up something they have got and that has been sold to them. So we don't think it will be an easy job...and as yet, we have not been successful in achieving that goal. In some of our business plans that go up to 2003 it is included that we will be splitting some territories, but as yet I cannot say that we have been successful in achieving that goal because franchisees don't want their territories split"(Distribution Sector, Firm A).*

The franchisor conceded that offering compensation was the next step in the negotiation process to enable territorial restructuring. Other franchisors in the sample offered a lump sum (raised from internal revenue) or a percentage of goodwill if a territory was split to franchisees which continued to operate with the system.

Exhibit 5.7 Restructuring through Territorial Buy-Backs, Negotiation and Compensation – An Example

Distribution Sector, Firm H
In 1991, a second phase of restructuring occurred for Distribution Firm H, a parcel courier firm (the first phase of restructuring had involved the large geographical territories being split into smaller operational areas as new franchisees were recruited to the network – see Table 5.2). The technicalities of parcel distribution often meant franchisees had difficulties catering to the demands of parcel *collections*. Whilst parcel deliveries were straightforward, collections tended to be ad hoc and franchisees would often not know where demand for this service would arise from within their territories. Although it was not a problem to pick up collections, it was not necessarily profitable to do so. If a franchisee was using his/her resources (e.g. vans, petrol, and employees) to go and collect just one parcel, it was not a profitable venture, particularly if the collections were at opposite ends of a territory. It was more lucrative for a franchisee to pick up all the collections in one area. Therefore, the franchisor instigated an innovative restructuring scheme to overcome the difficulties posed by the nature of the courier business. The franchisor proposed to the existing franchisees that part of their territories could be sold to *mobile operators*, who would cater for the ad hoc nature of parcel collections. The franchisor's rationale for this was that the basic extent of franchisees' territories were an encumbrance and serviced at a loss because franchisees had to run down revenue to take on resources to cover collections. Therefore, mobile franchisees could operate in small sections of an existing franchisee's territory and cater for the collections (whilst advantageously and simultaneously creating deliveries for colleagues).

Thus, in 1991, mobile operators were added to the existing network of depot based franchisees. So, for example, the Portsmouth territory had one main depot, where the original franchisee serviced the core part of the territory and dealt with the deliveries within that area. Subsequently, under the restructuring scheme 15 mobile franchisees were added to the Portsmouth territory, but operating in the sub-postal districts (i.e. mini territories) and dealing with collections. Adding this resource to the network created a total of 325 franchise territories (with an aim of achieving 400 territories in total). In the franchisor's opinion the second phase of network restructuring developed a stronger and more efficient network. However, restructuring has not been without cost to the franchisor. The restructuring entailed several negotiations with the existing network of franchisees as well as financial compensation. For every mobile operator added to an existing franchisee' territory, franchisees were compensated. Thus, the new mobile franchisees, which were recruited to the network, paid a fee (of £12,000) for a sub-territory, which went to the original franchisee. For every mobile operator added to a territory, franchisees were compensated in this way. Ordinarily, such fees are for the franchisor (an in the corporate situation, financial gains from new unit development go straight to the company). However, as the franchisor altered territories during the term of existing franchisees' contracts compensation was necessary to allow network restructuring to occur.

Financial Compensation

One franchisor (Personal Services Sector, Firm I) was distinct from other firms in the Groups 1 and 2 as its policy was to add new units to existing territories *during* franchisees' contracts. However, the franchisor could only restructure and add new operators to the network during the contractual term by *compensating* the franchisees affected by this. Thus, a franchisee that was already established in the network was compensated if a new franchisee was added to its territory with a percentage of the new operator's franchise fee. However, the franchisor's policy of facilitating network restructuring through compensation was *planned and implemented from the start of operation*. Thus, the compensation policy also enabled this strategically focused franchisor to build a management hierarchy within the network to strengthen the internal structure of the operation and create managerial development opportunities, whilst consolidating the franchise network (see Exhibit 5.8).

5.4.3 Mechanisms Used to Restructure: Groups 3 - Firms with Non-Exclusive and Non-Territorial Networks

Firms in Group 3 did not allocate exclusivity or territories and therefore did not have the same contractual obligations of the first and second groups. As only market areas were allocated, which were not defined by fixed geographical boundaries, the firms did not have to wait until the contract renewal period to add new units into networks. However, firms in this group still had to consider the effect establishing new units could have on networks of existing franchisees. Units placed too close to existing ones could cause encroachment and cannibalisation and ultimately conflict within the network. Thus, the firms had to employ a number of mechanisms and policies to enable new unit development.

Franchisor-franchisee discussion meetings

The first mechanism, used by all six franchisors in this group, was to hold discussion meetings with franchisees to discuss the issue of placing new units into the network with the franchisees that were affected by such restructuring. Use of this mechanism reflects the nature of the franchise relationship: franchisees were part of the discussions, as the franchisors felt that this was a way to avoid misunderstandings and minimise potential conflict and disputes that can arise with new unit introductions. Thus, this mechanism was a way to maintain good working relationships with existing franchisees, as network expansion continued over time.

Exhibit 5.8 Restructuring through Compensation – An example

Personal Services Sector, Firm I

Personal Services Sector, Firm I, (a mobile will writing service established in 1990 with 139 franchisees), is an example of a non-exclusive territorially based franchise system, which restructured its network *during* the term of existing franchisees' contracts. As the business developed and optimal market penetration levels altered, opportunities to add new units into the existing network arose. Therefore, the franchisor acted upon new market potential and added new franchisees into existing franchisees' territories. In so doing, the franchisor continued and consolidated network development. The franchisor - aware that system penetration levels may increase over time - did not make territories exclusive and gave short, one-year contracts to retain the flexibility to control and alter the territorial basis of the network if the need arose. However, the ability to restructure and alter an existing territory was only feasible if a franchisee, affected by new unit introductions, was financially compensated for 'loss' of territory by the addition of a new operator. Thus, the network had substantively altered during the consolidation stage as larger territories were restructured into smaller geographical areas to incorporate new units and franchisees. Use of the financial compensation mechanism to enable network restructuring was also a strategic policy planned and implemented *from the start of operation.* Using this mechanism meant the franchisor could instantly act on new market opportunities and not be forced to wait until the contract renewal period to continue network development, as some of the other franchisors in this group were.

In addition to employing the compensation mechanism to enable network restructuring, the franchisor also took the opportunity in the consolidation stage to create an internal structure within the firm by building a management hierarchy. Thus, for a fee, franchisees could progress from 'franchisee' to 'regional manager' to 'regional directorship' and 'main board directorship' with each step increasing in cost and managerial responsibility. If, for example, a franchisee became a regional manager, this individual would be in charge of all franchisees in an area or region. The franchisor's reasons for building the hierarchy within the firm were four-fold. First, the franchisor believed that it was important to create an infrastructure within the firm in order to strengthen the network:

> *"if you start a business at the top, you have got to start building a downward infrastructure. When you set up a franchise, or own a business, there is nothing – you've got a deck of cards, which can be blown away - so you have to build a downward infrastructure, but it's a hard thing to do in a franchise system, because of the concept of it...everyone is used to working on their own and having their own business."*

Second, the creation of the management hierarchy was an opportunity to encourage those franchisees that wished to work hard and improve their status within the network to pursue the next level of the hierarchy. The franchisor's management hierarchy therefore ensured highly motivated franchisees in the network were used to their full potential for the overall benefit of the network. The third reason for creating the management hierarchy was to enable the franchisor to control and 'manipulate' the network of franchisees into working together in local and regional groups. Thus, the hierarchy would ensure that groups of franchisees, located in the same area, worked and communicated together, provided support and resolved problems together as a group under the guidance and leadership of regional managers and directors. With this arrangement a network-wide franchisee association would not be necessary and this was one way the franchisor controlled the network, as it believed having a network-wide franchisee association would empower franchisees too greatly and could potentially generate collective bargaining power:

> *"It depends how you run the business, don't have national meetings, I don't ever. They get a newsletter, they get briefings, they meet regionally or locally, but they can organise that. I don't want to organise them because it becomes the 'tail wagging dog'...so they have a regional manager and they invite all the other franchisees along within that area, so that there are 20 of them, for example. They are delighted and I'm delighted, because now they are together and they are not interested in other regions. They have gone back to being insular again, and now they are all together and its self-managing and self-running ...so its how you control and manipulate the network"*

And lastly, by paying a fee for a position in the hierarchy, the franchisor was able to generate a further source of revenue within the network. Thus, in the consolidation stage, the franchisor embarked upon not only a process of network restructuring, but also a process of creating an internal managerial structure to strengthen and enhance the franchise network.

In all six cases, the franchisors had either added, or were planning to add, extra units into their networks which would be located close to (and in some cases impact upon) existing units. The franchisees affected by this were informed of franchisors' intentions to add extra resources into networks through discussion meetings. Indeed, one firm (Fast Food Sector, Firm C) had even set up a 'working party' to deal with encroachment potential problems, (which could arise from the franchisor's proposed restructuring scheme) with the intention of involving franchisees in the restructuring process and decision-making discussions. The franchisor acknowledged that managing new unit introductions was a difficult issue to deal with:

> "*...cannibalisation is seen universally by everybody in franchising as a very dirty word and not what we want to happen to our businesses...so right now, by accelerating development, I think that this is probably one of the most strategically difficult issues we are facing*" (Fast Food Sector, Firm C).

Inevitably, such discussion meetings raised concerns over the introduction of new units from the franchisees that were affected by this. In such cases, the franchisor asked the franchisee to discuss/demonstrate how a new unit located near to its own would affect the business it operated. Franchisees would be asked to explain how its business would be negatively affected by the introduction of a new unit located in an adjacent market area.[25] A franchisee may, for example, generate business in the proposed new market area (as it was where they lived, or had business contacts and associates) but service clients from its existing unit. Therefore, the franchisor may be unaware that the franchisee was deriving business from a wider catchment area.

In two cases (Retail Sector, Firm D and Fast Food Sector, Firm C) franchisors had attempted to develop locational models to assess the effect of new unit introductions on existing units and networks as a whole, as has been suggested in the literature (Current and Storbeck, 1994; Ghosh and Craig, 1991; Kaufmann and Rangan, 1990; Stassen and Mittelstaedt, 1995; Zellar *et al.*, 1980). By using the models the franchisors were able to monitor sales and profits throughout the network as well as predict and assess the cannibalisation effects that could occur by placing new units into different locational scenarios, and highlight claims of false encroachment. The models were therefore useful predictive tools that could help the franchisors judge the best locations for new unit introductions in terms of minimising encroachment of existing units.

However, it is significant that the two systems which used locational models, were also internationally renowned franchise networks that had been operating for a number of years. The firms therefore had the financial resources to develop and utilise locational models. However, the models have limitations as they are only able to *predict* likely scenarios caused by new unit additions. Whilst the models were insightful tools, the franchisors' still had to use personal judgement and decision making skills when placing new units into networks to minimise the effects of cannibalisation.

If, following further investigation by the franchisor (using the discussion meetings and/or locational models), it was judged the franchisee had a legitimate case and a new unit would severely encroach upon the franchisee's unit, the franchisor would not establish a new unit in that location. However, in most cases this rarely happened and new units were nearly always opened. Franchisees complained because they were merely trying to protect their own business, for example:

> *"a franchisee said if you are going to open there, you will take a lot of my business. So we said show us how much business you have there [in the new market area], make a map, put pins for every one of your clients, where they are, and then we can see the concentration. But he said he is not going to do that. So we said you can't just stop us, you have to show us and if you* ***prove*** *that you have a substantial part of your business there, we will consider what you are saying. But he didn't and we opened and it didn't affect his business at all." (Industrial and Commercial Sector, Firm E, emphasis added).*

In the opinions of the franchisors' it was the *perceived* threat of potential encroachment, which caused disputes: rarely did encroachment occur in reality. As the franchisors argued, placing new units too close to existing ones would not be for the ultimate benefit of the network. Recruitment of new franchisees would

[25] However, as Price (1997) has observed this may mean a franchisee has to expend time money and effort commissioning market research to prove encroachment has occurred.

also suffer as new operators would be unlikely to accept a situation where neither the old or the new unit would be as successful or profitable as it could be located in a legitimate market area.

Multi-unit franchisees

The second mechanism used by four firms in this group (Retail Sector, Firm D; Fast Food Sector, Firms C and E; Personal Services Sector, Firm A) to enable new units additions was to *offer new units to existing franchisees*, thereby making the franchisees multi-unit operators (a mechanism also used by firms in the first and second groups). Thus, a new unit was, in the first instance, offered to the nearest existing franchisee in the area where the proposed unit was to be located. If the new unit did encroach upon a franchisee's original unit, franchisors argued a franchisee would derive the benefit from operating the new unit and this would compensate for the original unit's initial loss of revenue.

However, as with the first and second groups, there were a number of limitations with this mechanism. The franchisors acknowledged that changing from a single unit operator to multi-unit operator could be problematic for a number of reasons. First, requiring an existing franchisee to take on additional units, (an action which may not necessarily be beneficial for that franchisee but for the ultimate good of the network) was a difficult task:

> *"it is a very difficult concept to say to someone, now you need to build another store, because you are going to do what is right for the brand and you will take more money out of the whole market, but your profit out of your existing unit will go down, and the reality is that it will short term." (Fast Food Sector, Firm C).*

Second, taking on a new unit may also be a demanding task for the franchisee, as time, money and effort will need to be spent on developing, promoting and operating the unit. For these reasons, a franchisee may not be willing to take on a new unit. In this situation, new units may have to be developed by new franchisees recruited to the network and conflict from the introduction of additional units may arise.

Third, whilst the franchisors proposed existing franchisees could take on new unit introductions, not all franchisees were necessarily capable of developing and operating additional units. However, the franchisors maintained the majority of franchisees in the networks *were* capable of operating multiple units, as the franchisors had stringent recruitment policies ensuring only high quality individuals joined the networks. The franchisors also argued there was less risk in granting new units to existing franchisees than taking on the unknown and unproven entity of a new franchisee, a finding reiterated by Bradach (1995). One franchisor (Fast Food Sector, Firm C) also believed it owed its franchisees the opportunity to grow and develop with the firm, as the franchisees had invested time, money and effort to make the franchise units and the system as a whole successful. Offering existing franchisees new units was a way to achieve this.

Fourth, and specific to Group 3, a difficulty may arise when a proposed new unit could impact upon, and affect, *several* adjacent franchisees' units if it was proposed to locate a new unit at the *borderline* of a number of market areas. In this situation any one of the franchisees affected by the new introduction could run the new unit. One franchisor (Fast Food Sector, Firm C) operated a compensation policy to minimise the potential conflict that could occur between adjacent franchisees that were all eligible to run additional units. Thus, the franchisee which developed the new unit compensated its neighbouring franchisees, which lost out on the opportunity to operate the new unit through a percentage payment from the new unit's profits. Furthermore, if this situation arose again and a franchisee had missed out on the opportunity of new unit development, the franchisor would try to ensure the same franchisee did not miss an opportunity for a second or third time. In so doing, the franchisor tried to deal with the problem fairly and equitably.

Corporate-run units

The third mechanism, which had been, or was going to be used, by all six franchisors in this group was to develop new units as *corporate-run operations* (Retail Sector, Firms B, D and E; Fast Food Sector, Firm C; Personal Services Sector, Firm A; Industrial and Commercial Sector, Firm C). However, this mechanism was only implemented after the franchisor had discussed this with the franchisee affected by the new unit introduction, and the new unit had been offered to them. If the franchisee did not want to open a new unit, or if the franchisor thought that the franchisee was not capable or did not have the skills to operate an additional unit, the franchisor established it as a corporate-run operation to prevent the loss of a new growth opportunity. Corporate-run units were also used as a way to minimise the problem of new units encroaching upon several adjacent franchisees' businesses. However, this did not necessarily combat the problem of encroachment and conflict. It is probable the affected franchisees also saw a corporate unit as a potential threat and source of encroachment. This 'solution' did not always avoid conflict therefore. However, the franchisors maintained this policy was to help avoid conflict occurring between *original* and *new* franchisees.

What is evident from the mechanisms that have been used by firms in Group 3 is that franchisors would not lose an opportunity to develop new market potential (see Exhibit 5.9). Addition of a new unit would have been discussed with, and offered to an existing franchisee. If the franchisee did not want to take on the new unit, the franchisors would develop the site as a corporate unit. Although the franchisors utilised this mechanism at the risk of causing an encroachment to an existing franchisee's unit and in the knowledge this could cause conflict between the franchisor and franchisee, the franchisors argued this situation was dealt with as ethically as possible as franchisees were offered first refusal on new units. As the franchisors argued, the restructuring actions that were implemented were for the ultimate good of the network even if this caused operational difficulties for old and new franchisees. Franchisors would not lose development opportunities and leave networks open to competitive encroachment.

Exhibit 5.9 Restructuring through a Combination of Mechanisms – An Example

Retail Sector, Firm D
Retail Sector, Firm D specialises in dealing with second hand goods and other financial services. The franchisor has been operating in the UK under a master licence from its Australian master franchisor since 1989. At the time of interview, the firm intended to embark upon a restructuring scheme, thus, substantially altering the basis of the existing network. To date, the firm operates 100 stores. However, the franchisor plans to increase the number of units in operation to approximately 340, as research conducted by the firm demonstrated the market was under-exploited. Increasing the number of stores will allow extended growth, locational gaps to be plugged (before competitors gain a foot-hold) as well as help raise the profile of the brand and the business concept. Thus, the franchisor proposed to fully exploit new market potential through restructuring and adding 'Concept Stores' into the existing network of units. The concept stores are intended to be smaller, cheaper outlets with less overheads, suitable for use in smaller market locations, where market gaps have arisen. It is also proposed that the concept stores will be used to create a buffer zone around existing franchisees' businesses, thus protecting franchisees from competitive encroachment. However, increasing the number of units will affect the existing network, as the concept stores will be located in *existing franchisees market areas* and may potentially encroach upon franchisees' sales and profits. Although, at the time of interview, no final decision had been made regarding the products and services the concept stores will provide, the franchisor admitted it would have difficulty introducing a concept store to an existing market area *if* the concept store offered the same core services as a conventional store but ownership of the new store was different. Existing franchisees would perceive such action as an encroachment and this could result in dispute. For this reason, the franchisor planned to instigate a number of mechanisms to enable the restructuring scheme to proceed.

First, the franchisor plans for a concept store to be offered to the franchisee operating in the market area where the new concept unit is proposed. Thus, existing franchisees will be unable to claim encroachment has occurred, as any benefit derived from a new concept store will be to an existing owner-operator. The franchisor also argued the multi-unit franchisee mechanism would give the franchisee an opportunity to grow and support its existing business. Second, if an existing franchisee does not wish to develop a concept store, which is proposed to open near to their own unit, the franchisor will run the concept store as a corporate unit; a strategy intended to minimise conflict between old and new franchisees. Third, if ownership is different, and an existing franchisee is running a conventional store, whilst the franchisor or a new franchisee is running a concept store, it is intended that the concept stores will only provide a range of core services. Thus, the franchisor argued overlapping of products and services should not be an issue of conflict, as there will be product differentiation between an old and new store. By introducing new concept stores into the network, the franchisor has had to carefully consider the implications of its proposed restructuring scheme on the existing franchisees, even though territories and exclusivity are not in place within the network illustrating the importance of the franchisor-franchisee relationship. Thus, the mechanisms outlined above have been planned, and in addition, a clause stipulated in the franchise contract states that although the franchisor reserves the right to place stores in any location, new units will not be placed in a position which will encroach upon an existing store or franchisee.

5.4.4 Summary

In sum, as all three network allocations affected the restructuring process, it was necessary for firms to employ a number (and sometimes a combination) of mechanisms and policies that have been outlined in this section. Groups 1 and 2 utilised multi-unit franchisees or bought back territories through negotiation and compensation to enable network restructuring. Firms in Group 3 adopted a number of policies from franchisor-franchisee discussion groups, multi-unit operators to corporate units. Implementation of these policies not only facilitated the network restructuring process, thereby enabling new market opportunities to be taken advantage of, but also minimised the potential for conflict from new unit introductions.

5.4.5 Future Restructuring Mechanisms: Firms in Roll Out or Early Consolidation

For the seventeen firms, currently in roll out or early consolidation, network restructuring was not yet an issue. Eleven of these firms had not considered potential changes to future levels of market penetration and the effect of this on networks (Retail Sector, Firm C, Fast Food Sector, Firms D and E, Personal Services Sector, Firm B, G and H, Business-to-Business Sector, Firms A, B, C and E, Industrial and Commercial Sector, Firm E). These franchisors had therefore not planned restructuring mechanisms. Instead, the firms intended to wait, assess and deal with such situations as and when they occurred.

However, the remaining six firms *had planned* restructuring mechanisms for future implementation in order to take advantage of any new market opportunities *if* they arose in future (Fast Food Sector, Firm A, Personal Services Sector, Firms C and J, Distribution Sector, Firms E and F, Industrial and Commercial Sector, Firm A). As with two other firms in the sample (Retail Sector, Firm A and Industrial and Commercial Sector, Firm B) the intended mechanisms was implicit within the method of expansion used by the firms. Five of the six firms operated with large-scale territories and sequential multi-unit franchisees, whilst the remaining firm operated as an area franchise. All six firms had therefore planned for the dynamic of the market by designing networks so that existing franchisees could develop new units if new market potential arose.[26] However, there were potential problems with the intended mechanisms common to the other firms in the sample, such as under-exploitation of large territories and assessing franchisees' capabilities for additional unit operation.

[26] In some cases, use of this method (and potential restructuring mechanism) was following advice from parent franchisors, which had the operational know-how and experience to advise master franchisees of the problems that can occur with network restructuring (Fast Food Sector, Firm A, Personal Services Sector, Firms C and J, Industrial and Commercial Sector, Firm A).

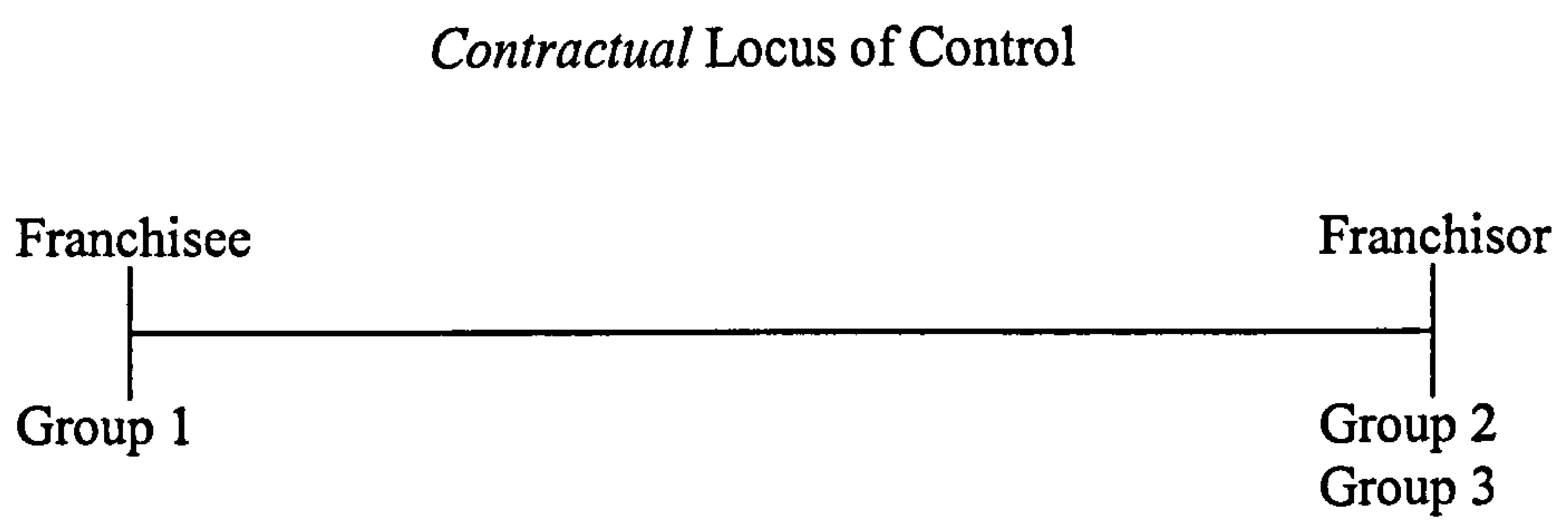
5.5 Conclusions

The common perception of franchising, often portrayed by the franchise fraternity and the 'How To' literature is that all franchisees operating in a franchise system will have exclusive territories in which to operate. However, in the current sample, the assumption that there is one typical network allocation was inaccurate. Instead there were three types of network allocation: networks allocated on the basis of exclusive territories; networks allocated on the basis of non-exclusive territories; and networks where neither exclusivity or territories were allocated where units were simply licensed to franchisees and located within a market area.

The lack of clear trends within each of the three groups, which has been evident throughout this chapter, suggests that factors other than sector and type of operation determine the network allocation process. Therefore, the first conclusion is that network allocation is likely to be as a result of key actors (franchisor/founder/head office team) decision making processes rather than being entirely dictated by sector or type of sector considerations. This decision may be based on knowledge, previous experience of franchising or the advice that was sought regarding the network allocation process. The network allocation decision will also be governed by strategic objectives and affected by the market environment. As the franchise system grows and develops, such factors - and therefore the network allocation decision – may be subject to change over time (as illustrated by the firms in Group 2, which altered the network exclusivity status).

The three network allocation models had different *contractual* and *operational* implications for the restructuring process and the ability of a firm to add new units to a network if market penetration levels altered over time. Firms in the first group (networks allocated on the basis of exclusive territorial networks) could not add new units to networks until franchisees' contracts had ceased or were due for renewal because of the exclusive territorial contractual obligations. Therefore, as Figure 5.1 demonstrates the *contractual* locus of control regarding the restructuring process resides with the *franchisee*. For firms in the second and third groups exclusivity was not a contractual obligation and in legal terms, firms could implement restructuring schemes, alter franchisees' territories and add extra units to established territories during the term of existing franchisees' contracts. Therefore, Figure 5.1 also demonstrates that in *contractual* terms the locus of control regarding the restructuring process resides with the *franchisor.*

Figure 5.1 The Contractual Ability to Restructure Networks

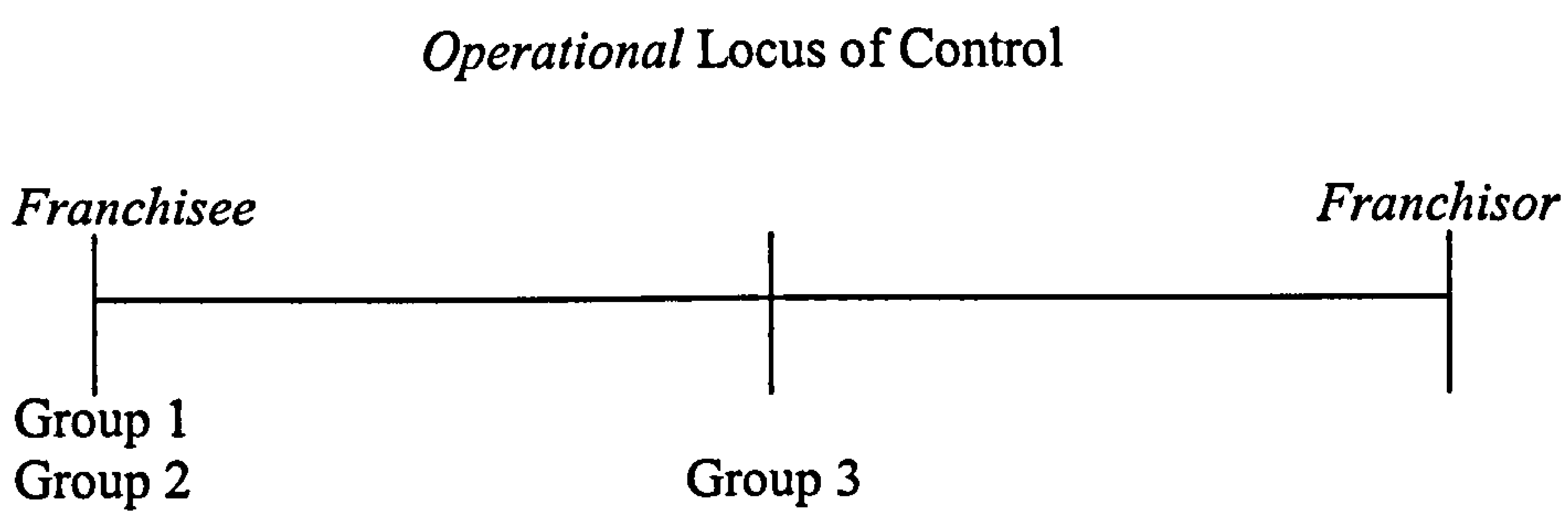


However, the second conclusion to be made is that the contractual form of the network was not a reasonable guide to the *operational* behaviour of a firm or group. The majority of firms in the second group (non-exclusive territorial networks) did not act upon the full flexibility afforded to them by the terms of their contracts.[27] Whilst the absence of exclusivity implied a franchisor could at least, in theory, alter and add extra resource to a network during existing contracts, *in operation* the establishment of new units in existing territories was difficult to implement, as precedence was given to existing franchisees. Therefore territories would not be restructured or altered until the contract renewal period or contracts had ceased. Although the franchisors did not have the exclusive contractual obligations of the first group they acted in an ethical manner. Thus, as Figure 5.2 demonstrates, at the *operational level,* the locus of control regarding the restructuring process resided with the franchisee for firms in Group 2.

The firms in the Group 3, which operated without exclusivity clauses or the geographical limitations of territories had both contractual and spatial flexibility to add new units to networks over time if opportunities arose. This group of firms had not constrained growth and development. However, in some cases, the introduction of a new unit caused encroachment of an existing franchisee's business. Therefore, *in operation*, the firms modified their behaviour with the actions and measures that were taken (i.e. franchisor-franchisee discussion groups, multi-unit operators, corporate units) to minimise the effects of potential encroachment on existing franchisees and to minimise any potential conflict arising from this situation. As Figure 5.2 demonstrates, the locus of *operational control* for firms in the third group regarding the restructuring process shifts more to the franchisee, although not completely away from the franchisor. Franchisors with this network allocation maintained the majority of control over new network expansion.

Thus, both Groups 2 and 3 illustrate that there is a divergence between the contractual and operational behaviour in this sample of franchise firms. This finding is similar to Curran *et al.,* (1984) and Stanworth (1995) as their research demonstrates that franchisees are given greater control at the operational level than is evident at the contractual level. The findings from this chapter provides further support to the contention of those authors that there is a greater degree of operational flexibility afforded to the franchisee than is suggested by only a contractual analysis of franchising, such as the study conducted by Felstead (1993).

Figure 5.2 The Operational Ability to Restructure Networks



[27] There was one exception within this group – Personal Services Sector, Firm I – which acted upon the full contractual rights of the contract by restructuring during existing franchisees' contractual terms.

The third conclusion is that firms in the first and second groups were more restricted by network allocation than firms in the third group. The contractual and operational obligations of exclusivity and/or territories necessitated the implementation of restructuring mechanisms to enable new expansion. This chapter has provided significant new insights into the mechanisms that were used to attempt to resolve the issues caused by new unit introductions.

Some of the mechanisms that were used by the firms in Groups 1 and 2 were reactive (as they were not in place at the start of roll-out) and therefore not necessarily effective solutions. Not every franchisee was capable, or indeed, willing to become a multi-unit operator and buy-backs necessitated financial and managerial costs. If firms do not plan for the dynamic element of franchise system expansion the ensuing restructuring process can be difficult, time consuming and costly for firms to implement. A franchisor may even be unable to develop new market opportunities, which could be to the detriment of a network. Therefore, the process of network allocation is an important decision to give consideration to as this can have long-term consequences for the effectiveness of a network. By exploring territorial and network allocation issues, Chapter 5 has considered one of the key operational and contractual issues of business format franchising. Chapter 6 goes onto discuss another operational and contractual aspect of business format franchising by examining the issue of franchise format standardisation/adaptation in response to the conditions of local market environments.

Chapter 6 Franchise Formats and The Role of the Local Environment

6.1 Introduction

Business format franchise systems operate on the principle of replicating tried and tested business formats in different localities. Standardisation and uniformity are imperative in franchise operations to ensure not only successful format implementation but brand consistency and repeat customer patronage (Dandridge and Falbe, 1994; Falbe and Dandridge, 1992; Kaufmann and Rangan, 1990; Michael, 1996; Price, 1997; Stanworth *et al.*, 1996). As franchise systems are decentralised operations, units compete in diverse local markets which can vary in supply and demand and constraints and opportunities (e.g. competitive pressures, consumer tastes, labour markets). Paradoxically, franchise systems attempt to operate in diverse local markets with international/national standardised business formats which may constrain local responsiveness; consequently adaptation of the format may be sought by the franchisee to ensure closer market fit of a product/service and more competitive and successful operation. The local market environment may be a factor which instigates tensions in a franchise system between the two strategic imperatives of standardisation and adaptation (Kaufmann and Eroglu, 1998). Therefore, it is the aim of this chapter to explore the affect of local geographical environment on format implementation, as this factor has not been rigorously examined in the extant franchise literature. Thus, the chapter seeks to answer the two questions: 1.) Does local geographical environment affect format implementation? and 2.) To what extent will a franchisor permit local market responsiveness before format conformity is enforced? The chapter starts with an in-depth discussion of format components (Section 6.2) before assessing the role that local geographical environment can have on format implementation.

6.2 Franchise Formats – Core and Peripheral Components

As Chapter 1 outlined, business format franchising is composed of a contractual relationship between the franchisor and the franchisee, with the franchisee licensed with the rights to copy the franchisor's business. A franchise will centre on either a product or service and may be a location or mobile-based operation. The franchisor will provide the franchisee with the blueprint of the business including the support systems necessary to implement and operate the business for which the franchisee, in return, pays ongoing fees/royalties to the franchisor.

Kaufmann and Eroglu (1998) argue that the franchise format comprises a number of elements which divide into four distinct components. First, *product/service deliverables* are the unique features of the format which make up the 'concept' of the business (such as a unique menu and convenience in a fast food franchise or the quick and quality preparation of a customer's printing needs in a fast print franchise) and give the format its competitive niche in the marketplace.

Second, *benefit communicators* are the existence of intangible or unobservable benefits for the consumer (which are difficult to measure directly or objectively) such as quality, reliability and professionalism which give the consumer confidence in the product/service (e.g. clean uniforms in a fast food unit which suggests cleanliness and hygiene or professional certification which suggests credibility). Third, *system identifiers* are visual and auditory elements that link the individual unit with a system or chain. The tradename, trademark or logo of a firm are the most easily identifiable elements of this component, but colour schemes, uniforms and décor of a unit are also system identifiers.

Fourth, *system facilitators* are the policies and procedures which enable the format to function efficiently at both the individual unit level as well as at the system level. The system facilitators are the managerial and operational infrastructure necessary for format implementation and cover elements at the unit-level such as unit layout and design and specification of equipment and at the system-level, elements such as financial reporting mechanisms, royalty payment methods and training procedures. However, Kaufmann and Eroglu (1998) point out that the system facilitators are essentially invisible to the consumer except for their indirect effect on the other components, although like the product/service deliverables defines the franchise concept, system facilitators are crucial for defining the organisation, operation and governance of the franchise system.

Kaufmann and Eroglu (1998) also argue that not all elements of the four format components are equal in terms of their centrality and importance. For example, with the system identifier component, in most franchise systems the tradename or trademark will be more important than the colour scheme of a unit. Therefore, the authors make the distinction between the *core* and *peripheral* elements of each format component (see Figure 6.1):

> *"[c]ore elements are described as those whose standardisation must be enforced across all franchisees without exceptions since they are deemed indispensable for the system's survival. In contrast, peripheral elements are those where the franchisor must balance the system-wide benefits of standardisation against the benefits of adaptation to the idiosyncrasies of local demand" (Kaufmann and Eroglu, 1998, p72).*

Figure 6.1 Examples of Format Component Elements Relative to Centrality

FORMAT COMPONENTS

CENTRALITY*		**Product/Service Deliverables**	**Benefit Communicators**	**System Identifiers**	**System Facilitators**
	Core	Basic menu Accuracy of work	Clean uniforms Professional certification	System name Trademark Logo	Sales reporting procedure Operating manuals
	Peripheral	Hours of operation Parking	Mint on pillow Display of professional certificates	Colour scheme Décor of unit	POS equipment Local advertising

*It should be noted that what might be peripheral in one system could be core to another

SOURCE: Kaufmann, P and Eroglu, S (1998) Standardisation and Adaptation in Business Format Franchising, Journal of Business Venturing, 14, pp69-85.

The authors observe that what is core to one franchise system may be peripheral in another. For example, both a donut shop and a convenience store may both sell fresh donuts. The product is obviously a core element of the product deliverable component in the donut franchise system, whereas in the convenience franchise it is a more peripheral element of the format.

However, one important omission by Kaufmann and Eroglu (1998) is that they do not identify that it is the core elements of the four format components which can give a franchise operation *competitive advantage* on a local scale over other independent firms. As unit operators within franchise systems, franchisees may have access to a branded tradename and a standardised product/service which is marketed nationally, in addition to a formulaic operating system. It is these elements which can give a franchisee the competitive advantage to operate locally with what may be an internationally and/or nationally recognised and established business format.

Identification of the core and peripheral elements of the format components has important implications for a franchisor's standardisation strategies. As outlined in Chapter 2, the necessity of standardising the core elements of a business format are obvious. System uniformity and consistency are imperative for ensuring successful implementation of the format, attracting and retaining customers and maintaining the integrity of the brand (Dandridge and Falbe, 1994; Michael, 1996; Price, 1997). However, there may be circumstances or factors which make it necessary to adapt the peripheral, or indeed even the core, elements of the format components, if the overriding benefits of modification lead to increased revenues or better product/service market fit. As Chapter 2 and Section 6.1 also outlined, the local geographical environment may be one such factor which affects successful format implementation and necessitates format adaptation to enable a franchisee to respond locally. In the following section (6.3), this contention is tested with the current sample of firms.

6.3 The Role of the Local Environment – Format Standardisation/Adaptation

6.3.1 Introduction

A conceptual model, devised to explain the affect of local geographical environment on franchise formats, is outlined in Figure 6.2. The model attempts to determine the circumstances in which adaptation of format components (core/peripheral) will occur according to whether the pressures to 'standardise' or 'localise' are high or low. The discussion begins with Box 2 (Peripheral Components of the Format Change), as all of the firms in the sample are located within this part of the model (Section 6.3.2). Sections 6.3.3-6.3.5 examine the remaining boxes in more depth.

Figure 6.2 The Role of Local Environment on Format Standardisation/Adaptation – A Conceptual Model

Pressure To Localise	Pressure To Standardise: *Low*	Pressure To Standardise: *High*
High	**Box 1** Core Components of Format Change	**Box 2** Peripheral Components of Format Change
Low	**Box 3** Franchise Format has No Market	**Box 4** No Format Adaptation Occurs

6.3.2 Box 2 – Peripheral Components of Format Change

All the firms in the sample are located within Box 2 on the Format Standardisation/Adaptation Model. For firms in this category, the pressures to standardise the franchise format and maintain uniformity were high. However, the pressures to localise were also high. The firms acknowledged that spatial environment varied across the UK and franchisees operated in diverse local markets. In such circumstances, peripheral components of the franchise format altered in response to the idiosyncrasies and conditions (constraints/opportunities) of the local market, although adaptation of the core components – those which offered franchisees competitive advantage – was not necessary. Altering core format components would negatively affect the franchisee's business, brand consistency and customer patronage negating the benefits of competitive advantage. Factors of the local market environment which affected format implementation, and the local responses resulting from this, as well as franchisors' reasons for allowing adaptation to occur are outlined in more detail in the following sections.

Factors of Local Market Environment Affecting Format Implementation

The franchise firms in the sample acknowledged that markets varied, despite firms' efforts to minimise spatial variation with the techniques and criteria used to define sufficient territories and market areas (as discussed in Chapter 5). Specifically, firms identified that local markets varied in the degree and uncertainty in consumer demand (different consumer tastes, preferences and culture) as well as differences in socio-economic compositions (e.g. incomes, age distributions). The degree and type of competition and availability and level of resources (e.g. labour, property) were also factors which varied spatially. Franchisors observed that some franchisees simply had better areas than other franchisees operating within the same network. Although the core components of the format (e.g. product/service offering, brand name) provided a franchisee that was experiencing local market difficulties with competitive advantage over other independent operations, the conditions (constraints/threats) of the local market were pressures which, in some cases, affected successful format implementation and performance.

Local Responsiveness – Adaptation of the Peripheral Components of Franchise Formats

Franchisees were able to generate local responses to the particular constraints/demands of their individual operating areas. This resulted in peripheral components of franchise formats being adapted to ensure better market fit. Therefore, franchisees modified the product/service mix, took advantage of local suppliers, set competitive local prices and were responsible for marketing, promotional and recruitment strategies.

Product-Mix Variation and Locally-Sourced Suppliers

All five fast food franchises (Fast Food Sector, Firms A-E) and four of the retail firms in the sample (Retail Sector, Firms A-D) were product-based franchise operations (n=9). As a response to local market demands, product mixes were modified and different product lines were added to the core product offering in these franchises to meet consumer tastes and preferences. Altering the product mix did not entail significant variation of the core product component of franchise formats; rather it involved adapting or adding to existing product ranges.

Some of the fast food franchisees were able to develop customised menus to meet local customer preferences and tastes. For example, some of the firms had different side dishes, accompaniments or 'optional products'. Franchisees operating as part of a pizza delivery franchise (Fast Food Sector, Firm B) had 9 main menu items (known as the 'Classic Pizzas'), but had the flexibility to be able to put additional pizzas on the menu to suit customer preferences (such as 'halal' meat around ethnic enclaves). Franchisees could also use locally based suppliers for such goods, provided that proprietary ingredients (dough, pizza toppings - which in the case of this firm - were core product components) continued to be supplied by the franchisor. Therefore, product mix variations led to different menu ranges across the system and from unit to unit. As Bradach (1998) argues, this type of 'tactical' local response is not outside the bounds of the franchise contract (whereas a strategic response, which attempts to alter the core product, would be considered so). Optional items had been pre-approved by franchisors and may have been former mandatory items on menus.[1] Therefore, such types of variation in product mix which was implemented by franchisees was acceptable to franchisors and considered consistent with franchise formats.

[1] For three of the fast food systems (Firms A, B and C) company units were also operated. Franchisees sometimes continued to offer optional menu items which had been withdrawn in the company units.

For the retail franchises, franchisees altered the product mix to take account of local and regional consumer tastes, as well as taking advantage of local suppliers. So for example, some franchisees with a convenience retail franchise (Retail Sector, Firm A) altered the product mix to emphasise local produce from local suppliers.[2] The other three retailers (Firms B, C and D) varied the product mix according to market segments and demographic profiles of catchment areas. Products were offered which were suitable for the type of consumer most likely to found in a market (see Exhibit 6.1)

> ***Exhibit 6.1 Peripheral Format Component Adaptation: Product Mix – Sample Responses***
>
> *"the business is defined to satisfy local needs and reflect local or regional bias...franchisees have the ability to be able to tinker with the product mix" (Retail Sector, Firm A)*
>
> *"clearly, [franchisees] have got to think local and act local in order to make a success of their shop. There will obviously be some slight tweaks and franchisees can influence their product mix...but once they are in a locality, then they have got to understand and tweak their individual store to meet the needs of their local market." (Retail sector, Firm B)*
>
> *"there are local market variations and our concept is built around that, it is a flexible concept within the defined product areas...we're market focused rather than product focused, we're based on a market and our product range is changing the whole time...the local market can differ, but we have 32 different product areas within the store, so the mix can vary depending on the local market" (Retail Sector, Firm D)*

Pricing Structures

Franchisees were able to set their own pricing structures for products or services which were offered in franchise units. Franchisors are not permitted, by law, to stipulate prices to franchisees under EU regulations as it is deemed anti-competitive behaviour: franchisors can only *recommend* minimum or maximum pricing structures (Abell, 1999, personal correspondence, Ishani, 1999, personal correspondence, Mendelsohn, 1999, personal correspondence, Pratt, 1999,

[2] It is illegal for franchisors to dictate suppliers to franchisees, unless for proprietary goods or services (Abell, 1999, personal correspondence; Ishani, 1999, personal correspondence). Franchisors in the current sample did, however, recommend suppliers to franchisees or had final approval of local suppliers. (The term 'supplier' encompassed a variety of products and services from food and ingredients to equipment and maintenance services).

personal correspondence). However, franchisors in the current sample argued that by not fixing prices, franchisees were able to act responsively to the opportunities and/or constraints of their local markets. Franchisees were able to set prices to act competitively, to suit their suit local marketing campaigns and to meet local consumer demand (see Exhibit Box 6.2).

Exhibit Box 6.2 Peripheral Format Component Adaptation: Pricing Structures – Sample Responses

"We don't have standard pricing...it allows us to respond to local market conditions and it makes sure that individual franchisees are competitive" (Industrial and Commercial Sector, Firm D).

"One of our franchisees has been experiencing difficulties with one of our competitors as, unfortunately, the franchisee has the competitor's head office located on the edge of his territory. However, even though they are very strong...he can tweak his marketing campaigns and set his prices to undercut the competitor" (Distribution Sector, Firm A).

"Some of our pizzas go for £14 in London, but a franchisee operating up north – in Leeds or Liverpool, for example, – would never be able to get that price - £9 is about the most they can hope for." (Fast Food Sector, Firm B).

Local Marketing

Franchisees were able to conduct their own marketing to facilitate local responsiveness. However, all marketing material was approved by franchisors to ensure that the core components of the 'system identifiers' (i.e. the brand image and tradename) were not compromised. Franchisees could use the most appropriate type of marketing (such as leafleting, TV and radio advertisements, promotional brochures) to achieve the most effective results for their local market. For example, some of the service based franchise systems (Personal Service Sector, Firms C and D and Distribution Sector, Firms E and F) which were domestic cleaning services and home delivery services found that local leafleting worked more effectively than local radio advertisements because it was more direct. Both new and existing franchisees within these systems were advised of this by the franchisor, but were free to choose their own marketing strategies. Franchisors also reported that franchisees instigated different promotions. For example, in response to aggressive local competition some of the retail and fast food franchises used 'two for the price of one' promotional offers (Retail Sector, Firms A and E; Fast Food Sector, Firms A, B, C and D) to target consumers.

Franchisees that were part of mature, well-established (even internationally renowned) systems often benefited from the experience of large marketing departments. For example, franchisees in three of the mature Personal Services Sector Firms (A, D and F) needed assistance with generating new marketing ideas and promotions in response to the actions of new competitors offering cheaper services. Marketing officers from the franchisors' head offices were able to assist the franchisees in this instance with new advertising campaigns and promotional literature.

Unlike the mature firms in the sample, in other franchise operations, which were in the early stages of expansion (i.e. roll–out) marketing functions were not necessarily well developed because the firms were new in operation.[3] However, in some of these systems (Retail Sector, Firm C; Fast Food Sector, Firm D; Distribution Sector, Firm E), franchisors went through a process where they learnt from franchisees what marketing ideas and promotions worked (or did not work) effectively in the market place. If the franchisor felt that the ideas were suitable and were not idiosyncratic or specific to local markets, they would be implemented system-wide. This finding is similar to Bradach, (1998) who argues that firms undergo a 'local learning process' with franchisors benefiting from the local responses and experiences of franchisees, which can be valuable for using in the franchise system as a whole (see Exhibit 6.3).

Labour

Franchisees were responsible for recruiting staff, setting wages and setting operating hours. The deployment of staff will largely be dictated by the

[3] However, half of the ten firms in roll out were internationally renowned franchise systems and had the potential to benefit from the support and know-how of the parent organisation or master franchisor in areas such as marketing, financial accounting procedures and recruitment (Fast Food Sector, Firm A; Personal Service Sector, Firms C and J, Industrial and Commercial Sector, Firms A and E).

type of business concept, but the majority of firms in the sample (n=31) had franchise operations which necessitated that franchisees employ staff.[4] However, labour markets vary spatially and temporally in occupational and skill structures. In some cases, franchisees had difficulties recruiting staff with suitable skill levels and so responded to the constraints of their local labour markets by implementing recruitment and training policies to try to combat this problem.

This was evident in some of the professional service based franchise systems (Personal Service Sector, Firms A, B and I; Business-to-Business Sector, Firms A-E) where franchisees required employees to have higher levels of skill or specialised knowledge (for example, in utilities cost management). If franchisees experienced difficulties in recruiting such types of potential employees in their local area, an individual with a lower or different skills base may have been employed but a job specific training scheme would be provided by the franchisee to compensate for skill deficiencies or lack of experience.

In some of the retail firms (Retail Sector, Firms A and D) and in all of the fast food firms (Fast Food Sector, Firms A-E), franchisees had difficulties with recruiting staff in addition to high levels of staff turn over. Such problems are perhaps reflective of the nature of the businesses, as the type of work is low skilled, involving unsociable shift work in traditionally poorly paid roles. To try to combat the difficulties of recruiting staff, franchisees (sometimes with centralised assistance from the franchisors) attempted to adapt and improve recruitment and training policies. In one fast food system (Fast Food Sector B), the franchisor had developed a recruitment policy which assisted with the interviewing process, recommended open days for prospective employees and had set up a job incentive loyalty scheme. Although an employee may start as a delivery driver, the individual could assume other roles and learn different aspects of the franchise and even progress through to the management training scheme. Although such policies were partially successful, franchisees found that

[4] The exceptions were Distribution Sector, Firms A-F and Personal Service Sector Firms D, F and I which were operations that had no obvious need to employ staff, as the franchisee was capable of delivering the end product to the customer alone (products and services such as delivery of greetings cards and dog food and the writing of wills). However, in some of the operations,

if an employee was given a more flexible shift pattern to largely suit the individual and was paid more highly this reduced staff turnover levels. Franchisees also found that advertising in *local* job centres and/or *local* 'free-ad' newspapers was more successful than national recruitment campaigns run by the franchisor. Therefore, while centralised assistance from the franchisor was useful, local responsiveness by franchisees proved to be more effective in devising potential solutions to the constraints of local labour markets.

Franchisors permitted local responsiveness of the peripheral format components for a number of reasons. First, as decentralised organisations franchise systems function with individual franchisees operating at the local level. Therefore, the franchisors in the sample observed that it is the franchisees that are operating at the 'front end' with (in most cases) intimate knowledge of their local markets, which could lead to better product/service market fit and increased revenues. Second, if a franchisee was prevented in being able to utilise their local knowledge in a way that was beneficial for the franchise unit (e.g. to attend to customers, local competitors) by the rigidity of the franchise format this could potentially lead to operational difficulties for franchisees as well as resentment, distrust and conflict between the franchisor and franchisee (Floyd, 2001; Micheal, 1996). Third, the franchise contract permits franchisees the autonomy to exercise local control in some operational aspects (such as pricing, which the franchisor cannot legally control). However, as agency theory contends, the franchise contract also gives the franchisee the economic incentives and motivation to act responsively since it is the franchisee that will be the recipient of the unit's profit (Bradach, 1998).

Franchisees were therefore the local decision-makers, acting responsively and with autonomy in the areas of product-mix, suppliers, pricing, marketing and recruitment to meet with the opportunities and constraints of their operating areas (Figure 6.3). However, franchisors had ultimate centralised authorisation over operational aspects which had potential implications for the core format

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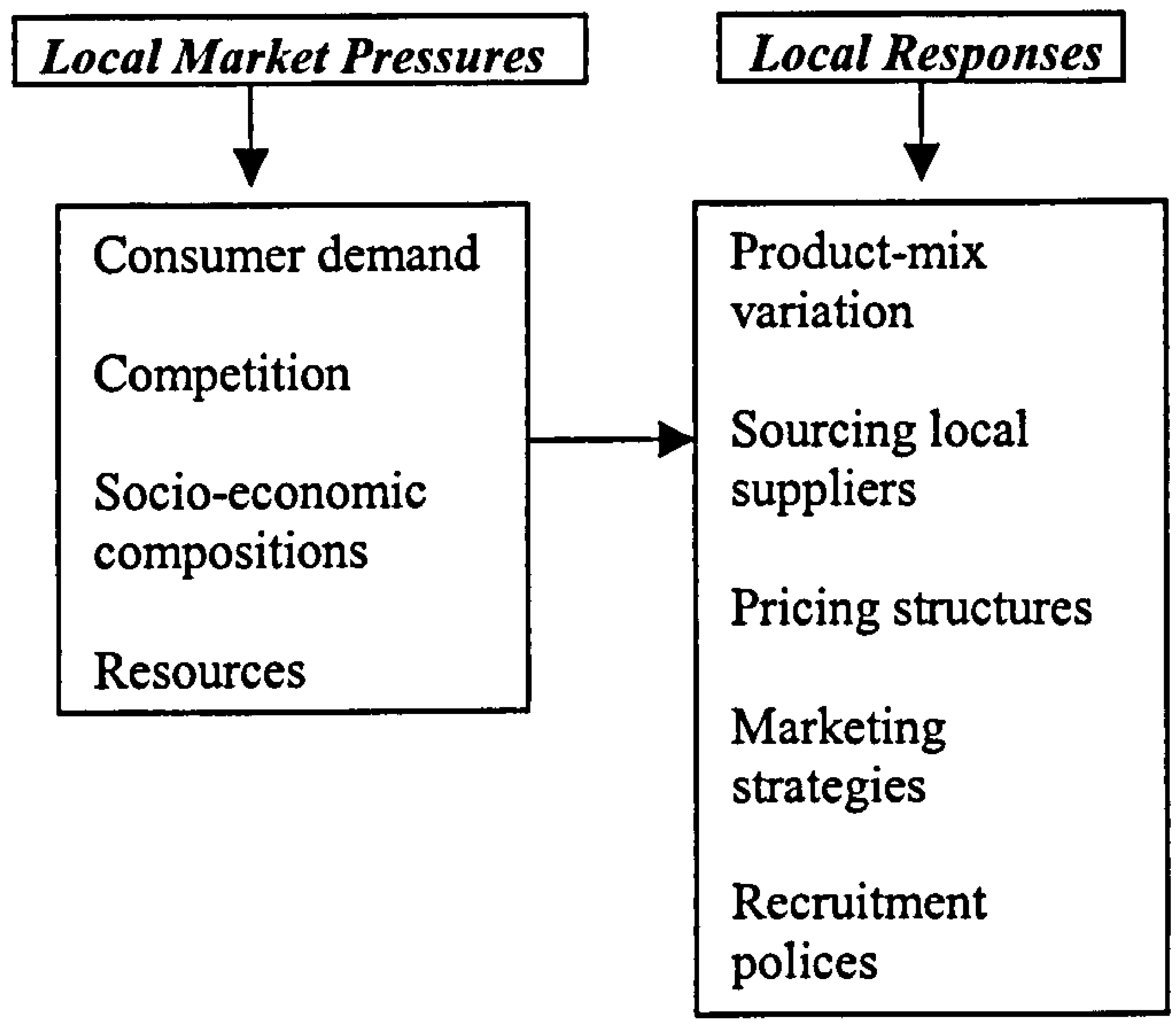
franchisees did instigate the help of spouses or family members, but this help may not have been on a permanent basis or of a salaried nature.

components which affected uniformity and the maintenance of standards (e.g. suppliers and marketing literature).

Figure 6.3 Peripheral Format Component Adaptation in Response to Local Market Pressures



In addition to the local responsiveness of franchisees, a 'top-down' or franchisor-led approach also took place to attempt to assist franchisees with the demands of their local markets. First, as Chapter 5 outlined, despite efforts to minimise spatial variation with the techniques and criteria used to define territories and market areas, some operational areas differed in market potential and constraints and opportunities. If a franchisee had a difficult local market in which to operate (a franchisee could be affected by a territory composed of low socio-economic groupings and high levels of unemployment, for example) which affected successful format implementation and resulted in lower financial returns, franchisors adjusted performance and royalty targets accordingly. Second, some of the location-based franchise systems in the sample (n=10) had units within their networks which were situated in conservation areas (Retail Sector, Firms A and B; Fast Food Sector, Firms A, C, and E; Personal Services Sector, Firms A and J; Industrial and Commercial Sector, Firms B, C and D). To take account of the legal and planning restrictions of such locations, franchisors ensured that the peripheral format components of system identifiers (e.g. unit colour schemes, décor and signage) were responsive and inkeeping to the demands of this type of local market environment. In sum, Figure 6.4 demonstrates Kaufmann and Eroglu's (1998) classification of the core and peripheral components of a franchise format with the addition of the current sample of firms' peripheral format components adaptations as a response to local market conditions.

Figure 6.4 Local Responsiveness and Peripheral Format Component Adaptation – Sample Responses

FORMAT COMPONENTS

ADAPTATION*	**Product/ Service Deliverables**	**Benefit Communicators**	**System Identifiers**	**System Facilitators**
Core	Basic menu Accuracy of work	Clean uniforms Professional certification	System name Trademark Logo	Sales reporting procedure Operating manuals
Peripheral: Franchisee-Determined	***Product-Mix Variation***			***Pricing Structures*** ***Marketing Strategies*** ***Recruitment Policies***
Peripheral: Franchisor-Determined			***Colour scheme*** ***Décor of unit*** ***Signage***	***Royalty/ Performance Payments***

*It should be noted that what might be peripheral in one system could be core to another

SOURCE: Adapted from Kaufmann, P and Eroglu, S (1998) Standardisation and Adaptation in Business Format Franchising, Journal of Business Venturing, 14, pp69-85.

Standardisation of Core Format Components

The preceding section outlined that peripheral format components were adapted in response to local market environment in all franchise systems in the current sample, although the extent to which this occurred varied among firms. However, franchisors generally did not permit adaptation of the core format components. Business format franchising centres on uniformity, consistency and replication of a system. If changes or adaptations to a system distort the core components of a franchise this could negatively affect competitive advantage, brand image, customer association, loyalty and patronage and lead to a loss of control for the franchisor in system implementation. Therefore, franchisors enforced conformity of core format components to ensure successful system implementation. The mechanisms used to enforce conformity are outlined in the following section. However, the emphasis on uniformity and conformity did not mean franchisors were not open to the ideas and innovations of franchisees (some of which had the potential to affect core format components) and this notion is also outlined in the following section. Lastly, variations and adaptations which are caused by franchisee deviation are also discussed.

Monitoring Mechanisms to Ensure Conformity

To ensure standardisation of the core format components, uniformity and conformity were enforced by firms in the sample through the use of monitoring mechanisms. Agency theory contends that franchising is a method which aligns agent effort and compensation in geographically distant markets remote from head office, leading principal monitoring to be minimised. However, as Kirby and Watson (1999) and Shane (1995) argue although monitoring and supervisory costs are lessened they are not completely eradicated. All forty firms in the sample confirmed that monitoring of franchisees was necessary to ensure consistency of franchise formats and that standards were maintained.

Monitoring took a variety of forms and evaluated different aspects of franchisee performance. Confirming Bradach's findings (1998), more formal forms of monitoring centred on financial auditing, on-site/field visits and mystery shopper audits. Financial auditing, which was used by all the firms in the sample, was necessary for monitoring sales and profitability levels and helped to determine royalty rates. Overt field or on-site visits were conducted by the majority of firms in the sample (both location and mobile based operations: n= 36), covert mystery shopper audits were conducted by only a minority of firms (n=5)[5] although both mechanisms were to ensure quality and service levels were maintained. Franchisees would be monitored and inspected (overtly/covertly) on a number of operational aspects such as health and safety standards, sales approaches, quality of product/service offering, layout of equipment within a unit and degree to which format procedures are followed.

A more informal mechanism for monitoring franchisees was through customer feedback, where consumers were able to express their views (complaints/issues/queries) of the franchise through 'telephone hotlines'. Although this mechanism was used by only a small number of firms in the sample (n=3: Fast Food Sector, Firm B; Personal Services Sector, Firm D; Distribution Sector, Firm F) the mechanism served as an informal way of monitoring the quality and service of the product/service offering.

The frequency of monitoring varied and depended upon the type of mechanism that was being used. Financial auditing occurred either monthly or yearly; field visits and mystery-shopper audits were conducted at monthly, bi-monthly or six-monthly intervals. The mechanisms that were used by the firms in the sample for the monitoring process differed in some instances by sector of operation, type of operation (location/mobile-based), life cycle stage and the method used to franchise. One sectoral difference in the types of mechanisms that were used was that the retail and fast food systems were the only firms to conduct mystery shopper audits, a mechanism which is perhaps most suited to these types of operation.

Use of the field/site visit mechanism varied between the two types of operation (location/mobile-based) as location-based franchisors used the mechanism to monitor franchisees more prominently than mobile-based

[5] Mystery shopper audits were conducted in the Retail and Fast Food sectors only (Retail Sector, Firms A, B and E; Fast Food Sector, Firms B and C).

franchisors. Location-based operations necessitate site visits as franchisees must be monitored on the presentation, layout and hygiene of a unit, for example, as this can affect the image and brand representation to the consumer: a poor unit may affect return patronage. Therefore, all 24 location-based operations in the sample conducted on-site visits of franchisees. However, some mobile-based operations (n= 10: Personal Sector Firms, C, D, E and F; Distribution Sector, Firms E, G, H, I and J and Business-to-Business Sector, Firm B) also conducted visits of franchisees at depots or out in the 'field' servicing customers, for example. The remaining six mobile-based operations (Personal Services Sector Firm I; Distribution Sector, Firms A, B, C, D, and F) were operations where there was no permanent base from which to run the business (i.e. the franchise was run from a franchisee's home, as in the case of all four greetings cards franchises and the home delivery pet food and will writing franchises). However, two of the franchisors (Distribution Sector, Firms A and F) conducted field/site visits and inspected the franchise operation at a franchisee's home (with the franchisee's consent) to check on stock and to monitor progress, as this was often the most convenient place to conduct such a task. The remaining four firms did not conduct field visits as a monitoring mechanism.

Depending upon life cycle stage, there were differences in the infrastructure and number of support staff a franchisor had to undertake field/site visits. Some of the firms in consolidation and maturity had up to 70 support staff to assist in the management of networks and the monitoring process. In contrast, firms in roll out had, on average, only six support staff for the same purpose. However, younger, smaller networks do not need such highly developed support systems when networks are not extensively developed or complete (the most units a franchisor was supporting for firms in roll out was 73 (Business-to-Business Sector, Firm E)), whereas support staff were monitoring up to 430 units in one firm in the maturity stage (e.g. Personal Services Sector, Firm F).

A final difference in the sample of firms is that the method used to franchise affected the monitoring process. For the four firms which used the area franchise method (Retail Sector, Firm A, Fast Food Sector, Firm A; Personal Services Sector, Firm J and Industrial and Commercial Sector, Firm A) an additional level of management for implementing monitoring mechanisms was necessary. As Chapter 2 outlined, employees and managers of area/multi-unit operations will not have the same financial incentive as a franchisee and may consequently shirk in their efforts (Bates, 1998; Price, 1997). Whilst franchisors monitored area franchisees, it was also necessary for the area franchisees to monitor employees/managers. Area franchisees used the same mechanisms (financial auditing, site visits and mystery shopper audits) that the four area franchisors used to monitor them, to assess level of conformity and level of standard.

Other, more informal mechanisms for encouraging conformity and achievement of standards focused on some form of award systems and/or league tables for franchisees, which almost half the firms in the sample implemented. Additionally, field/site visits were not only used for monitoring franchisees but to also provide encouragement, support and assistance for franchisees if they were experiencing a problem or difficulty in operation. However, if franchisees were not conforming to the franchise format and/or not reaching required standards, there were a number of options the franchisor could take depending upon the severity of the deviation/action by the franchisee. Informal discussion meetings were the favoured option by the majority of franchisors, as this could often resolve any difficulties or issues franchisees may have. More formal written warnings and penalisation/fines were the next stages if franchisees still did not conform. If the severity of the action warranted such an approach termination of the franchise contract (or threat of termination) was the last stage franchisors used to invoke conformity (although the majority of franchisors commented that this rarely happened, usually the threat of termination ensured improved levels of conformity and standards).

Idea Generation and Core Format Component Adaptation

Franchisors have to balance the two strategic management imperatives of format uniformity and format adaptation. As discussed in Section 6.2 uniformity is imperative to ensure a system's competitive advantage is not eroded: but adaptation of peripheral format components is imperative to ensure franchisee responsiveness and better product/market fit in local markets:

> *"innovation and adaptation are essential for survival the same as the stable image which the franchise concept represents is essential for the integrity and mass promotion of each system* (Dandridge and Falbe, 1994, p42).

It is important, therefore, that uniformity does not stifle creativity and idea generation, and the quotes in Exhibit 6.3 testify that franchisors in the current sample were open to the ideas put forward by franchisees. Generating new ideas/innovations and new operational practices may greatly improve many aspects of a franchise operation, particularly if ideas originate from franchisees, all of whom will be working at the local level and putting the franchise format into practice on a daily basis (Dandridge and Falbe, 1994; Falbe and Dandridge, 1992; Price, 1997; Tuunanen and Hyrsky, 2001).

Exhibit 6.3 Seeking New Ideas in Franchise Systems – Sample Responses

"if you don't innovate, then the system will die" (Personal Service Sector, Firm E)

"a franchisor doesn't necessarily have all the answers" (Personal Service Sector, Firm F)

"we have 70 odd franchisees working out there day to day, they feed back to us almost daily. We don't always agree...but it is a very important part of what we do. If we don't innovate, we are dead" (Distribution Sector, Firm E)

"they are at the 'coal face', dealing with customers on a day-to-day basis. So they know what is going on in their area better than ewe do. So yes, we listen to their suggestions" (Industrial and Commercial Sector, Firm A)

"we are pretty open to be honest, we don't have the monopoly on good ideas...it is also a way for franchisees to add value back into the system. For us, it is part of using the network to its full extent" (Fast Food Sector, Firm C)

Channels for encouraging and fostering new ideas and innovations ranged from informal discussions with support staff to more formal local, regional and national meetings, which the majority of firms in the sample used. A minority of firms (n=10) also used competitions to generate new ideas and held award ceremonies with cash prizes to rewarded the best ideas (Retail Sector, Firm D; Fast Food Sector, Firms A, B and C; Personal Services Sector, Firm A and J;

Distribution Sector, Firms A, I and J and Industrial and Commercial Sector, Firm C). A small number of the older franchisors in the sample (n=4) additionally had formal committees with franchisee involvement (Retail Sector, Firm D; Fast Food Sector, Firm C; Personal Services Sector, Firms D and E). For example, franchisees participated on advertising, personnel training and product development committees to assist franchisors in the future development of their formats.

Whilst all the franchisors in the sample were willing to listen to franchisee ideas and even reward the best ones, this did not equate to every idea/innovation being implemented within systems. Franchisors actively constrained local responsiveness and enforced conformity[6] if it was idiosyncratic to a particular market or location and if (unlike peripheral format adaptation) it eroded the integrity of the core format components and system uniformity unnecessarily.[7] Conversely, if a franchisee devised and proposed an idea, innovation, modification or adaptation to a franchisor, which although affected core format components, had the potential to improve or be beneficial for format implementation, such an idea may be developed and rolled out system-wide. However, firms in the sample undertook a number of formal processes before the implementation of a new system-wide format innovation occurred, as innovations which are not suitable may be detrimental to a franchise system and result in a firm losing customers and money. Therefore, the first stage in the process was that franchisees could propose new ideas, innovations and adaptations through the channels outlined above. Second franchisors would trial the new idea/innovation/adaptation (normally among a small group of franchisees) to test viability and idiosyncrasy and third, the innovation would be reviewed and assessed on suitability for system-wide implementation.

[6] achieved through the monitoring mechanisms and penalisation schemes outlined in the preceding section

[7] For example, franchisees in one of the fast food systems (Fast Food Sector, Firm D) attempted to add new menu items and a delivery franchisee (Distribution Sector, Firm I) offered additional delivery services to the core parcel collection and delivery service. Both innovations were not approved by franchisors as it was considered the adaptations eroded system identity and detracted from the core product/service offering.

Within the current sample, only a small number of firms (n=9: Fast Food Sector, Firms B, C; Personal Services Sector, Firm E, I; Distribution Sector, Firm A, E and G; Industrial and Commercial Sector, Firms C and D) stated that some franchisees had proposed new ideas/innovations, which led to system-wide adaptation, although the ideas were not necessarily in response to local market pressures. The majority of new ideas focused on improved ways of operating a system (e.g. production ideas, successful marketing campaigns, IT developments) which led to changes in the operation system and operational manuals: i.e. the core format system facilitators component. However, in a minority of firms (Fast Food Sector, B and Distribution Sector, Firm A) innovations which were adapted system-wide focused on the core product/service deliverable component. For example, in Fast Food Sector, Firm B, a multi-unit franchisee had secured a deal with a soft drinks manufacturer and distributor and sold the product in its units. Although this innovation had initially started as a peripheral format component adaptation (adding different items to the product menu), the idea of promoting soft drinks with its core product offering appealed to the franchisor. The innovation had proved successful in its 'trial test phase' with the multi-unit franchisee and so a deal was secured nation-wide with the soft drinks manufacturer and distributor to promote the innovation system-wide.

A franchisee in the second system (Distribution Sector, Firm A) invented a display stand for storing cards and wrapping paper which was easy to construct, took up little room and was relatively inexpensive to manufacture. Implementation of this innovation system-wide also led to core format component adaptation, as the franchisor began to produce and distribute its own wrapping paper as a core service offering. It is evident, therefore, that in some of the franchise systems within the sample, franchisees originated ideas/innovations, but they necessitated central ratification (i.e. franchisor approval) if they were implemented system-wide.

Format Variation and Franchisee Deviancy

Difficulties may arise for the franchisor if a franchisee implements an idea/innovation which affects core format components and erodes system uniformity and brand value unnecessarily. Significantly, the format variation/deviation which is implemented by the franchise is not as a result of local market initiative, but rooted in motives which may be damaging to the overall system and has no justifiable reason for implementation. The variation/deviation may also incur costs (financial, brand consistency, customer patronage) to the franchise and other franchisees in the network. Although a franchisor may enforce conformity through monitoring mechanisms, a franchisee may proceed regardless with the deviation. While agency theory contends that franchising can resolve some of the incentive problems of agent (franchisee) effort and compensation, the perspective is not able to account for problems resulting in *misdirected* effort or franchisees which 'free ride' on the efforts of other franchisees in the network by cutting corners to save costs, for example (Kaufmann and Eroglu, 1998; Shane, 1996).

The franchisee is a factor which had been discussed within the academic franchise literature as another variable which can affect format implementation and standardisation (Bradach, 1998; Dandridge and Falbe, 1994; English and Hoy, 1995; Falbe and Dandridge, 1992; Kaufmann and Eroglu, 1998; Michael, 1996; Price, 1997; Rosenbloom, 1995).[8] A number of firms in the current sample (n=15) acknowledged that the franchisee was a factor affecting format variation and standardisation, as Exhibit 6.4 highlights. However, it is not the focus of this chapter to examine the effect of the franchisee on format standardisation, as this is a separate debate; rather the chapter has sought to examine the role of local geographical environment on format variation and standardisation.

[8] The literature has typically focused on franchisee personality traits/characteristics and assessed what 'type' of franchisee (e.g. 'conformist', 'independent', 'entrepreneurial') a franchisor should recruit to ensure successful format implementation.

Exhibit 6.4 Format Variation as a Result of Franchisee Implementation - Sample Responses

"People buy a system and then want to reinvent the wheel. They get distracted and don't spend too long on following the system. We try and persuade them the value of doing it [our] way…" (Personal Services Sector, Firm C)

"We do get franchisees who don't follow procedures if they don't we may end up going our separate ways" (Distribution Sector, Firm B)

"The successful franchisees are the ones who follow the rules and do as the training tells them to do" (Distribution Sector, Firm C)

"Franchisees have to work to a system, it is all operated through the manual, franchisees have to work to a format, you can't run this with creative thinkers" (Distribution Sector, Firm H)

"If you aren't going to follow it – don't buy it" (Business-to-Business Sector, Firm E)

6.3.3 Box 1 – Core Format Components Change

There were no firms in the sample that were located within Box 1 in the Format Standardisation/Adaptation Model. For firms which may be located in this category, the pressures to localise are high but the pressures to standardise are low (see Figure 6.2). Or in other words, in such circumstances the franchise format offers the franchisee no competitive advantage in their local operating environment (because of the constraints, demands and opportunities of local markets) and may be failing. Therefore, it may be necessary for the franchisee, with the co-operation of the franchisor, to invoke local strategic responses and adapt all or some of the core format components in order for individual unit and franchise system survival.

Stages in the life cycle may be a factor affecting the adaptation of core format components. Firstly, young firms in the initial or roll out stages of expansion may not have clearly defined or established core format components and there may be ambiguity over what elements of the core format are sacrosanct. As Bradach (1998) also observes, in smaller, less well-know franchise systems, deviations from uniformity may be greater than in well-established systems but this may have minimal impact of the performance of the unit as there is no consumer expectation of the product/service offering. Franchisees may, therefore, make significant contributions to the development of the format in the early stages of expansion. Although firms in the current sample were positioned in Box 2 at the time of interview, some firms (n=16) acknowledged that in early stages of development (i.e. initial and roll out) their position within the standardisation/adaptation model was in Box 1 (see Exhibit 6.5). Franchisee involvement in core component adaptation and format development was only evident in firms which were domestic systems (i.e. formats originated in the UK). Format adaptation and development did not occur in firms that were international concepts in origin (n=15), as such types of formats were well established before being rolled out in the UK.

Exhibit 6.5 Early Life Cycle Stage Core Format Component Adaptation – Sample Responses

"In the early days, we actively sought the franchisees opinions and they fed back to us their ideas...they helped to develop this business into what it is" (Retail Sector, Firm C)

"Our format has definitely improved and developed over time" (Retail Sector, Firm E)

"We listen to anything being a new franchise operation and we are still learning...we are perhaps more adaptive than other franchisors and we listen to our franchisees" (Fast Food Sector, Firm D)

"Our franchisees have driven quite a lot of what's new in the franchise" (Personal Service Sector, Firm J)

"Some of our earlier franchisees drove this business forward, they contributed to how the business was set up, what should be in the manual, the types of cards we should be producing" (Distribution Sector, Firm A)

"In the early days, it happened almost everyday, where franchisees came up with new ideas and we encouraged it and that helped the development of our format by taking on board their ideas and innovations. It was, and is, an important part of what we do" (Distribution Sector, Firm E)

Secondly, firms in the consolidation and maturity stages may also find that core format component adaptation is necessary if the franchise system loses its effectiveness through changes in its environment (e.g. competitive, technological, legal or market related) and the competitive advantage that once defined the system no longer does so. Although this had not occurred in any of the firms in the current sample, a franchisor may have to alter its strategic positioning and change the core format components to remain competitive or to survive (Bradach, 1998; Kaufmann and Eroglu, 1998). Therefore, it is evident that core format adaptation may occur at any point in the life cycle of a franchise system from the initial to maturity stages. However, a firm's positioning within this category may only be transitional. For example, a firm may start in Box 1 in the initial stage of expansion but move across to Box 2 in the roll out stage as it begins to clearly define the core components of its format after the initial operational experience and franchisee input has been gained. Or a firm in the maturity stage may improve its product/service offering to abate competitors, enabling the firm to re-establish itself in the market place. Therefore the firm effectively moves from Box 2 to Box 1 to Box 2 again.

6.3.4 Box 3 – Franchise Has No Market

There were no firms in the sample that were currently located in Box 3 in the Format Standardisation/Adaptation Model. However, a number of firms in the sample (n=15) were located within this category at earlier stages (initial/roll out) of development. If the pressures to localise and standardise are both low (see Figure 6.2) a franchise format effectively has no market. Or in other words, in such circumstances the franchise is situated in the wrong location or territory, as there is little or no market demand for the franchise product/service offering. Chapter 5 outlined that territory/market area definition and siting of units are important tasks for a franchisor to undertake successfully. Particularly in the early stages of expansion, the 15 firms admitted that mistakes were made with some locations and that unsuitable locations/territories led to severe operational difficulties in format implementation, and even failure, for some franchisees and units. However, with operational knowledge and experience, this occurred less frequently in latter development stages.

6.3.5 Box 4 – No Format Adaptation Occurs

There were no firms in the sample that were located in Box 4 in the Format Standardisation/Adaptation Model. If the pressures to standardise are high but the pressures to localise are low no format adaptation (either of the core or peripheral components) will occur (see Figure 6.2). Or in other words, in such circumstances there is little pressure (constraints/opportunities) within local markets making format adaptation necessary. As discussed in Section 6.3.2, all firms in the sample are located in Box 2, where adaptation of peripheral format components occurred in response to the demands of local market environments. While franchisees were given some flexibility to be able to respond locally, this did not mean that *all* franchisees within a franchise system will necessarily experience pressures in their local markets and have the need to adapt a franchise format.[9] Therefore, such franchisees may be located in Box 4 in the standardisation/adaptation model whilst their franchisor may be positioned within Box 2.

6.4 Conclusions

Identification of the core and peripheral elements of franchise format components has important implications for understanding a franchisor's standardisation strategies. The conceptual model developed in this chapter also has important implications for understanding the circumstances in which it is necessary to enforce standardisation and conformity to format components and the circumstances in which it is necessary to adapt format components (core or peripheral).

Firms in the current sample confirmed that local geographical environment was a factor affecting format implementation and standardisation. Local markets varied in consumer demand, socio-economic compositions, competition and resources. The conditions (constraints/opportunities) of local markets were pressures which affected format implementation. However, franchisees could respond locally by adapting the *peripheral* elements of format components. Adaptation occurred mainly in the 'system facilitators' component (elements which are largely unseen to the consumer, but which are the infrastructure of a franchise system ensuring effective operation) but also in the product/service deliverables component. Franchisees could act locally and responsively by

[9] However, it was not part of the research design to interview franchisees and so it was not

varying product-mix, setting prices competitively and implementing local marketing campaigns and recruitment policies to suit local market conditions.

Franchisors permitted adaptation of the peripheral elements of format components as the overriding benefits of modification enhanced format implementation. Franchisors enforced conformity to the format if a franchisee's attempts at adaptation distorted the core elements of format components, negatively affecting competitive advantage, brand image and customer patronage. Conformity was enforced through monitoring mechanisms (e.g. financial audits, site/field visits) and penalisation schemes (e.g. informal meetings and formal written warnings). There was some evidence within the sample that adaptation of core elements of format components occurred, but this was not as a result of pressures of the local market environment; rather this was as a result of the franchisee. Franchisees may have proposed a new idea/innovation which had the potential to affect core format components (in a positive way) or the franchisee was deviating from the format (which had the potential to affect the core format components in a negative way). Therefore, the first conclusion is that the circumstances in which the pressures to standardise *and* localise (i.e. meeting the demands of local markets) are both high, format adaptation of the peripheral elements of format components and standardisation of the core elements of format components will occur. Standardisation of the core format components will satisfy the franchisor, as competitive advantage will be maintained and adaptation of the peripheral format components will satisfy the franchisee by allowing local responsiveness and effective format implementation.

The second conclusion is that the standardisation/adaptation model illustrates the transitory nature of format development. Whilst the sample of firms were *currently* located in Box 2 of the standardisation/adaptation model ('Peripheral Format Components Change') at earlier development stages firms' positioning in the model differed. As Chapter 4 outlined, the majority of firms in the sample are in the consolidation and maturity stages of the franchise system life cycle.

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possible to test the responses and actions of franchisees on this matter.

Therefore, as these firms had formats that had been developed and operating successfully for several years, adaptation of the core elements of format components is likely to be unnecessary as competitive advantage (brand image, core product/service offering) is well established in such types of systems. However, a number of firms in the sample had been positioned within Box 1 ('Core Format Components Change') in the initial and roll out stages of development as core format components were not clearly defined or developed. Other firms in the sample had been positioned in Box 3 ('Franchise Has No Market') in early development stages as through a lack of operating experience, locations/territories were chosen which were unsuitable for franchise development.

Chapter 7 Conclusions, Implications and A Future Research Agenda

7.1 Introduction

The purpose of this concluding chapter is to summarise and discuss the main findings of the thesis in light of the research questions that have underpinned this exploratory study. The chapter then moves on to discuss the implications of these findings for both the academic and practitioner audiences. Suggestions are made regarding the ways in which our theoretical understanding of franchising might be improved by the findings of the study. Suggestions are also made for the potential, new or existing franchise operation regarding the expansion and restructuring processes and the format standardisation/adaptation issue which may aid successful operation. Finally, questions arising from this study are used to propose direction for future research efforts.

7.1.1 Justification for Research

The increased economic significance and international scale of franchise activity since the post war period (as outlined in Chapter 1) has led to a burgeoning academic literature of this organisational form. However, Chapter 2 identified that the academic franchise literature is limited in its disciplinary and topic focus. While certain issues have been extensively examined (e.g. why firms franchise, the internationalisation of franchise activity) other aspects of franchising are less well understood. This thesis aimed to partially redress this imbalance by comprehensively examining new research issues. It has been argued throughout this thesis that there are inherently geographical aspects to franchise activity. Therefore, a number of geographical dimensions of business format franchising have been examined, across a broad range of sectors of activity.

7.1.2 Summary of Research Findings

In Chapter 2, a number of questions were posed which underpinned the basis of the research undertaken in this thesis. To summarise the key findings of the study, each of these questions will be addressed in turn.

- **Why do firms use franchising to achieve expansion?**

As Chapter 4 outlined, the majority of firms in the sample franchised operations because the method enabled access to vital resources (the financial and human capital of the franchisee), which facilitated rapid organisational and spatial growth; a finding which supports the resource constraints theory of franchising. Only a small minority of firms identified agency-related factors as the reason for franchising – agency theory is the alternative theoretical explanation for franchising. According to these firms, using franchisees as unit operators enabled access to highly motivated individuals which translated into greater levels of commitment and service compared to employees or managers. Such benefits arose because the franchisee has a vested interest in making the unit successful because of capital invested in the business. However, a number of firms (37.5%) maintained that it was for *both* resource and agency related advantages that franchising was used as a strategy for achieving growth. Having access to financial resources to fund expansion *as well* as access to highly motivated unit operators was what made franchising a particularly attractive option for these firms.

- **How do franchisors achieve spatial expansion – what strategies and methods are used to achieve growth?**

The findings in Chapter 4 suggest that spatial expansion occurred over four identifiable stages - the spatial expansion life cycle - with each stage characterised by key expansion processes. The first stage is the initial stage of expansion, which is characterised by piloting the franchise operation and the establishment of the first few franchises. Pilot operations were established by two-thirds of the sample, indicating that the majority of firms in the sample considered it important to test the franchise concept before embarking upon roll out. The remaining firms did not pilot the franchise because firms had previously operated company-owned units, or because firms had immediately expanded on a national scale. Whilst operating without a pilot unit initially caused some teething problems for firms, this did not affect long-term viability.

Initial expansion strategies were either geographically focused around the home base of the franchisor or centred on achieving nation-wide growth.

The second stage of the spatial expansion life cycle is roll out. This stage is the main period of expansion, where firms determine the strategies and methods which are used to achieve nation-wide expansion. Three main strategies were identified. Almost half the sample used pro-active franchisor-led strategies to expand. The majority of the sample used reactive franchisee-led strategies and a small number of firms used a mixture of both expansion approaches. Single unit operators was the main method facilitating expansion, but a small number of firms used the area franchise method at roll out.

The third stage of the expansion life cycle is consolidation, a stage characterised by strengthening and reinforcing networks by filling locational gaps. As with the previous stage of expansion, strategies that were used for the infilling process were determined by the franchisor, the franchisee or a combination of both. Altering the method of franchising facilitated the infilling process, as existing franchisees became multi-unit franchisees and operated new units. The last stage of the spatial expansion life cycle is maturity. This phase is characterised by a process of managing and maintaining franchise networks. Therefore, firms dealt with a number of strategic and operational issues from restructuring and reorganising, to seeking new expansion opportunities external to the franchise network.

- **What techniques and criteria do franchisors use to define and delineate operational areas and locate franchise units?**

Franchisors defined operational areas by either formally allocating territories with set geographical boundaries or licensed units to franchisees and defined market areas in which to situate units. Techniques used to define operational areas utilised a range of demographic data and market information (e.g. population and business counts, postcode data, socio-economic groupings, geographical and visual assessments, communication networks). This finding confers with the advice given to potential franchisors for territory definition in the practical 'How To' literature (see for example, Barrow *et al.,* 1999). The micro-siting techniques for locating franchise units for location-based operations centred on footfall and traffic flow measurements and site characteristic surveys (such as visibility, type of location, ease of access and level of competition). The techniques and criteria used to define operational areas helped to ensure viable territories and/or suitable locations for franchise units, although for some firms successful territory/market area definition was something that was only learned over time.

However, the difficulty with defining operational areas is that this is a static process which is undertaken at one point in space and time at the early stages of expansion. Markets are dynamic not static and original territory/market area delineations may be subject to change over time as demographics shift and the franchise format becomes better known. Thus, there may be opportunities to establish additional units in a network if market potential extends beyond original expectations. The consequence of this, however, is that original operational areas may need to be redefined and restructured in latter development stages.

- **How common is it for firms to undergo network restructuring and does network design and allocation affect the restructuring process?**

Original definitions of operational areas altered for over half the firms in the sample as the systems experienced changes to market penetration levels in the consolidation and maturity stages of the expansion life cycle. (The remaining firms in the sample were still in the early roll out stages of expansion). Thus, it was necessary for the majority of these firms to restructure the basis of networks as new expansion opportunities occurred over time. However, the three network allocation models identified in Chapter 5 had different contractual and operational implications for the restructuring process and the ability of a firm to add new units to a network over time. In contractual terms, firms in the first group (networks allocated on the basis of exclusive territorial networks) could not add new units to networks until franchisees' contracts had ceased or were due for renewal because of the exclusive territorial contractual obligations. For firms in the second and third groups exclusivity was not a contractual obligation and in legal terms, firms could implement restructuring schemes, alter franchisees' territories and add extra units to established operational areas during the term of existing franchisees' contracts.

However, the contractual form of the network was not necessarily a reasonable guide to the operational behaviour of a firm or group. In operation, the firms in the second group (non-exclusive territorial networks) did not act upon the full contractual flexibility afforded to them by the terms of their contracts. Whilst a non-exclusivity clause entitled a franchisor to at least, in theory, alter and add extra units to a network, in operation, implementing this process was difficult because existing franchisees and existing territorial allocations were given precedence. Therefore, network restructuring did not take place until the contract renewal period or contracts had ceased because the franchisors in this group maintained an ethical obligation towards existing franchisees. As firms in the third group had not constrained growth and development opportunities by allocating exclusivity and territories, new units could be added to networks as opportunities arose. However, in some instances, the introduction of new units caused an initial encroachment of existing franchisees' units. Thus, in operation, the franchisors in this group modified their behaviour with the actions and measures that were taken in order to minimise the effects of potential encroachment and to minimise any potential conflict which could occur. Firms in both the second and third groups illustrate, therefore, that there is a divergence between the contractual and operational behaviour of a firm regarding the restructuring process, findings reiterated in other operational contexts of franchising (e.g. Curran *et al.*, 1984; Stanworth, 1995).

- **How do franchisors resolve the network restructuring problem: what mechanisms or policies do franchisors use or have in place to facilitate the restructuring process?**

All three network allocations affected the restructuring process. The consequences of not acting upon new market opportunities may have resulted in network gaps being open to exploitation by other franchised and non-franchised systems, leading such firms to gain competitive advantage. In the opinions of the franchisors, this would have been detrimental to networks. Thus, it was important that firms filled market gaps and developed new market potential. The franchisors therefore utilised a number of mechanisms and policies to facilitate the restructuring process.

Firms in the first and second groups which had the contractual and 'ethical' obligations of exclusivity and/or the geographical constraints of territories utilised either the multi-franchisee mechanism or had the policy of buying-back territories through a process of negotiation and compensation to enable network restructuring to occur during the term of existing franchisees' contracts. However, these reactive mechanisms were not necessarily effective in all situations. Not every franchisee was capable or indeed willing to take on additional units and territorial buy-backs necessitated financial and managerial costs. The mechanisms that were used by firms in the third group (networks without territories or exclusivity) were to minimise the potential conflict that could be caused by new unit expansion. Thus, firms instigated franchisor-franchisee discussion groups or used retail models to assess the impact of new unit introductions on existing franchisees. Measures (such as compensation) would be taken if a new unit had an initial negative affect on an existing unit. Multi-unit franchisees and corporate units were also used as mechanisms to facilitate the network restructuring process by firms in the third group.

- **Does local geographical environment affect format implementation?**

Business format franchising operates on the principle of replicating tried and tested business formulas in different locations (Julian and Castrogiovanni, 1995). Standardisation and uniformity are important for ensuring successful format implementation and system and brand integrity. However, local geographical environment can be a factor affecting format implementation, although there has been little acknowledgement of this in the academic literature. Firms in the current sample confirmed that local geographical environment affected format implementation and standardisation. Local markets varied in constraints and opportunities and factors such as consumer preferences, socio-economic compositions, degree and type of competition and the availability of resources affected format implementation.

- **To what extent will a franchisor permit local market responsiveness before format conformity is enforced?**

Franchisors permitted local responsiveness of peripheral format components. Peripheral components are defined as those which are less central and important to the format (as opposed to the core elements, which are those where standardisation must be enforced as they are considered indispensable to a system's survival). Franchisees could act in response to local market conditions and format adaptation occurred in product-mix variation to suit consumer preferences, setting prices and implementing local marketing campaigns to compete with other local operations and devising recruitment policies to suit local labour markets. Franchisors permitted adaptation of the peripheral format components as the overriding benefits of modification led to enhanced format implementation and operation. However, conformity to the franchise format was enforced if adaptation distorted the core elements of format components and affected competitive advantage and brand integrity. Monitoring mechanisms ensured conformity and uniformity of the core format components.

7.2 Research Implications

7.2.1 Theoretical and Methodological Implications

The findings of this thesis make significant contributions to our understanding of franchising and adds to a number of key theoretical debates in the academic franchise literature.

Theoretical Contributions

The spatial expansion life cycle model, developed in Chapters 4 and 5, provide the conceptual framework in which to understand and observe empirical regularities and generalisations of the spatial expansion process of franchise systems. Chapters 4 and 5 are the first therefore, to provide systematic evidence of franchise system expansion in the UK and in so doing the chapter contributes to not only the franchise literature, but also the geographical and organisational studies literatures. In Chapter 4, the life cycle model assessed how franchise operations achieve expansion by examining the strategies and methods which are used to grow and develop over time. Previous academic literature, which has examined this issue, is limited in nature as it focuses only on the patterns of spatial expansion and not the *processes* (i.e. the decision making processes of the franchisor and the franchisee) causing those patterns.

Chapter 5 contributed to new insights regarding the network allocation and the network restructuring processes. The first insight of Chapter 5 aids understanding of the criteria and techniques used to define territories and market areas, an issue, which although well established in the 'How To' literature, had yet to be examined by the academic literature. The second insight of Chapter 5 is that territory/market area definition is something which is subject to change over time, often making network restructuring necessary. Identification of the three network allocation models (exclusive territories, non-exclusive territories and networks allocated with neither exclusivity or territories) illustrated the different contractual and operational implications of each network allocation for the network restructuring process and the mechanisms which are necessary to facilitate the restructuring process in each allocation. The spatial expansion life cycle therefore captures the dynamic nature of spatial development, demonstrating that decisions which are made earlier in development regarding network allocation has important implications for latter stages of expansion and network restructuring.

Chapter 6 has made significant contributions to the academic franchise literature and enhanced our understanding of the factors and circumstances which can affect franchise format implementation and standardisation. Although the format standardisation issue has been explored to some extent within the academic literature, this has largely focused on an international scale and format standardisation at the national or local levels has not been rigorously explored within the UK. Chapter 6 demonstrated that local geographical environment is a factor affecting format implementation and franchisors' standardisation strategies. The standardisation/adaptation model developed in Chapter 6 demonstrates the circumstances in which standardisation or adaptation of the core or peripheral elements of format components occur according to local market pressures. The model also links with the life cycle and shows the transitory nature of format development, illustrating that firms may be positioned at different points on the model with either format standardisation or adaptation occurring more frequently according to life stage and local market pressures.

In addition to the three key contributions of this thesis, a number of findings from each of the results chapters also contribute to the main theoretical debates of the existing franchise literature, which were outlined in Chapter 2.

Definitional Debates

The prevalence and use of multi-unit franchising by firms in the sample - evident in growth strategies and restructuring mechanisms - provides support for Hoy *et al's.,* (2000) and Kaufmann and Dant's (1996) contention that 'multi-unit franchisees' (including area franchisees) should be included in future definitional debates of franchising. Excluding this type of franchisee and method of expansion fails to capture the full diversity of franchise activity:

> *"[t]heory that is based on the convenient fiction of single-unit fully franchised chains will not answer all of the complexity surrounding modern franchising. Multi-unit franchising (in all its forms) must be incorporated into franchise theory"* (Kaufmann and Dant, 1996, p356).

Why Firms Franchise

Agency theory has largely assumed predominance in the academic literature as an explanation for why firms use franchising to expand. However, the findings presented in Chapter 4 illustrate that the majority of firms in the current sample used franchising because of resource constraints reasons, emphasising that this theoretical perspective should not be discounted by the academic literature. However, a number of firms in the sample used franchising for both resource *and* agency related reasons, illustrating that a combination of both theoretical perspectives can lead to greater insights into the reasons why firms franchise. The life cycle model also demonstrates that Oxenfeldt and Kelly's (1968) contention - that franchising is used only as a short-term development strategy to gain access to valuable resources in early growth stages – did not occur. The majority of firms in the sample had reached the consolidation and maturity stages and intended to continue operating as franchise networks.

The disadvantages of franchising are less well established in the literature than the advantages, therefore Chapter 4 contributes to this debate by outlining two key disadvantages identified by firms in the sample. First, compared to other forms of organisation, franchisors recognised that operating as a franchise returned lower levels of profit, as this had to be shared with franchisees. Second, franchisee autonomy sometimes led to management difficulties for franchisors. As Chapter 6 demonstrated franchisees may be deviant and not follow franchise formats to franchisors' specifications and may mis-represent the brand at a local level. Although agency theory contends that franchising will be a method used to align agent effort and compensation in geographically distant markets remote from franchisors' head offices leading to principal monitoring to be reduced, Kirby and Watson (1999) and Shane (1995) argue that monitoring is not totally eradicated. Indeed, the findings in Chapter 6 provide support for this contention, as franchisors used a number of policing mechanisms to monitor franchisees.

Franchisor-Franchisee Relations - Conflict

It is proposed in the academic franchise literature that there is potential for conflict to arise between a franchisor and a franchisee regarding system development over time as encroachment and cannibalisation may occur with the addition of new units to a network. However, this contention is not supported by the empirical findings of Chapter 5, which identified that there is a divergence between the contractual and operational behaviour of a firm. In operation, some of the firms did not act upon their legal rights (i.e. non-exclusivity clauses) to add new units to a network if encroachment and conflict were the outcomes. According to these franchisors, such actions went against the ethos of a franchise network: instead alternative solutions (i.e. restructuring mechanisms) were sought, to enable new unit development. The literature also identifies that conflict may occur if the uniformity and rigidity of the franchise format constrains a franchisee's ability to meet with the conditions of their local operating environment. However, Chapter 6 illustrated that the firms in the sample permitted adaptation of peripheral elements of format components to enable local responsiveness, thereby minimising the potential for any conflict between the franchisor and franchisee. The findings from this study illustrate therefore, that there is a divergence between the theoretical propositions put forward in the academic literature and operational reality.

Franchise Failure

Franchise failure was not a central theme of this thesis, as the focus of the study was to examine the franchise system life cycle and not the death cycle. Therefore all the firms in the sample were examples of 'successful' operations. However, there was some evidence within the sample that inadequate definition of operational areas and poor siting of unit locations occurred in the early stages of development leading to operational difficulties for franchisees, and in some cases, unit failure. With operational experience and know-how, operational area definition and locating franchise units improved over time. These findings provide new insights into some of the causes of franchise failure and, importantly, relate this to stage of development.

Methodological Contributions

Business format franchising is heterogeneous in nature, although in the business, economic and management literatures, franchising is often portrayed as a homogenous activity. Part of the reason for this, as Chapter 3 outlined, is a lack of a cross-sectoral methodology of much franchise research. This thesis therefore aimed to take a far broader sectoral perspective to capture some of the diversity and complexity of franchise activity. The diversity of franchise activity was evident in the current sample of firms in the strategies and methods used to expand, the choices of network allocation and the mechanisms used for restructuring and the degree of local responsiveness, for example. Therefore, this thesis has highlighted an important methodological consideration for future franchise research: the heterogeneous nature of franchise activity must be given greater recognition and a far broader sectoral perspective should continue to be considered as part of research designs.

7.2.2 Practical Implications

The findings from this study highlight a number of management challenges inherent in unit and network growth, the restructuring process and system standardisation/adaptation. There is potential for new or established franchise systems to benefit from these findings and practical suggestions, which may aid successful operation, are made in the following sections.

Lessons of Expansion

In a practical context, the expansion life cycle model can provide an informative framework to guide firms intending to franchise. Knowledge of each of the expansion stages can enable an existing franchisor, or a potential franchisor, to better understand the processes and possible problems associated with each stage, as well as anticipate any challenges of future stages. Such advantages have also been highlighted by other types of organisational life cycles (see Churchill and Lewis, 1983, for example).

The key process of the first stage of expansion – the initial stage – was to establish a pilot unit and the first few franchises. Several authors have argued that the pilot operation is one of the most vital components in the organisational development stage of a franchise network as this could determine whether the franchise has the potential for success as well as allowing a franchisor to test aspects of the format and the franchise in operation (e.g. Falbe and Dandridge, 1992; Felstead, 1993; Forward and Fulop, 1997; Price, 1997; Stanworth *et al.*, 1997). Reflecting this, two thirds of the firms in the sample established a pilot operation. However, as Price (1997) cautions, establishing a pilot can substantially add to the time and financial costs of developing a franchise operation. New systems, which are about to franchise, should therefore give careful consideration to the costs and benefits of establishing a pilot. One further consideration for the potential franchisor, and highlighted by firms in the current sample, is that the majority of the franchisors did not test the franchise concept in a different geographical market. Instead, pilot units were established in the same locations as franchisors' head offices and were also operated as company-run units. As Floyd and Fenwick (1999) observe, this is not necessarily a true test of the franchise concept as 'unit-specific factors' such as location or good corporate staff may be responsible for the unit's success. Whilst establishing a pilot operation (whether franchised or corporate-run) in the same location as a franchisor's head office can enable monitoring and support to occur more easily, firms that set up pilot units in the same geographical market and as a corporate pilot have not necessarily tested aspects of the franchise operation or the franchise relationship.

For firms in the sample, initial franchise units established in networks were either geographically clustered around the home base of franchisors or initial expansion was focused on a wider geographical scale. The two types of expansion had advantages and disadvantages, and a consideration of both can allow a new franchise system to assess the appropriateness of each type of expansion approach. Initial clustering (although not always intentional) facilitated greater monitoring, support and collaboration between the franchisor and franchisee so that any initial 'teething' problems in operation could be detected and acted upon quickly. This early development stage strategy is particularly useful if management infrastructure is limited. However, if the geographical clustering strategy is intentional, it can have the potential to deter prospective franchisees from outside the geographical 'test-bed' area and vital initial development opportunities may be lost. Conversely, initial expansion that is more widely spread across the UK can achieve greater dissemination of the franchise format and brand. However, this could cause operational and logistical problems for a firm, as some franchisors in the sample found that it was difficult to manage the demands of developing and promoting a new concept in the marketplace and well as manage a network of new franchisees dispersed across the UK.

The key process of the second stage of expansion – roll out – was to achieve nation-wide expansion. This was accomplished by using a variety of strategies and approaches which were determined by the franchisor, the franchisee or a combination of both parties. The methods which facilitated the expansion process and used in this stage by the current sample were single unit operators or area franchisees. Thus, as Forward and Fulop (1995) observe, new or potential franchisors can assess which strategy and method is most appropriate to use. A new franchisor may, for example, wish to predetermine territorial allocations or use area franchising, as some of the firms in the sample did, because it is most appropriate for the type of operation. Other new franchisors may simply consider it more appropriate to wait for potential franchisees to approach the firms. A possible challenge of this stage is the difficulty of finding suitable franchisees to fill territories/units or finding suitable locations/units in which to establish the franchise. As identified by the findings in Chapter 4, some firms in the current sample had difficulty in recruiting franchisees for units which had been identified as suitable for development. The solution to this was that these firms developed units as corporate-run entities until suitable franchisees were recruited to the networks, although in four cases, franchisors had intentions of developing as dual distribution systems (operating both franchise and corporate units) so this was not a transitional solution. However, new or potential franchisors should be aware that temporary or permanent corporate unit development may take considerable financial resources to fund.

The key process of the third stage of expansion – consolidation – was to infill gaps in networks (the process of network restructuring also began to occur in this stage for firms in the sample, although the challenges that this process incurs are examined in following sections). However, for a number of firms in the sample, filling network gaps posed some difficulty. To overcome the problems associated with this stage, a number of responses occurred, which have the potential to be of use for new or existing franchisors which are in the early stages of expansion if such problems are encountered. Firstly, for some firms, marketing, promotion and advertising became more targeted and concentrated on locational and network gaps. Secondly, locationally mobile franchisees were sometimes sought by firms in response to greater locational constraints and as a solution to the infilling problem. Thirdly, for a minority of firms, corporate units were established in network gaps (a continuation of the strategy used by some firms in the roll out stage). Lastly, some firms altered the method of franchising that was used in the roll out stage – from using single unit operators to using multi-unit operators – as this facilitated the process of filling network gaps.

In the last stage of expansion – maturity – the key challenge of the stage was to maintain and manage franchise networks. New or potential franchisors may find, therefore, that when this stage is reached (as with the firms in the current sample) management time is spent in dealing with territorial/unit resales or renewing existing contracts. In addition, if development opportunities are saturated with the original franchise concept, new expansion opportunities - external to the original network - may need to be considered. With firms in the current sample, new franchise concepts for rolling out in the domestic market were established or new expansion opportunities were sought on an international scale. However, for some firms in maturity, as with firms in the consolidation stage, new expansion phases occurred within the original network, making a restructuring process necessary (and the practical implications of this is discussed in the following section).

In sum, with an understanding of the main processes and challenges of each of the four key stages in the spatial expansion life cycle (based on the experiences of firms in the sample) it is possible for potential, new or existing franchisors to assess and anticipate the demands of each stage, as well as adopt the most appropriate responses in their own attempts at achieving expansion.

Lessons for Network Allocation and Network Restructuring

One of the key geographical aspects of franchise activity is that a franchisee is given the right to trade within a defined operational area. Chapter 5 generated some significant new insights into the criteria and techniques that are used to define operational areas. One outcome of these findings is that there is potential for new franchise systems to gain from the experiences of firms in the current sample, when embarking upon the task of defining operational areas. New or potential franchisors could assess whether the techniques and criteria used by the current firms to define territories/market areas are applicable and appropriate to implement within their individual operations. As some of the firms in the sample admitted, territory or market area definition was not something that was always successfully implemented at the start of operation. Indeed, some firms highlighted the lack of advice that exists for this purpose. Therefore, a further outcome of these findings is the suggestion that there is perhaps a role for the franchise fraternity to play (e.g. the British Franchise Association, the commercial banks and specialist franchise consultants) in providing and disseminating *low cost* effective advice for operational area definition.

However, whilst territory/market area definition is an important task to ensure successful and viable operating areas, as Chapter 5 demonstrated, what is also an important issue is that the potential franchisor appreciates the dynamic nature of expansion and is aware that original operational areas may be subject to change over time. Therefore, a new system, which is about to franchise its operation, should give careful consideration to the decision of network allocation and advice for this at the early stages of expansion may also be vital. Chapter 5 gave an account of why firms allocate networks in the way that they do, and in some cases, this was related to the sector of operation and the type of franchise (mobile or location-based). New firms which are about to embark upon franchising could use these findings to assess which network allocation is the most appropriate to implement.

Whilst an exclusivity clause and/or allocation of a territory can be useful marketing tools to ensure successful recruitment, as well as effective operation in the initial stages of growth, such network allocations, may be organisational and spatial constraints affecting the ability of a firm to act on development opportunities in the long term. Although firms that do not allocate territories or exclusivity may have to implement mechanisms to minimise the effect of new expansion on existing units, a firm with this network allocation will retain the spatial flexibility to add new units where demand arises over time. However, if the new or potential franchisor thinks that it is necessary to operate with exclusivity clauses and/or territories, the dynamic aspect of franchise system expansion should be considered and mechanisms for facilitating future network development should be planned. Otherwise the ensuing restructuring process can be timely and costly to implement. Consideration given to network allocation and future restructuring mechanisms at the initial or roll out stage will only be of benefit to a firm which is about to franchise.

Lessons for Successful Format Implementation

Identification and classification of the core and peripheral format components can allow the potential, new or existing franchisor to use the distinction as a framework to assess elements of their franchise formats for strengths and weaknesses. In addition, a franchisor will be able to use the core and peripheral components distinction to assess a competitor's business format, which may assist a franchisor to develop clear strategic objectives and market positioning through product/service differentiation, for example. The standardisation/adaptation model developed in Chapter 6 also helps the potential, new or established franchise system to recognise the circumstances and factors which lead to format standardisation or format adaptation. Acknowledging that local markets vary and permitting franchisees to act autonomously and to be responsive to the opportunities and constraints of their local markets by adapting the peripheral elements of format components will enhance format implementation and operation. Franchisors should also recognise the circumstances where conformity and standardisation must be enforced: situations where the core format components are altered, negatively eroding system uniformity and brand integrity.

7.3 Limitations and An Agenda for Future Research

This thesis has argued that the academic franchise literature is limited in disciplinary and topic focus. By being the first study in the UK to comprehensively examine the geographical dimensions of business format franchising, this thesis has broadened the focus of academic inquiry and contributed to new insights and understandings of franchise activity. It has been demonstrated throughout the thesis that franchising is inherently geographical as issues of expansion, location, territory and local market environment are central to franchise activity. Whilst this exploratory study has gone some way to furthering our knowledge of franchise activity, addresses some of the methodological weaknesses of previous studies and reaches some important conclusions, the study is not without limitations. The findings from the study also raise and identify a number of issues which would benefit from further research. The limitations of the study and future research directions are outlined in more depth below.

The life cycle model, developed throughout the thesis, captures the dynamic nature of franchise system expansion over time and space. However, the study has been conducted in only one spatial context - the UK. There is potential, therefore, for the expansion life cycle model to be transposed to other contexts and the model's applicability to different countries and economies could be tested to assess comparability in type and sequencing of expansion stages. As Chapter 4 examined only *national* expansion, the life cycle model could also be tested on a larger geographical scale (i.e. internationally) to explore whether similar or different expansion processes and stages occur in the international expansion process. Such future research would generate further insights and observations of the empirical regularities and irregularities of franchise system expansion.

Throughout this study, the focus has been on firms which have succeeded at establishing franchise operations: little consideration has been given to firms which attempt to franchise but which either fail or withdraw from franchising completely. By focusing only on the life cycle, the research does not examine the 'death cycle'. Although it may be difficult to track firms which have failed, firms which have withdrawn from franchising but continue to operate as alternative organisational forms could be examined. Future research could assess the stage of withdrawal (e.g. early or late stage of development) and the reasons for withdrawing from franchising. Factors causing early stage failure/withdrawal such as those identified in the sample (inadequate territory definition and poor siting of units) are likely to be markedly different from late stage failure (where succession issues or loss of competitive advantage may be factors which cause failure/withdrawal).

A possible limitation of this study, which Chapter 3 outlined, is the reliance on only a singular viewpoint – the franchisor's – to generate the findings of this thesis. While the questions, which the study sought to address, necessitated the responses of the key decision makers of franchise systems (i.e.

franchisors) it is evident that there is potential for future research to address many of the issues and findings of this thesis with *franchisees*.[1]

One of the difficulties of interviewing is ensuring reliable answers are gained, and whilst every measure was taken to ensure cross-referencing with secondary sources where possible, many of the questions and responses were subjective in nature. For example, franchisors may have withheld information or simply not told the truth if it was felt to be of a commercially sensitive nature (Cook and Crang, 1993; Curran and Blackburn, 2001; Jankowicz, 2000; Schoenberger, 1991; 1992). This may have possibly been the case with *some* of the respondents in the sample regarding issues which were considered sensitive in nature: the restructuring process and format standardisation/adaptation. For example, franchisors may have related that conflict did not occur with the development of additional units in a network, when in fact, it was an issue, but the franchisor did not want to admit this. Or franchisors may have reported flexibility in format implementation, when in fact, this did not occur.

Therefore, the network restructuring and format standardisation/adaptation issues could be examined from the franchisee's perspective. Future research could address questions on the restructuring issue such as: whether difficulties arise in the franchise relationship if a franchisor blocks a franchisee from opening a new unit or sub-divides a territory against the franchisee's wishes; the effect of encroachment on a franchisee; and how successfully restructuring mechanisms are implemented. For the format standardisation/adaptation issue, future research could assess questions such as: the level of flexibility in franchise format adaptation; whether channels for idea generation work sufficiently; the franchisee's experience of the monitoring process; and reasons for deviating from the franchise format. As Kaufmann and Eroglu (1998, p80) suggest:

> *"it is logical to assume that over the life cycle of the individual franchise, the franchisees' willingness to comply with franchisor-enforced standardization [sic] will change."*

[1] It was not possible in the current study to interview franchisees because of limited resources.

Franchisees at the early stage of the life cycle may be more willing to conform to the franchise format to reduce uncertainty and risk and because of a lack of operating experience. In later stages of development, with operational experience, the franchisee may become more expert in knowing its local market and the operation of the business and may be less willing to comply to the franchisor's standardisation strategies and deviation from the format may occur. Therefore, franchisee maturation could be another factor affecting format standardisation/adaptation and this issue could be examined further in future research.

An important issue raised throughout Chapters 4 and 5 was the prevalence of the multi-unit franchisee in the sample. Future research could therefore examine the multi-unit (including area) franchisee, as Grunhagen and Mittelstaedt (2001) argue this perspective has received very little attention in the academic franchise literature. Questions could focus on the motivations and capabilities of individuals that become multi-unit franchisees (distinguishing between individuals that start as multi-unit operators and those that become so over time). The potential for multi-unit or area franchisees to become powerful players in a franchise network (because they control a large amount of territory and a large number of units) could also be an issue for investigation. For example, the area/multi-unit franchisee may deviate from the franchise format or may refuse to implement changes to the format that the franchisor wishes to make. Future research could assess how franchisors manage this situation, particularly if the relationship between a franchisor and multi-unit franchisee breaks down.

A valuable area of future research would be to test the conceptual standardisation/adaptation model developed in Chapter 6 and link this with the life cycle model of Chapter 4. The degree to which format standardisation or adaptation occurs in response to local environmental pressures at different stages of the life cycle - and the reasons for this - could be examined in more depth. For example, a great deal of format variation and adaptation may occur in the early stages of the life cycle as the franchisor works towards developing a standardised franchise format and defining its competitive advantage (of which there was some evidence in the current sample). The extent that the initial franchisees assist in this process could also be assessed. In latter stages of the life cycle, changes in a firm's operating environment may also lead to format adaptation to maintain competitive advantage. Future research could examine and compare firms in such situations (at opposing ends of the life cycle) and explore the effect of life stage on franchise format adaptation.

One of the strengths of this study has been the inclusion of a broad range of franchise sectors, which has reflected the more diverse nature of franchise activity. A weakness of past research has been the over-reliance on only one sector of activity – namely the fast food sector (Stanworth, 1998). However, including six sectors of franchise activity in the sample led to only a small sub-sample of firms within each sector (five firms in the smallest sub-samples). This factor may have possibly contributed to the lack of clear sectoral trends within the sample. Future research could examine some of the themes of this thesis but include a larger sample of firms. However, future research should continue to capture the heterogeneity of franchise activity by examining a broad range of sectors, otherwise the complexity of franchise activity is lost.

In summary, the present study has contributed to new theoretical and methodological insights by examining the geographical dimensions of franchise activity and raised a number of avenues for future research which can continue to contribute to the development of theory and accumulation of knowledge relevant to both academia and the practitioner.

Appendix A Papers Contained in Journal of Business Venturing (1996-1999) Special Editions Demonstrating the Dominance of Quantitative Methodologies

Author(s)	Publication Reference	Title	Method of Analysis	Sector	Sample size used
Shane &Hoy	Vol.11 (No. 5) Sept. '96 pp. 325-328	Franchising: A Gateway to Co-operative Entrepreneurship	Discussion Paper	N/A	N/A
Spinelli & Birley	Sept. '96 pp. 329-342	Toward a Theory of Conflict in the Franchise System	Discussion Paper	N/A	N/A
Kaufmann & Dant	Sept. '96 pp. 343-358	Multi-Unit Franchising: Growth and Management Issues	Regression Analysis	Fast Food	152 respondents
Baucus, Baucus & Human	Sept. '96 pp. 359-378	Consensus in Franchise Organisations: A Co-operative Arrangements Among Entrepreneurs	Regression Analysis, T-tests and Correlations	Fast Food	162 respondents
Phan, Butler & Lee	Sept. '96 pp. 379-402	Crossing Mother: Entrepreneur-Franchisees' Attempts to Reduce Franchisor Influence	Regression Analysis	Commercial Truck Industry	160 franchisees
Leblebici & Shalley	Sept. '96 pp. 403-418	The Organisation of Relational Contracts: The Allocation of Rights in Franchising	Correlation Co-efficients	Various Service	30 respondents
Fladmoe-Lindquist	Sept. '96 pp. 419-438	International Franchising: Capabilities and Development	Discussion Paper	N/A	N/A

Author(s)	Publication Reference	Title	Method of Analysis	Sector	Sample size used
Dant & Nasr	Vol. 13 (No. 1-2) Jan. '98 pp. 3-28	Control Techniques and Upward Flow of Information in Franchising in Distant Markets: Conceptualisation and Preliminary Evidence	Two-stage methodology: 1st stage: In-depth interviewing 2nd stage: Hypothesis testing Correlation and Regression Analysis	Not stipulated	34 respondents
Vincent	Jan. '98 pp. 29-42	Encroachment: Legal Restrictions on Retail Franchise expansion	Discussion Paper – Legal Perspective	N/A	N/A
Hoy & Shane	Vol. 13 (No. 2) March '98 pp. 91-94	Franchising as an Entrepreneurial Venture Form	Discussion Paper	N/A	N/A
Lafontaine & Shaw	March '98 pp. 95-112	Franchising Growth and Franchisor Entry and exit in the US Market: Myth and Reality	Regression Analysis	All sectors	1980-1992 data set
Bates	March '98 pp. 113-130	Survival Patterns Among Newcomers to Franchising	Regression Analysis	All sectors	1987-1991 data set
Litz and Stewart franchisee	March '98	Franchising for Sustainable Advantage?	Regression Analysis	Retail and	307 independent and
	pp. 131-150	Comparing the Performance of Independent Retailers and Tradename Franchisees			owners
Falbe & Welsh	March '98 pp. 151-171	NAFTA and Franchising: A Comparative of Franchisor Perceptions of Characteristics Associated with Franchisee Success and Failure in Canada, Mexico and the US	Univariate and Covariance Analysis	Food, Business Services, Consumer Services, Retail	Sample size not stipulated Respondents from Mexican, Canadian and US Franchise Associations

Author(s)	Publication Reference	Title	Method of Analysis	Sector	Sample size used
Kaufmann & Dant	Vol. 14 (No. 1) January '99 pp.5-17	Franchising and the Domain of Entrepreneurship Research	Theoretical discussion paper	N/A	N/A
Lafontaine	January '99 pp.17-34	Franchising versus Corporate Ownership: The Effect on Price Dispersion	Regression analysis	Fast food	911 respondents from 36 chains, 2 states, sampled in '91 & '93
Dant & Gundlach	January '99 pp.35-67	The Challenge of Autonomy and Dependence in Franchised Channels Of Distribution	Multiple Regression analysis and cluster analysis	Fast food	176 respondents from 26 chains
Kaufmann & Eroglu	January '99 pp.69-86	Standardisation and Adaptation in Business Format Franchising	Theoretical discussion paper	N/A	N/A
Wu	January '99 pp.87-102	The Pricing of a Brand Name Product: Franchising in the Motel Services Industry	Regression analysis	Motels	155 motels
Williams	January '99 pp. 103-124	Why do Entrepreneurs Become Franchisees? An empirical Analysis of Organisational Choice	Statistical modelling	Various Sectors Used (4)	14,550 single owner firms used (6.1% = franchises)
Falbe et al	January '99 pp.125-140	The Effect of Organisational Context on Entrepreneurial Strategies in Franchising	Correlation analysis	Various Sectors used (8)	50 respondents

Author(s)	Publication Reference	Title	Method of Analysis	Sector	Sample size used
Stanworth & Curran	Vol. 14 (No. 4) July '99 pp323-344	Colas, Burgers, Shakes and Shirkers: Towards a Sociological Model of Franchising in the Market Economy	Theoretical Discussion	N/A	N/A
Kaufmann	July '99 pp.345-362	Franchising and the Choice of Self-Employment	Regression analysis	N/A	63 respondents
Jambulingham & Nevin	July '99 pp. 363-396	Influence of Franchisee Selection Criteria on Outcomes Desired by the Franchisor	Regression analyses	Various sectors (5)	154 respondents
Blair & Herndon	July '99 pp.397-415	The Misapplication of Kodak in Franchise Tying Suits	Legal paper	N/A	N/A

Appendix B

INTERVIEW SCHEDULE

DATE OF INTERVIEW: **PLACE OF INTERVIEW:**

NAME OF INTERVIEWEE: **POSITION:**

BACKGROUND INFORMATION

- What is the name of the firm?
- What is the name of the franchise?
- Is the firm a domestic/international franchise operation?
- What is the product/service of the firm?
- In what year was the firm founded, where was it founded and by whom?

MOTIVATIONS FOR FRANCHISING

- When and why did the firm decide to franchise?
- How many units are there in the operation that are company-owned/franchised?
- Why have both company-run units and franchise units?
- What is the average number of franchise units opened per year?
- Is this typical?
- What is the saturation point?

METHODS OF FRANCHISING

- What methods of franchising does the firm use to franchise?
- What are the advantages/disadvantages of these methods?
- Does the firm use different methods of franchising in different situations?

ISSUE 1 SPATIAL EXPANSION

PILOTING FRANCHISING

- Did the firm have a pilot franchise operation?
  If no, why not?
  If yes, when and where was it located?
- Why operate a pilot unit(s)?
- Was the pilot a franchise or company-run operation?
- Why was this so?
- How many units did the pilot operation involve?
- What does the firm feel to be the key lessons learnt from the pilot operation? [PROMPT: franchise-related/operationally/geographically]
- Did the pilot operation relate to the subsequent growth and distribution of the franchise network? [PROMPT: Was there an initial pattern or cluster of growth near to the pilot?]

LOCATION OF FIRST FEW FRANCHISES

- Where was the first franchise unit established? [PROMPT: Was it the pilot?]
- Why was this location chosen?

EXPANSION STRATEGIES

- What has been the locational objective of the firm?
- What is the current locational distribution of franchised units?
- What is the locational strategy of the firm?
- Has the locational strategy of the firm changed over time, and if so, in what way?
- What is the future locational strategy of the firm?
- Does the firm have preferred types of locations in which to franchise, if so, why?
  [FILTER: If both franchise and company-owned units are operated]
- Are the locations of company-owned and franchised units different. If so, why?

BARRIERS TO EXPANSION

- Are there any locations where the firm does not think it is feasible to set up a franchise unit or units?
- If yes, what does the firm perceive as the problems with these types of locations/places?
- Amongst the locations where the firm has had, or has franchise units, are there any areas where the firm feels that it is harder to operate franchise units?
- If so, where?
- What happened in this situation? [PROMPT: did the firm withdraw from these places in such instances?]
- What were the reasons for the locational difficulties?
- Has the firm had any franchisee/unit failures?
- What is the approximate number?
- Why did failure occur?

RECRUITMENT OF FRANCHISEES

- How does the firm identify and attract interest from suitable potential franchisees?
- To what extent would the firm's locational strategy be shaped by the availability of potential franchisees?
- To what extent are franchisees locationally mobile?
- How important is the franchisee's local market knowledge?

ISSUE 2 TERRITORIES

DEFINING TERRITORIES

- Does the firm allocate territories (i.e. defined market areas) for franchisees to operate in?
- How does the firm define franchise territories/market areas, what techniques are used?
- Has the firm sought external advice on how to define territories/market areas and if so, from whom?
- Has the firm evolved in it thinking concerning territorial allocation?
- Have the techniques that the firm used for defining territories changed over time and in what ways?
- Do problems arise at the borderline of territories, which are operated by different franchisees?
- Does the franchisor know, or do anything about this?
- Does the firm grant exclusive territories?
- What are the advantages/disadvantages of granting exclusive territories for the firm?

TERRITORY AND CONTRACT

- How is the issue of territory dealt with in the franchise contract, does the contract state boundaries, postcodes, exclusivity, for example?
- How long does the contract last for?

ENCROACHMENT

- Has growth of the franchise network put pressure on the existing territories of longer established franchisees?
- What was the impact on the franchise network?
- What have been the effects of this on the franchisees that have been affected?
- Has the firm done anything about the effects of restructuring for the franchisee?
- Does the firm use any form of modelling techniques to evaluate the potential impact of new unit introductions on existing franchise units and networks?

ISSUE 3 FORMAT VARIATION IN RESPONSE TO LOCAL GEOGRAPHICAL ENVIRONMENT

INTERNATIONAL FIRM:
- Has the firm altered the format to take account of specific features of the UK market?
- Does the firm alter the format in other countries?

UK FIRM:
- Do franchisees have a standardised franchise format to operate to? What does it include and cover?
- How consistent is the franchise format across the franchise system and country wide?
- Do regional/local variations have to be taken into consideration?
- In your opinion, does the local market environment have an effect on the franchise format and the franchisee's ability to operate to that format?
- If yes, what aspects of the local environment affect the franchise format and in what ways is the format affected?
- Can you give me any examples of cases of franchisees that have encountered difficulties in operating to the format because of local conditions? If yes:
    - What was the nature of the problem?
    - What was the origin of the problem?
    - What was the franchisee's response?
    - What was the firm' response?
    - What was the outcome for the franchisee?
    - What was the outcome for the franchise system?

CLOSING QUESTION

- What does the firm feel to be the most important factors influencing the franchise system and network in the next five years or so?

APPENDIX C - CHARACTERISTICS OF THE SAMPLE OF FRANCHISE FIRMS

Firm Name	Year Firm Founded	Year Firm Franchise	Number of Firm Outlets	Number of Franchise Outlets	HQ Location	International Firm
RETAIL						
Firm A	1984	1984 single f.ees	1 territory = 250stores	36 appx.1440stores	Southampton, Hampshire	No
Firm B	1825	1983	550	120	Street, Somerset	No
Firm C	1930	1991	9	41	Isleworth, Middlesex	No
Firm D	1991	1991	1	99	Ware, Hertfordshire	Yes
Firm E	1984	1987	1	69	London	No
FAST FOOD						
Firm A	1991	1996	2	18	Bourne End, Buckinghamshire	Yes
Firm B	1985	1985	8	170	Milton Keynes, Bedfordshire	Yes
Firm C	1965	1965	150	350	Woking, Surrey	Yes
Firm D	1979	1996	0	650	Reading, Berkshire	No
Firm E	1979	1979	0	30	Bognor Regis, Sussex	No
PERSONAL SERVICES						
Firm A	1972	1986	0	42	Potters Bar, Herfordshire	Yes
Firm B	1980	1992	5	24	Milton Keynes, Bedfordshire	No
Firm C	1985	1986	0	60	Slough,Berkshire	Yes
Firm D	1971	1971	0	70	Abingdon, Oxfordshire	No
Firm E	1963	1965	0	93	Surbiton,Surrey	No
Firm F	1959	1959	14	430	Leicester, Leicestershire	Yes
Firm G	1991	1991	2	69	High Wycombe, Berkshire	Yes
Firm H	1991	1991	1	27	London	Yes
Firm I	1989	1989	0	139	Woking, Surrey	No
Firm J	1980	1995	0	18 units 5 area devpers (>40 units)	Crydon, Surrey	Yes

DISTRIBUTION						
Firm A	1992	1992	0	81	Farnham, Surrey	No
Firm B	1994	1994	0	51	Tipton, W.Midlands	No
Firm C	1994	1994	0	37	Felixstowe, Suffolk	No
Firm D	1991	1991	1	52	Richmond, Surrey	No
Firm E	1994	1994	0	65	Devizes, Wiltshire	No
Firm F	1990	1989/90	0	187	Faringdon, Oxfordshire	No
Firm G	1989	1989	0	68	London	No
Firm H	1987	1987	14	106	Bristol	No
Firm I	1969	1980	12	69	Sunbury, Middlesex	No
Firm J	1981	1981	1	117	Bristol	No
BUSINESS-TO-BUSINESS						
Firm A	1994	1996	1	60	Winchester, Hampshire	Yes
Firm B	1988	1988	0	27	Bath, NE Somerset	Yes
Firm C	1977	1985	13	39	Gloucester, Gloucestershire	No
Firm D	1982	1985	1	64	Bingley, Yorkshire	No
Firm E	1992	1993	0	73	Windsor, Berkshire	Yes
INDUSTRIAL AND COMMERCIAL						
Firm A	1988	1988	1	16	Scarborough, Yorkshire	Yes
Firm B	1966	1982	0	35	East Grinstead, Sussex	No
Firm C	1978	1979	0	200	Ruislip, Middlesex	No
Firm D	1971	1973	0	230	Watford, Hertfordshire	No
Firm E	1992	1993	0	23	New Malden, Surrey	Yes

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