HOSPITALITY, LEISURE AND TOURISM

FRANCHISING HOSPITALITY SERVICES

EDITED BY
CONRAD LASHLEY
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ROUTLEDGE

Franchising Hospitality Services

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and
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Routledge
Taylor & Francis Group
LONDON AND NEW YORK

First published by Butterworth-Heinemann

This edition published 2011 by Routledge
2 Park Square, Milton Park, Abingdon, Oxon OX14 4RN
711 Third Avenue, New York, NY 10017, USA

Routledge is an imprint of the Taylor & Francis Group, an informa business

British Library Cataloguing in Publication Data
Franchising hospitality services
1. Hospitality industry 2. Franchises (Retail trade)
I. Lashley, Conrad II. Morrison, Alison J.
338.4'7647'068

ISBN - 978 0 7506 4772 4

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Foreword

A decade in the hotel and catering industry and a decade in the franchising sector has taught me one important lesson – generalizations are dangerous. Yet it is the business of professional study and the nature of a body of knowledge to be based on a history of generalized hypotheses propounded by 'researchers' and tested over time for their explanatory and predictive power. Such a history of investigation, hypothesis, testing and revision has to start somewhere. Franchising is a relatively young business method, which is only just beginning to attract the attention it deserves from the academic business community. This book represents a significant step along the road to the production of a body of knowledge on franchising. Undoubtedly, the book will stimulate debate, maybe even argument, which is all to the good, providing it is argument in pursuit of truth rather than fame or fortune.

Fulop makes the significant observation in Chapter 2 that franchising for franchisees 'is a distinct way of starting a new business'. Franchisors are not just in the business of distributing or marketing goods or services, they are in the business of starting legally independent businesses which are saleable by their owners with the benefit of the goodwill they have built in their business. This represents a defining characteristic of business format franchising and a characteristic that is evident even in conversion franchising. The introduction of saleability with a premium based on turnover and profitability was the major change made in the licensed trade first by Inns Partnership when it was part of Greenalls. In their excellent analysis of pub tenancies in the Licensed Retailing chapter Lincoln and Lashley touch on this change. I could similarly venture interpretations of the underlying factors principally at work in the changes in KFC, Wimpy, Pierre Victoire and Pizza Express. These may differ somewhat from the those offered by various authors in this work, but would focus in the end on the 'subjective factors'. The fact of the matter is that franchising is fundamentally a people business that makes investigation, explanation, interpretation and prediction an uncertain world where we are all at risk of claiming too much, or indeed too little.

Price, in Chapter 3, controversially challenges what is propounded as the franchise fraternity's rhetoric on the success rates of franchising. The challenge is made with a rhetorical fervour that outshines the franchise establishment's original claims, which in fact relate to its success in starting new businesses, that is to say in establishing successful franchisees. That claim is supported by the most extensive and consistent quantitative research on franchising in the world, the NatWest/BFA annual survey, which should nonetheless be open to criticism and debate if we are to secure continuous improvement.

There is in any case a real problem here that we must all address. Morrison and Macmillan powerfully describe the real cost of franchise entry for new franchisors. There are too many new franchisor withdrawals which are unnecessary and expensive and but for want of a better access to franchise know-how, could have been avoided. Fortunately, their impact on franchisee withdrawal rates overall is very small – though this is little comfort for those of their start up franchisees who are not bought back or otherwise survive in their business.

The strength of this book is particularly apparent where the considerations concentrate on a specific sector, for example Taylor's work on the international hotel business; or on a particular company, Lashley's work on McDonald's; or on a particular function, Morrison and Macmillan's work on franchise financing; the hypotheses put forward here seem to me to be more sustainable. But this does not mean that we should not venture to present generalized work on franchising, it means that we should do more of it until we do find interpretations and explanations of good franchising that will stand the test of time. Explanations that will offer a predictive power to prospective new franchisors to help them decide whether or not to adopt the franchising method.

This book makes a valuable contribution to the collection and presentation of such an organized body of knowledge on franchising that will I hope stimulate debate on franchising in business schools, by professional advisors and by the franchising community itself.

Brian Smart
Director General
British Franchise Association

Preface

The dimensions of franchising hospitality services

Franchising is growing in significance in Europe and internationally, as the traditional independent retailer structure falls away, the range of 'franchisable' services and products increases, and new social and economic trends create exciting novel commercial opportunities. In the UK this growth has been aided by the:

- general health of the UK economy;
- growth in consumer and commercial spending;
- general spread of the service sector in the wider economy;
- expansion of organizations into international markets as home markets reach saturation point;
- deregulation and easing of trading restrictions;
- advent of new retailing formats, including home shopping and the Internet;
- continuing number of new entrants to the UK franchising sector.

Consequently, franchising has become an established way of carrying out business. The most popular use of the term franchising is in relation to what is known as business format franchising, which is the subject of this book. It involves (DTI, 1998, p. 2):

> the granting of rights by a company (the franchisor) for a third party (the franchisee) to operate their business system using a common brand and common format for promoting, managing and administering the business.

Although by no means a new concept, business format franchising has become an established global enterprise trend within the service sector, in general, and specifically within the hospitality services sector. It represents a popular method of financing the expansion of multi-site chains that deliver a consistent service concept (Houston, 1984), and is a strategy adopted by franchisees to take advantage of a more entrepreneurial management system (Falbe and Dandridge, 1992). The number of separate businesses created by some 568 business format franchisors stands at 29,100 and more than 273,000 persons are directly employed in franchising (NatWest/BFA, 1998). Success stories are plentiful: for example, Holiday Inn, McDonald's, Burger King, Kentucky Fried Chicken, Benetton, Levi, Vision Express, Body Shop and Prontoprint, but franchising is not free from failure, as the demise of the Pierre Victoire restaurant company in 1998 illustrated.

From a European perspective, Stanworth (1995) predicts that service-oriented franchising is likely to experience growth rates notably faster than those that apply to franchising as a whole. Key Note (1998) forecasting that, by 2002, the UK franchising industry will be generating a turnover of £11.6 billion substantiates this. This represents a growth of 65.7 per cent over 1997, and catering, hotels, retail, domestic and personal services, and direct selling, are likely to be the fastest growth areas (Table 1).

In general, franchises represent a small percentage of the total market sector in which they operate. However, within catering and hotels it can be seen (Table 2) that the percentage is significant and growing. This is particularly the case within the fast food, themed pubs, budget hotel and travel sectors. Invariably the best franchises are based around strong brands or business concepts, such as Burger King, Tom Cobleigh's, Holiday Inn Express, and British Airways.

Given the seemingly unstoppable forward momentum of franchising, it is clear that its impact will be substantial on the structure and characteristics of the hospitality services sector over the coming decades. Increasingly, large franchise systems are replacing, absorbing or making redundant a vast array of atomistic, traditional small firms (Stanworth, 1995). Drawing on

	1998	1999	2000	2001	2002
Franchised systems	589	617	646	681	702
(% change year-on-year)	5.2	4.8	4.7	5.4	3.1
Franchised units	37,976	50,128	66,670	90,604	121,863
(% change year-on-year)	56.2	32.0	32.9	35.9	34.5
Total turnover (£bn)	5.6	6.4	7.3	10.3	9.6
(% change year-on-year)	6.6	10.5	10.7	10.8	10.6

Source: Key Note (1998, p. 53)

Table 1 Forecast for UK franchising (1998–2002)

Market share of business format franchising	9.1%
Growth in franchised units 1993–1997	3%
Number of franchised units in 1997	3,675
Growth in franchised systems 1993–1997	1%
Number of franchised systems in 1997	65

Source: Key Note (1998)

Table 2 Catering and hotel franchising summary information

the qualities of individual-operator franchisees, and blending proven business concept and local expertise, franchisors have the potential to benefit from the synergy of collective entrepreneurship (Falbe and Dandridge, 1992). Franchising is transforming the service sector previously characterized by small unit size, local orientation, resource poverty and absence of professional management skills (Lovelock, 1991).

The scope of this book

So it is that we present this book to you. Based on the foregoing discussion it is clear that, in the UK, Europe and internationally, franchising has taken strong roots that will support an ever-strengthening franchise sector. We as students, academics and practitioners associated with services in general, and hospitality services in particular, need to lift the lid off the seductive popularist understanding of what franchising is hyped up to be, and delve deep into its complexities, nuances and logic. In particular, it is important to look behind the associated dominant rhetoric of success. Only in this way can we all gain an understanding of this kaleidoscopic form of economic organization.

The objective of the book is to draw together a comprehensive and consolidated collection of streams of knowledge relative to franchising hospitality services into a package that rates high on 'readability'. We do this through structure, style, content and varied learning approaches.

The book is organized into two parts. Part One provides a rich exploration of theoretical frameworks and debates, and their application to hospitality services. It covers an array of themes, including: the theory of the firm; the historical development of franchising; the failure of literature adequately to test out the success rhetoric; franchisees as intrapreneurs; and empowering franchisees.

Part Two then moves to focus on some of the fundamental issues associated with the structuring and financing of franchising and the specifics of four sub-sectors of hospitality services – catering, hotels, licensed retail, and travel trade and transport. At this sub-sector level our understanding of franchising is progressed as various interpretations of franchising, similarities and disparities emerge. In particular, the concept of 'tight' and 'soft' brands, and 'hard' and 'soft' franchise systems has prominence throughout. Part Two culminates in a chapter dedicated to the McDonald's Restaurant Corporation, which serves to elucidate and consolidate the range of key issues that emerge from the previous chapters.

How to get the most out of the book

Each chapter ends with a summary. After the chapter summary, we have included debate topics and selected reading to further encourage readers to engage in, and reflect on, the content of the chapter. We have striven to help you get the most out of this book by enhancing its learning and expressive value in two major ways:

- theoretical debate has been supported with real world examples; and
- interactive learning features have been designed and integrated to increase understanding of franchising hospitality service concepts.

Put simply, this means that the content has been deliberately formulated to integrate learning and understanding through the use of multiple approaches. An overview of these approaches is now given, and together they form the structure of the content of the book.

Chapters

There are eleven chapters in all, written by leading experts on franchising and the hospitality services sector, and drawn from the worlds of both academia and commerce. These authors have reviewed the current state of knowledge, introduced real world examples and developed innovative perspectives on franchising hospitality services. The result is a content that is academically challenging, determined to stimulate, enable contextualization, and to facilitate the linkage of theory to practice.

Case studies

The content of the book is interspersed with short and more substantial case studies. In Chapter 1, Taylor draws heavily on the case of the McDonald's Restaurant Corporation as a means to illustration the theory of the firm as it relates to franchising. The same company is also used by Lashley in Chapter 11 to achieve an in-depth investigation of the company at a more operational level. The rationale for this singular focus is simply that McDonald's is arguably the most successful pioneer of business format franchising in hospitality services. Together, these two case studies are intrinsically fascinating and illuminate a substantial number of franchising issues. In Chapter 10, Pender brings in accounts of British Airways and the Advantage Travel Centres to provide strong linkages to the theoretical arguments presented.

Debate topics

A range of provocative debate topics can be found at the end of each chapter. It is anticipated that these may be used to form the basis of reflection on learning, and the stimulation of further intellectual debate. This may be carried out in class with debate groups, form the basis for group or individual assignments, or be addressed in private study mode.

Selected readings

For each chapter the author(s) have selected what, in their opinion, represent the most significant texts in the area, for those who wish to take the chapter theme to a higher level of understanding and analysis.

Finally, this book is intended for students in the latter stages of their management qualifications, whether at degree or postgraduate level. In addition, it is proposed that it will appeal to a wide range of audiences, including practitioners who may find the content challenging and containing ideas and concepts that could contribute to business success. We sincerely hope that you enjoy this book, as through enjoyment comes effective learning.

Conrad Lashley
Alison Morrison

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PART 1

Franchising Organization and Debates

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CHAPTER 1

An introduction

Stephen Taylor

Key points

- Franchising represents a mode of organization that can be interpreted and understood from the perspective of the theory of the firm.
- In essence, a business format franchise is concerned with the transference of intellectual property rights that provides both parties to the transaction with access to valuable benefits.
- The existence of franchising as an organizational form can be explained through two main theories: resource scarcity and agency.
- The key to any successful franchise strategy is that franchisors recognize as an economic imperative the importance of having an ongoing interest in, and relationship with, franchisees.

Introduction

In the second half of this century a major revolution in business organization occurred. Originating in the USA during the post-war economic boom of the 1950s, franchising emerged as a powerful new way of facilitating the growth of service organizations. It was to prove to have a particularly strong efficacy within the hospitality services sector and became readily adopted by many hotel, fast food and restaurant organizations. Indeed, in the USA today, it is almost certainly the dominant organizational mode across these sub-sectors. It is estimated that franchising accounts for 41 per cent of all retail sales in the USA, which amounts to some $800 billion annually. Behind these figures are 550,000 franchised businesses and 8 million employees. In the UK it is estimated that there are 29,100 franchised businesses employing around 273,000 people. Around an eighth of these franchises operate in the UK hospitality services sector (NatWest/BFA, 1998).

While franchising has historically been less prevalent in a UK and, more generally, the wider European context, here too in the past twenty years it has emerged as an important element of the hospitality services sector. Further afield, in the newly emerged markets of Asia and the Far East, franchising is proving to represent a major instrument of growth in the modern hospitality services sector. In many instances this reflects the internationalization of the US-developed franchising organizations such as McDonald's (fast food), Holiday Inns (hotels) and Starbucks (coffee). However, there has also been a growing trend of indigenously developed concepts such a Wimpy (UK), Jollibee (Philippines) and Novotel (France). Accordingly, franchising is not simply an American phenomenon, but rather represents a more fundamental development in business organization that enjoys an increasingly global presence in the hospitality services sector. None the less, the questions remain as to what actually is franchising and why has it proved to be so successful in recent decades?

What is franchising?

While this is a seemingly innocuous question, franchising as a concept can be characterized as one that has been subject to a wide range of definitions resulting in a great deal of confusion. As Price (1997) highlights in his seminal contribution to the franchising literature, this confusion, in part, stems from the disparate types of business relationships to which this term has been applied. Indeed, 'franchising definition' can almost be viewed as a stream of literature in its own right. It is not intended to revisit this debate here (see Chapters 2 and 10), but rather to adopt a more pragmatic approach with a view to delimiting the focus of this chapter and those that follow. The franchising context with which this book is concerned is business format franchising (which is sometimes referred to as second generation franchising) as this represents the franchising mode most frequently deployed within the hospitality services sector. However, it is worth noting that franchising as a concept has its origins in the tied public house system in eighteenth-century Britain (Stern, 1998). These origins are discussed in full in Chapter 9. The business format franchise involves the owner of a brand name and business system (the franchisor) transferring the right via a contract (the franchise agreement) to use this name and format to another party (the franchisee), usually for a fixed time period in a prescribed geographic area. In return, the franchisee agrees to pay an initial up-front fee and thereafter a royalty based upon a percentage of actual revenues generated (see Chapter 6).

In essence, a business format franchise is concerned with the transference of intellectual property rights (in the form of trademarks and technical know-how) that provides both parties to the transaction with access to valuable benefits. In the case of the franchisor, these benefits are primarily in the form of access to a means of rapid growth at a minimum level of capital investment (the franchisee is responsible for capital expenditure on plant and equipment), and the 'recruitment' of highly motivated owner–managers to operate the business units. For the franchisor this provides the basis for establishing the critical mass (minimum efficient scale) required to gain access to the benefits inherent in operating a chain of hotels or restaurants. The franchisee benefits from acquiring the rights to own and operate a proven business format while gaining access to a level of support (managerial assistance, marketing support etc.) typically found only in large chain hospitality organizations. A critical advantage frequently cited for the franchisee is a considerably reduced level of risk of failure compared to other small business start-ups. That said, in Chapter 3 Price controversially challenges the empirical foundations of such propositions. Furthermore, the extent to which franchisees can be classified as entrepreneurs is debatable given the high level of conformity typically inherent in a business format franchise (see Chapters 4 and 5).

Franchising and the theory of the firm

Within economics, approaches to the theory of the firm seek to provide explanations for the existence of the firm, its scale and scope or, in other words, its existence as a mode of economic organization. For our purposes here, these can be broadly grouped into two distinct literature streams (Foss, 1996). As will be demonstrated below, the foci of these research paradigms closely mirrors that of the two main theories advanced to explain franchising (Carney and Gedajlovic, 1991):

- the **resource scarcity** thesis, which shares some of the concerns of the knowledge perspective of the firm; and
- the **agency thesis,** which shares some of the concerns of the efficient contracting literature on the theory of the firm.

However, before turning our attention to these explanations of franchising *per se*, it is useful as a means of providing a wider theoretical context, briefly to review these two broad groupings of research which attempt to explain the existence of the firm.

The first stream of literature in the theory of the firm are those explanations which are concerned with and share a **resource perspective** (e.g. the resource-based view: Conner, 1991; Conner and Prahalad, 1996; and the literature sharing a more evolutionary focus: for example, Kogut and Zander, 1992). Here the focus is upon investigating successful firm growth strategies, their technological development and the creation of competitive advantage. In this first group of explanations the main emphasis is upon the role of valuable resources (capital, managerial, know-how, reputation etc.) in the context of organizational growth and evolution. The resource-based category, is generally acknowledged to have its antecedents in the seminal contribution by Penrose (1959), *The Theory of the Growth of the Firm*, which was concerned with explaining firm evolution.

The second category of explanations are those which are concerned with the **efficient contracting perspective** (for example, Alchian and Demsetz, 1972; Williamson, 1975), where the focus is upon explaining firm existence, boundaries and internal organization. This efficient contracting approach has its origins in Coase's (1937) seminal contribution '*The Nature of the Firm*', which posed the question: 'why do firms exist?'. Coase argued that 'the distinguishing mark of the firm was the suppression of the price mechanism' (1937/1952, p. 334). Instead of using the price mechanism to co-ordinate external transactions, the firm utilized the power of fiat (authority) for internal co-ordination. The resultant dichotomy of markets versus hierarchies (which is also referred to as the 'make or buy' decision – albeit with the order of the terms reversed), has been an enduring theme within this literature stream. Ultimately, a primary concern here is the issue of organizational control.

Why franchise?

A central question that occupies academic researchers is why firms choose to expand through franchising (equivalent to the market mode and the 'buy' decision) rather than through company-owned units (equivalent to the hierarchy mode and the 'make' decision). Two reviews of the franchising literature (Elango and Fried, 1997; Fulop and Forward, 1997) suggest that it is possible to identify two competing theories in relation to this question. These are, as indicated above, termed resource scarcity (or resource allocation theory) and agency theory. The former is concerned with resource constraints to firm growth, while the latter is concerned with the issue of incentives and organizational control (Lafontaine and Kaufmann, 1994). As such, these two theories closely parallel the two literature streams on the theory of the firm outlined above. That this is the case should not be surprising as each seeks to offer an explanation for the popularity of franchising as a mode of economic organization and, in addition, why firms frequently operate a mix of franchised and company-owned units.

Resource scarcity theory

This stream of research explains franchising as being a response to a shortage of the necessary resources required for firm expansion, such as financial capital, labour capital, managerial talent (Oxenfeldt and Kelly, 1969; Norton, 1988a) or local market knowledge (Minkler, 1990). This view has its origins in the seminal work of Oxenfeldt and Kelly (1969), who suggested a life-cycle model of franchising in which a firm utilizes franchising as a means of overcoming resource constraints in the early stages of its growth. These constraints are typically seen as being mainly in relation to financial resources, although as Thompson (1994) has argued, a scarcity of managerial talent may be an even greater constraint for the growing organization. The desire for rapid early growth is associated with the need to achieve a minimum efficient scale and to develop the brand name capital that is so vital for retail oriented operations (Combs and Castrogiovanni, 1994). The life-cycle model suggests that as the firm grows in size, resource constraints ease and the firm will ultimately acquire the more profitable units operated by franchisees (see Thomas *et al.*, 1990). Those in low volume locations where there is a danger of 'free-riding' in the form of lower investment, poor maintenance of quality standards and so on, by franchisees (see agency theory below in relation to this particular issue) will also tend to be acquired by the franchisor. Full vertical integration (i.e. full company ownership) will be avoided as greater economic benefits can be derived from quasi-vertical integration, albeit with a dominant percentage of company-owned units. Implicit in this view is that company ownership is the preferred mode of economic organization.

Hunt (1972) provided early empirical support for the Oxenfeldt and Kelly conjecture. He examined the US fast food industry and detected an aggregate trend towards company-owned units. Later research by Caves and Murphy (1976), which examined hotel, motel and restaurant sectors in the USA, reported similar findings. More recently, Anderson (1984) found evidence of a systematic increase in the percentage of franchisor-owned units over a ten-year period (Elango and Fried, 1997). None the less, subsequent reviews of this stream of research suggested that, while interesting, the empirical support for this ownership redirection thesis remains equivocal (see Dant *et al*., 1992, 1996). Indeed, data gathered over the period 1975 to 1990 indicate a very steady ratio of 80:20 in favour of franchised units (Trutko *et al*., 1993).

The resource scarcity thesis thus suggests that firms use franchising as a means of reducing financial and managerial constraints and to transfer a measure of risk from the firm to a franchisee. This latter issue of risk spreading is arguably a third theory of franchising in its own right (Combs and Castrogiovanni, 1994). Risk spreading could be particularly attractive to new firms with a relatively unproven concept and who require the rapid achievement of a sustainable critical mass (Gilman, 1990). It has been suggested that where units require a high level of initial investment or where high growth is being experienced, franchising is likely to be preferred to company ownership (Thompson, 1992). The importance to firms of the use of franchising as a growth strategy appears well supported by survey data (see Lafontaine, 1992b; Dant, 1994).

Rubin (1978), who suggested that raising funds from investors is more efficient, has questioned the use of franchising as a means of raising scarce capital *per se*. Accordingly, it is argued that there must be other reasons for franchising than simply that of access to capital. However, Lafontaine (1992a) has suggested that the existence of higher incentives at the single (franchised) unit than those found in a company-owned and managed chain, could produce a scenario whereby franchising was a more efficient source of capital than investors. This is an important issue, as clearly there are companies who do have access to capital markets, but who continue to prefer franchising as a mode of operation and consequently this behaviour cannot be explained by sole recourse to resource scarcity theory (Lafontaine and Kaufmann, 1994).

Agency theory

It is the apparent anomaly in resource scarcity theory described above that the second explanation for franchising seeks to address. Here researchers draw upon the theory of efficient capital markets which suggests that a franchisor would reduce the level of risk inherent in a given activity through direct ownership and thus achieve a lower cost of capital – and thus a reduction in capital scarcity – than could be achieved by franchisees. Consequently, there must be an alternative explanation for franchising and to this end researchers draw upon what is known as agency theory (Brickley and Dark, 1987; Mathewson and Winter, 1985; Rubin, 1978). The agency problem arises because of a divergence of goals between the managers (agents) that firms (principals) employ (Eisenhardt, 1989; Jensen and Meckling, 1976). Here it is argued that managers as agents, since they have their compensation fixed, will tend to shirk in their duties to the firm (the principal). A related danger is that agents will behave in an opportunistic fashion and pursue their own interests at the expense of those of the principal. A primary reason for this potential behaviour is that in an employment situation any surpluses generated by employees belong to the owner and thus they have no incentive to maximize their work effort in the interests of the firm. Since this is the case, the firm has to incur costs in order to monitor employee activities to ensure that they act in the best interests of their employer. The franchising arrangement is seen as being more efficient in this respect as the interests of both the franchisor and the franchisee can be more closely aligned through the effective design of the franchise contract and thus reduce the threat of potential opportunism (Elango and Fried, 1997).

From an agency perspective the argument is that rational franchisors will act to maximize the value of their system of operation through minimizing the cost of effective monitoring of the activities of units. Franchising, it is argued, can, given certain circumstances, provide a hybrid form of organization that delivers this desired outcome (Klein *et al.*, 1978; Rubin, 1978). The point at which franchising becomes superior to company ownership is the point at which the marginal cost of monitoring owned units becomes greater than the marginal cost of using franchise contracts (Norton, 1988b). It is claimed that in franchising there is a potential for greater goal convergence between agents (franchisees) and principals (franchisors) than in the employment arrangement as used in the case of company ownership (Combs and Castrogiovanni, 1994). In the case of the latter, monitoring costs are driven by a number of factors, including (Caves and Murphy, 1976; Rubin, 1978; Brickley and Dark, 1987; Martin, 1988; Norton 1988a, 1988b):

- the importance of local knowledge;
- spatial proximity of units to the head office and to one another;
- availability of trained managers;
- the population density at unit locales.

All of these factors act to determine the total costs of ensuring the effective monitoring of units.

The obvious question that arises at this juncture is why should franchising remove or reduce such costs? The primary reason cited is that the franchisee is motivated to maximize the present value of his or her own operation and this aligns with the interests of the franchisor. Since the franchisee has a significant personal investment in their own unit they will, if rational, act to maximize the returns from the operation. Through payment of an initial fee and the subsequent ongoing royalties to the franchisor, the franchisee has full residual claim on any profits that arise from the operation. The only way that the franchisee can maximize the present value of the unit and thus achieve an acceptable return on their investment (which also includes equipment and fitting out costs) is through engaging in effective day-to-day management practices (Alchian and Demsetz, 1972; Norton, 1988b; Carney and Gedajlovic, 1991). However, franchising itself is not without monitoring problems for the franchisor and thus it too has monitoring costs that must be considered.

A central issue for the franchisor is the attainment of system-wide goals and, at times, this may result in conflict between the franchisor and franchisees. For example, franchisees may resist pressure to make ongoing or additional investments in their operation given their high initial investment at start-up. While further investments may bring system-wide benefits they may provide little perceived additional value to the individual franchisee. Accordingly, a major challenge for the franchisor can be motivating franchisees to adopt more of a system-wide perspective of their individual activities. This can prove difficult where the franchisee discerns little or no tangible benefit from any additional investments requested by the franchisor. Typically, the franchisor will have to resort to the active selling of new initiatives and attempt to encourage a position of enlightened self-interest on the part of the franchisee. Success or otherwise in this endeavour is likely to depend upon the level of trust in the relationship rather than through invoking clauses in the franchise agreement or making veiled threats about future dealings with one another. In Chapter 4, Morrison explores this issue in more depth.

Empirical support for the agency theory of franchising has been provided by Brickley and Dark (1987), who found that high employee monitoring costs, low initial investment cost and a high frequency of repeat customers per unit favoured franchising over company ownership. The prediction of agency theory that both urban and larger units will induce company ownership has found support in research undertaken by Thompson (1992). Where franchising is deployed, the primary advantage from the franchisor's perspective is the high level of motivation among franchisees compared to paid managers (Lillis *et al.*, 1976). In short, owner–managers appear capable of working the assets deployed in a unit much more efficiently and effectively than employee–managers and at a lower cost to the franchisor. If the franchisor's operating system is configured to produce the optimum return from the business then the rational franchisee will be very strongly motivated for sound economic reasons to observe the system as prescribed by the franchisor.

Towards a 'unified' theory of franchising

While the two theories of franchising discussed above are often presented as competing explanations as to why companies franchise, there is perhaps merit in considering them as being complementary rather than distinctive perspectives. Some researchers have taken this approach and provided evidence that tends to support such a view. Martin (1988) found both resource scarcity (capital requirements) and agency (monitoring costs) reasons for franchising, in addition to competition and scale factors. The development of a path model of the franchising life cycle by Carney and Gedajlovic (1991) using data from Quebec, combined both franchising theories. Furthermore, research by Lafontaine (1992a) supported the prevalence of franchising as a solution to incentive problems, but also as a means of accommodating growth strategies. In the case of the latter issue, she highlights that the resource constraint to be confronted may well be other than that of a financial nature. Overall, it would appear that both perspectives on why companies franchise offer useful insights. The challenge that currently confronts academics is to draw these two sets of explanations together in a unified framework that resolves some of the apparent contradictions that remain.