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Examining strategic and economic development implications of globalising through franchising

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Abstract

This paper addresses the strategic and policy implications of franchise system expansion overseas. The study is based on survey data of 76 Mexican buyers of US franchise systems and information provided by seven directors of national franchise associations from both industrialised and developing countries. Globalisation, economic liberalisation and advances in communications provide strong incentives for franchising firms to seek access to foreign markets. This work delineates the conditions that favour, and that work against, international expansion of franchise networks from the perspective of franchisors, local franchise buyers and policy makers. The study questions the commonly held notion that franchising is consistent with successful firm strategies and the economic development goals of governments. © 2000 Published by Elsevier Science Ltd. All rights reserved.

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1. Introduction

The trend towards the globalisation of final markets, whereby firms increasingly perceive consumers separated by national boundaries as similar, has arguably led to a homogenisation of preferences (Levitt, 1983). This trend has helped to promote a rapid growth in business format franchising as a vehicle for entering new markets. In the vanguard of this growth are US franchising firms (Hoffman & Preble, 1993).

Franchising, however, remains a relatively poorly understood mode of inter-

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nationalisation. To a large extent, research has been hampered by the commonly held assumption that selling franchises into international markets is simply a cross-border extension of domestic sales. This study disputes this assumption. It draws upon the empirical results of two surveys; one, of Mexican firms operating US-originated franchise systems, and a second of the directors of national franchise associations in various industrialised and developing countries. We find that distinctions should be drawn between domestic and international franchising transactions, in terms of the resources provided and accessed by franchisors and foreign firms. The discussion then turns to the strategic considerations of franchisees and franchisors contemplating involvement in international business format franchising. It focuses on the concerns that format sellers and buyers might have with franchising as an effective and efficient mode of operation. Finally, some implications for policy makers in terms of the impact of franchising on economic development are considered.

2. Business format franchising

International business format franchising is a contract-based organisational structure for entering new markets. It involves a franchisor firm that undertakes to transfer a business concept that it has developed, with corresponding operational guidelines, to non-domestic parties for a fee. These business concepts tend to pertain most to service-based industries such as fast food restaurants and automobile repair and rental, and to professional services such as hotel management and real estate services. Once the potential franchisor has established a reputation for its business concept, this develops demand as a 'leasable' commodity. The franchisor packages the business concept, operational guidelines and access to its trade and brand marks, and offers this business format to firms, who purchase the rights to exploit commercially the concept and trade names for a given period of time (typically between five and fifteen years) in a given geographical territory. Typical franchise contracts require an up-front payment to the franchisor as well as royalty payments based upon sales in the stipulated territory.

At the outset, it is important to recognise that the transfer of rights surrounding the franchise format to an independent foreign firm can be effected in several ways (Burton & Cross, 1997). In the first, termed direct franchising, the franchisor negotiates and transacts with each owner–operator of the franchise outlet, the franchisee, on a one-to-one basis in the host market. In the second, known as area development franchising, the area developer is granted the right by the franchisor to establish a network of internal outlets run by employee–managers of the area developer in a specified territory. However, the area developer is not permitted to sub-franchise; that is, sell the franchise on to other local concerns. In the third form, master franchising, the master sub-franchiser is granted by the franchisor the right to sell, or sub-franchise, the format to individual owner–operators of outlets. In effect, it becomes the direct franchisor to sub-franchisees in the market. Franchisees, master sub-franchisers and area developers are hereafter referred to collectively as 'franchise buyers'. In each case, the buyer of the franchise is unrelated to the franchisor, and transactions between them occur at 'arm's length'.