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A strategic groups approach to the franchising–performance relationship

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Abstract

Although franchising is a pervasive organizational form, little is known about its performance consequences. Prior studies have not found a direct performance effect, suggesting a need for alternative approaches. Drawing upon agency and resource scarcity theories, we develop the idea that strategic groups exist among franchisors and that performance differs among the groups. Using a sample of 65 restaurant chains, three strategic groups were found. The strategic group most influenced to franchise out of resource scarcity exhibited poorer performance than the other two groups. Results indicate that important, but nonlinear, relationships exist among franchising, its antecedents, and performance.
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1. Executive summary

Franchising has been widely recognized as an important source of entrepreneurial activity both in the United States and abroad. Indeed, when all major types of franchises are considered, franchise systems account for an estimated 40% of all goods and services

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sold in the United States (International Franchise Association, 1994). Whereas a growing body of literature has evolved to further understand franchising (Kaufmann and Dant, 1998; Dant et al., 1996), few studies have examined the performance consequences for the franchisor (i.e., Combs and Ketchen, 1999a; Michael, 2002; Shane, 1996).

This study adopts a strategic groups approach to examine the effect of franchising on performance. Strategic groups are sets of firms in an industry that display similar competitive profiles (Porter, 1980). Drawing upon the dominant theoretical explanations for franchising—resource scarcity and agency theory—we describe three key resource scarcities (i.e., managerial expertise, local market knowledge, and capital) in addition to agency-based factors that affect the cost of motivating and monitoring outlet-level agents. We assert that franchisors' different resource scarcities and agency-based factors lead them into different strategic profiles with respect to the use of franchising.

Using data from 65 publicly traded restaurant chains from 1991 through 1995, we empirically derive strategic groups of firms that are similar along the described resource- and agency-based characteristics and test for performance differences among the groups. Cluster analysis revealed three strategic groups. Agency franchisors franchise at a moderate level, seemingly to overcome difficulties that arise from operating outlets in dispersed geographic locations, while taking care not to franchise so much as to harm their valuable brand name reputations. Agency franchise minimizers are regionally focused chains with strong brands, which they protect through greater use of company ownership. Resource scarce franchisors appear to rely more heavily upon franchising as a means to overcome a lack of resources. Performance tests revealed that agency franchisors and agency franchise minimizers were the best performers, suggesting that using franchising to overcome resource scarcity may not translate, at least in the short run, into improved performance.

One key implication of the study is that franchisors are heterogeneous. Researchers should thus avoid aggregating disparate firms and searching for linear relationships because aggregation can mask important insights (Miller, 1987). For managers, the results show that selecting between franchising and company ownership on the basis of agency cost considerations enhances performance. However, managers should be cautious about using franchising primarily to overcome resource scarcity.

2. Introduction

Whether to offer franchises is an important decision for many ventures. Franchising is an organizational form wherein one firm (the franchisor) allows a second (the franchisee) to market goods or services under the franchisor's brand name and to use its business practices (Stanworth and Curran, 1999). While used in many industries, franchising is most common in settings where the nature of the product or service prevents firms from separating production and consumption (e.g., food service, lodging). Such firms must offer geographically dispersed outlets located near customers (Kaufmann and Dant, 1998). Each outlet may be structured as a company-owned outlet

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