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Growing through copying: The negative consequences of innovation on franchise network growth

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ABSTRACT

We explore how more exactly copying a blueprint for establishing a franchise network in a new country influences franchising network growth. We test opposing hypotheses using panel data involving the transfer of franchising knowledge to 23 different countries, measuring the degree to which master licensees 'copy exactly' knowledge concerning how to grow a network in their country and the effect that their approach has on subsequent network growth. We conclude that a strategy of copying more exactly seems to enhance growth and that the benefits of more exactly replicating knowledge in the 1st year of a local network's existence persist for several years. Thus, innovation, in this specific context, seems to hinder firm growth.

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1. Introduction

Since Schumpeter (1911), sustained and comparatively faster innovative activity has often been considered to be a strong correlate of firm growth (Del Monte and Papagni, 2003). More recently, however, the replication, or exploitation, of an innovative business model has also become an increasingly salient driver of firm growth. Indeed, the successful geographic replication of a business model is the primary form of growth strategy for a diverse and increasingly large set of organizations that grow through the creation and operation of a large number of similar outlets that deliver a product or perform a service.

These 'replicator' organizations that focus on growth through exploitation rather than continuous innovation are emerging in many sectors as a dominant economic phenomenon of our time. In 1997, 62% of all retail sales in the United States passed through chain organizations and their share of economic activity is rising (Kalnins and Mayer, 2004). Chains are now active in over 75 industries as diverse as fast food, banking, discount retailing, hotels, accounting, mail service, interior design, and personnel consulting. By 2001, business format franchise chains alone had created 14% of all private-sector jobs and 11% of all private-sector payroll in the United States (Association, 2004).

Conventional wisdom suggests that the replicator's 'formula' for success is either sufficiently simple or well understood that it can be tailored uneventfully to fit the relevant characteristics of the host environment through adaptive modifications.[2] Few challenge the view that such innovations are to some degree necessary to fit new environments if performance is to be maximally effective,

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[2] Innovation is defined as introducing a new method of doing business. Adaptation to a new environment of a set of business practices comprising a franchise system is, by definition, innovation in as much as it introduces a new way of doing things in that environment, which is also different from the standardized, replicated franchise model. In this study we use the term innovation to describe modifications made to adapt a codified blueprint for how to build a franchise network in a particular country. Whether this is introduced locally or centrally is immaterial as it constitutes a method of doing business.

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especially when contexts vary widely, such as in the case of International expansion. Indeed, previous work in the International Business literature has suggested that such local adaptation may be essential for successful subsidiary operation (e.g., Bartlett and Ghoshal, 1989; Kostova, 1999) and possibly for subsidiary survival (Sorge, 1991).

Closer scrutiny of how replicator organizations grow, however, has uncovered possible dysfunctions of adaptive innovations. It is increasingly recognized that the business model or system leveraged by a replicator is often a complex set of interdependent activities (Porter, 1996; Rivkin, 2001; Winter, 1987). Reproducing such a 'recipe' often means re-creating the knowledge underpinning a system of complex, causally ambiguous, and imperfectly understood productive processes at each new site.

Thus, an emerging view contends that the nature of the knowledge to be replicated is an important factor affecting the relationship between local innovation and performance (Baden-Fuller and Winter, 2007; Winter and Szulanski, 2001) which is at least as important as knowledge of the local environment. Thus, knowledge for subsidiary success is no longer seen to reside mostly at the local level but may be embedded in headquarters, thus shifting the balance point between center and local knowledge at least early in a unit's life. Innovation in the form of local adaptation, if undertaken too early or too substantially may undermine the ability to utilize the template, or original set of practices, thus hampering the replication (Jensen and Szulanski, 2007; Szulanski and Jensen, 2006). In such circumstances, a strategy of discouraging innovation and copying the original as closely as possible has been found to be efficacious.

This paper addresses two primary questions. First, to what extent is such a strategy of 'copying more exactly' efficacious in the cross-border transfer of knowledge? Second, if such a positive effect exists, how persistent is it? Theoretically, over time exact adherence to an original template becomes less needed as knowledge is better understood and local innovations can be made more effectively.

Our setting is the transfer of franchising knowledge from the headquarters of Mail Boxes Etc., a large, US-based, non-food multinational franchise firm, to 23 of its foreign subsidiaries. The period of observation is from 1989, with the opening of MBE's first international network, to 2003. Specifically, we measure the correlation between the degree to which Master Licensees (MLs—individuals who own the right to build a network in a country or region) follow a codified blueprint for network growth and the ensuing growth of their franchising networks. The analysis suggests a strong positive correlation between growth and how closely the blueprint is followed, implying a negative correlation between ML innovation and growth, an effect that persists for the first several years of a network's existence.

2. Theoretical background and hypotheses

2.1. Replication of organizational routines

While many types of knowledge assets may be important for gaining and sustaining competitive advantage, Teece et al. (1997), following Nelson and Winter (1982), suggest that, due to causal ambiguity and inherent difficulty in imitating them, those most clearly contributing are embedded in organizational routines (see also Jensen and Szulanski, 2007; Rivkin, 2001; Winter, 1995). While possession of superior routines, i.e., those that produce superior performance, is a necessary condition for sustained competitive advantage it likely is not sufficient for most firms. Superior routines are often a product of a particular time and place, developed in relation to specific circumstances and personnel (Amit and Schoemaker, 1993). As such, they tend to originate in specific locations and require transfer, or replication, to other locations in order to exploit their value (Winter and Szulanski, 2001). While there is some cost to transfer, the value of successful practices is often maximized by transferring them to as many relevant units as possible within the organization.

Given that organizational routines embody a firm's productive knowledge, unless an MNC competes solely through exports, competitive advantage on a global scale may require the replication of successful practices. Indeed, replication is increasingly recognized in the strategy literature as a fundamental source of competitive advantage (Argote and Ingram, 2000; Bradach, 1998; Jensen and Szulanski, 2007; Kostova, 1999; Rivkin, 2001; Szulanski and Jensen, 2006; Teece et al., 1997; Winter, 1987, 1995; Winter and Szulanski, 2001) and scholars in International Business have long suggested that the value of leveraging superior organizational practices through replication in different countries is a fundamental reason for MNC existence (Buckley and Casson, 1976; Hymer, 1976; Kogut and Zander, 1993; Zaheer, 1995). This is particularly true for multinational franchises, which compete primarily through the replication of successful practices.

2.2. The case for local innovation in cross-border replication: the potential negative consequences of 'copy exactly'

One of the fundamental questions for organizations pursuing growth through replication is whether or not and to what extent they need to innovate by adapting transferred knowledge to fit varied local environments. Innovation and adaptation are synonymous in this regard as both engender changes to the established model. The general economic argument is that profit maximization in the presence of market heterogeneity necessitates local innovation. Geographic dispersion exposes replicating organizations to diverse market conditions. Thus, uniform operating procedures cannot optimize performance in each location (Kaufmann and Eroglu, 1999). Indeed, franchising as an organizational form is often considered to represent an efficient response to the need for local innovation as franchisees operate with the clear objective to maximize their own local profits (Alchian and Demsetz, 1972; Brickley and Dark, 1987). Moreover, local units have the most relevant knowledge of prevailing local tastes and market conditions which should presumably enhance the odds of success of any innovation they introduce to the replicating organization's standardized practices (Minkler, 1992).

This is particularly true for the replication of organizational practices across national borders. In general, it is argued that conditions vary widely in different locations,

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