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First mover advantage through franchising

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Abstract

Franchising has been argued to be a technique for entrepreneurs in service industries to assemble resources in order to rapidly create large chains and gain first mover advantage. Whether and how such first mover advantage is created is the subject of this paper. Using theories from strategic management and marketing, it is argued that the first mover advantage initially takes the form of a lead in the number of retail outlets, followed by a market share lead, and, finally, superior profitability. A structural equations model is specified, and empirical results from the restaurant industry support the model's predictions. Implications for research and practice are discussed.

Keywords: Franchising; Organizational form; First mover advantage; Restaurant industry

1. Executive summary

Franchising is a prominent part of the economy and a central phenomenon in entrepreneurship. Practitioners often recommend franchising as a method that entrepreneurs can use to assemble resources to create large chains rapidly. Whether and why such rapid growth is desirable has not been examined in the research literature, however. For rapid growth to be desirable, there must be a *first mover advantage* associated with the product market in which the franchise chain competes. This paper investigates whether first mover advantage exists in the restaurant industry, the specific mechanisms by which it occurs, and the role that franchising as an organizational strategy plays in its exploitation.

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Why might first mover advantage exist? Services such as retailing and restaurants, prominent franchising industries, typically must be delivered at a particular place, so preemption of valuable real estate may be possible. Second, the first product in a market can shape the preferences of the customer. A premium is then created on rapid expansion of geographic sites. More sites allow the preemption of more real estate, and more sites also allow for a broader base of customers to experience the product and shape their preferences.

These theoretical reasons suggest a model of how first mover advantage in services occurs. The entrepreneur develops an innovation in retail trade or services. The entrepreneur turns to franchising to develop resources quickly to gather persons, sites, and money needed for expansion. Rapid expansion is necessary in order to secure desirable real estate and desirable mind space against potential imitators. Rapid expansion yields high outlet share, high outlet share yields high market share, and high market share leads to high profitability. The theoretical model is summarized in Fig. 1.

Using a set of regression equations, empirical results support the hypothesized model. Across nine sectors of the restaurant industry, firms that are first to franchise have larger outlet share than competitors. Interestingly, the advantage does not fall to the oldest firm (the first to be founded) but the first to franchise. Thus, franchising is a key organizational strategy to secure an outlet share advantage. Next, regressing outlet share on market share yields a strong linear relationship. Finally, in a profitability equation, market share has a significant and positive coefficient. In short, expanding units rapidly through franchising leads to superior outlet share, and outlet share yields market share, and market share yields profitability. Therefore, franchising is one method of securing first mover advantage.

Aside from demonstrating how first mover advantage is secured, the results suggest two other managerial implications. First, how entrepreneurs assemble resources is and remains a central concern to academics and practitioners. Given the well-known problems of entrepreneurs obtaining resources (particularly financing) for opportunities dependent on consumer tastes, and the competitive advantage demonstrated by the first mover in this paper, entrepreneurs in services and retail trade should franchise in order to gain competitive

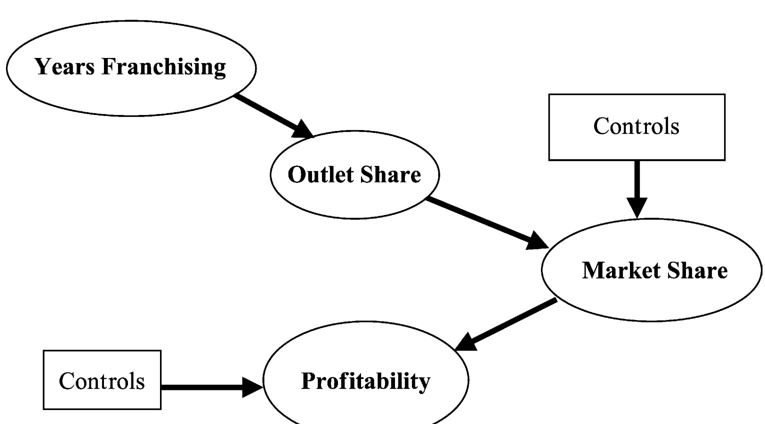

Fig. 1. Structure of the model.