Franchising from the franchisee's perspective

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A review of the multi-unit franchising paradox

Marko Grünhagen and Robert A. Mittelstaedt

Abstract: The focus of this article is on the emergence and development of multi-unit franchising in the USA from the franchisee’s perspective. After a historical summary of the development of franchising from a marketing viewpoint, a typology of different franchisee types is provided, and the multi-unit franchising paradox is presented. The article offers a discussion of reasons why individuals might be enticed to become multi-unit franchisees. Emphasis is placed on entrepreneurship as a possible motive for sequential owners’ involvement as multi-unit franchisees. The article concludes by providing encouragement for future research to investigate the issue empirically.

Keywords: Franchising; multi-unit; single-unit; franchisee; review; motivations

Over the past two decades, the franchising industry has experienced a phase of renewed expansion and continued growth, spurred to a large extent by the advent of new forms of franchising. New industry segments, such as funeral homes and car repair garages, have adopted franchising as a means to conduct business based on its standardization promise, and the expansion into so-called ‘non-traditional’ sites, such as airports, colleges and hospitals, has allowed for another push in the growth of franchise systems. In the wake of globalization, which accounted for much of the industry’s expansion between the 1960s and 1980s, a major portion of the more recent increase in sales and unit growth can be attributed to the emergence of franchise owners who own more than the traditional single outlet (Kaufmann, 1992). In many cases, such multi-unit franchisees’ mini-chains extend across entire states, encompassing hundreds of outlets (Kaufmann, 1988; Bodipo-Memba and Lee, 1997). In contrast, Bond’s Franchise Guide (1998) provides figures that put the median size of entire franchise systems at only 64 outlets. With half of today’s retail goods being distributed through franchise systems, the trend towards multi-unit franchising has become a pervasive phenomenon.

However, ownership attention as the core advantage of franchising for the franchisor seems to get lost in a multi-unit ownership arrangement. In addition, franchise ownership of multiple outlets seems to represent, at best, an equivalent solution to other types of capital investment, and at worst, an inferior alternative in light of the stock markets’ continued surge paired with semi-dependence on the franchiser. A clear need exists for entrepreneurship researchers to understand the emergence of such important and pervasive institutions as the new breed of multi-unit franchise businesses; this article is considered a step in this direction.
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First, an overview of the history and broad characteristics of traditional franchising in contrast to the more modern phenomenon of multi-unit franchising is provided. Then, the ‘multi-unit franchising paradox’ will be examined. Multi-unit franchising will be examined by offering suggestions why multi-unit franchisees might be interested in this particular business arrangement. Hence, a distinct focus will be placed on the discussion as to why multi-unit franchising may exist from the franchisee’s perspective, and on entrepreneurship as a possible motive for sequential owners for their involvement as multi-unit franchisees. Multi-unit franchising seems to be such a pervasive phenomenon today that the question of why those involved engage in this endeavour seems not just warranted, but almost overdue. The franchising industry in the USA serves as the basis for the conceptual exploration of this paper, due to its advanced development compared with less mature franchise markets around the globe.

Historical overview

Franchising as a distinct form of distribution goes back to the early 1800s, when beer brewers in Europe entered into licensing and financing agreements with bars and taverns to distribute their beverages under the exclusive rights of various types of beer and ale. In 1863, the Singer Sewing Machine Company instituted the first consumer product franchise system in the USA. During the 1890s, the automobile and soft drink industries adopted franchising as the primary means of distribution, and in the 1930s, petroleum producers followed (Hackett, 1976). The marketing and the economics literatures classify this ‘first generation’ of franchise systems, which was adopted early on and continues to the present, as ‘product and tradename franchising’. This is characterized by franchisees who simply distribute a product under a franchisee’s trademark (Preble and Hoffman, 1998). The franchising industry began a period of accelerated growth in the 1950s. After Howard Johnson had developed the first franchised restaurant chain in 1935, fast-food restaurants, hotels, entertainment and rental service businesses integrated the franchising concept into their respective strategy (Hackett, 1976). With these newer types of franchise systems, the main focus shifted from the traditional perspective of a distribution channel to a franchise business franchise with that of ownership of an entire businessidea by the franchisor, and its rental to the franchisee (Caves and Murphy, 1976). This so-called ‘second generation’ of franchising is defined as ‘business format franchising’ in which the relationship between franchisor and franchisee ‘includes not only the product, service, and trademark, but the entire business format itself — a marketing strategy and planning, operating transals and standards, quality control, and continuing two-way communication‘ (US Department of Com- mercial, 1988: 3). By the late 1960s, the initial rapid growth of franchising within the USA had levelled off due to changing perception of market saturation and heightened competition. Consequently, franchisors began to expand beyond US borders. While in 1969 only 14% of the major companies on a new development in Franchise Association (IFA) had foreign operations (Hackett, 1976), today more than 20% of established franchise chains, approximately 400 companies, have globalization their franchisees (Ryan, Louis, and Markoff, 1997).

During the past decade or so, the face of the domestic franchise industry has changed dramatically. An ever growing number of franchisees has established multi-unit operations within existing franchise systems, with various forms of multiple-unit ownership emerging. The following section will provide an overview of some of the more important types of single-unit as well as multi-unit ownership.

Franchising characteristics and types

Much confusion still surrounds the concept of franchising, as the franchisees agree to follow certain guidelines and operating standards, and pays an entry fee, royalties and various other recurring fees, in return for the franchisor’s advice and services regarding site selection, financing, advertising, litigation and so forth. A variety of franchise forms coexist under the same name. However, the traditional perception of franchising is the ‘mom and pop’ franchisee, who brings all of her/his entrepreneurial capability to the franchising entity by opening one outlet (Caves and Murphy, 1976). In recent years, practitioners as well as researchers’ attention has been directed to franchisees in franchising, the trend towards multi-unit franchising. In contrast to the historic ‘mom and pop’ franchisee, an ever growing number of franchise owners currently operates more than one outlet. Over the past few years, various studies have indicated the persistent importance of multi-unit franchising in the USA. Kaufmann and Dant (1996) found that 88% of the surveyed franchisees had multi-unit franchisees, while Kaufmann (1995) found that 83% of the surveyed new Mexican restaurants in 1994 were opened by existing franchisees. Within the McDonald’s franchise system, between 1980 and 1991, 61.5% of all new restaurants were opened by existing franchisees (Kaufmann and Lafontaine, 1994). Consequently, Kaufmann and Dant (1996: 346-347) conclude that ‘the typical location-based franchise system of which the fast food franchise is the prime model example) is populated with multi-unit franchisees.’ Further, based on various recent studies (eg Kaufmann and Kim, 1993 and 1995; Robicheaux, Dant, and Kaufmann, 1994), it can be concluded that the franchising sector is not only growing, but that a substantial portion of the industry’s growth can be attributed to the increasing popularity of multi-unit franchising. Kaufmann and his colleagues (Kaufmann and Dant, 1996; Kaufmann and Kim, 1993 and 1995) identify three types of multi-unit franchisees, apart from the traditional single-unit franchisee. ‘Subfranchising’, often also denoted ‘area development franchising’, is characterized by the franchisee’s permission to a franchisee to open a specified number of outlets (Robicheaux, Dant, and Kaufmann, 1994). Further, based on various recent studies (eg Kaufmann and Dant, 1996: 346-347) conclude that ‘the typical location-based franchise system of which the fast food franchise is the prime model example) is populated with multi-unit franchisees.’ Further, based on various recent studies (eg Kaufmann and Kim, 1993 and 1995; Robicheaux, Dant, and Kaufmann, 1994), it can be concluded that the franchising sector is not only growing, but that a substantial portion of the industry’s growth can be attributed to the increasing popularity of multi-unit franchising. Kaufmann and his colleagues (Kaufmann and Dant, 1996; Kaufmann and Kim, 1993 and 1995) identify three types of multi-unit franchisees, apart from the traditional single-unit franchisee. ‘Subfranchising’, often also denoted ‘area development franchising’, is characterized by the franchisor’s permission to a franchisee to open a specified number of outlets. ‘Sequential multi-unit franchising’ as well as ‘sequential multi-unit franchising’ denote the types of franchising in which the franchisee himself opens additional units under her/his own ownership and management. They are the prevalent types of franchising in the USA (Robicheaux et al, 1994), with sequential multi-unit franchising as the most common domestic form (Kaufmann, 1992). In area development franchising, the franchisor requires the franchisee himself to exercise the contractual obligation to open a specified number of outlets within a specified period of time. In sequential multi-unit franchising, the franchisor simply grants the franchisee the right to open additional units, with each subsequent outlet being legally governed by a separate franchise agreement. This franchising form is based on the desire by traditional single-unit franchisees to open additional units in order to grow their businesses, and qualification for expansion is often based on the performance of existing units (Kaufmann and Dant, 1997). Both of these types of multi-unit franchising actively encourage the creation of mini-chains, in multiple units owned by a single franchisee and operated by employee-managers of the franchisor.

Multi-unit franchising, either through incremental expansion by the franchisee one unit at a time, or through the contractual agreement to open multiple units contained in an area development contract, creates a collection of mini-chains within the franchise system. Both Kaufmann (1988) and Bodipo-Membu and Leit (1991) indicate that these mini-chains in some cases extend across entire states, and may encompass hundreds of outlets. Area development contracts force area developers to approach their assigned territory in a systematic fashion, thus accelerating the growth process. Area developers generally operate within a specified exclusive territory, which is defined in their contract with the franchisor. Hence, they forge cooperation with other franchisees and outlets owned by the franchisor (Ryans and Jauld, 1996). Sequential multi-unit franchisees, on the other hand, develop all of their outlets subsequently as money allows and opportunities arise, with overlapping trade areas between such franchisees frequently, individual area developers own more outlets that sequential multi-unit operators, as the expansion process for the sequential multi-unit franchisee is usually a slower one. The conflict prevention potential of area development franchising has spurred its growth in particular (Kaufmann and Kim, 1993 and 1995; Zeltzer, Achabal, and
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Brown, 1980). Consequently, the growth of multi-unit franchising as an aggregate is a result of various factors, among them:

(a) systemic and obligatory growth of area developers;
(b) prevention of territorial encroachment through exclusive territories for area developers; and
(c) increased, but widespread growth of sequential owners.

In the subsequent section, the focus will be on the issue of why individuals engage in multi-unit franchising. Multi-unit franchisees have become such large and pervasive marketing institutions that this question seems warranted. In contrast to the traditional research perspective taken in marketing, in which the role of the franchisor has been scrutinized for the most part, the viewpoint of the franchisee is emphasized here.

The multi-unit franchising paradox

From a theoretical perspective the phenomenon of multi-unit franchising seems counterintuitive. The main reason for the existence of franchising in the literature from the franchisor’s point of view has been attributed to the advantage of owner attention, the increased profitability that a franchised outlet generates, based on the economies, and often appears to provide franchisees with potential multi-unit franchisees to invest their money, such as the securities or real estate markets, may appear equally profitable, given the variability of returns across franchise systems. Hence, alternatives to multi-unit franchising might represent equally enticing investment options. The fact that multi-unit franchising has emerged as the dominant phenomenon in the US franchising industry despite the mentioned drawbacks is coined here the ‘multi-unit franchising paradox’. It seems as if, for the potential franchisee and the franchisor, the multi-unit franchising concept might be part of a considered set of alternative options. By no means, however, does multi-unit franchising seem to present itself as the clear superior choice. The three questions in Box 1 are suggested to provide overarching themes and guidance to the basic question of ‘what is the justification of multi-unit franchising from the franchisee’s point of view?’ The third suggestion will be pursued further, while the first two suggestions are meant to encourage further research.

Why multi-unit franchising?

(1) Perhaps for the same reasons as single-unit owners, with the only difference being more franchisor’s involvement.
(2) Perhaps the belief prevails that, being bigger than single-unit operators, multi-unit owners might be able to ‘beat the game’.
(3) Perhaps a completely different philosophical orientation, of franchisees might consider themselves more entrepreneurial than others.

To try to answer the general question, ‘why multi-unit franchising?’, three possible answers seem to emerge from the literature:

(1) Single-unit franchisees may be so eager to get into business for themselves that they become risk-averse, that is, fear losing the cost of capital relative to a vertically integrated system. This argument is extended by saying that multi-unit franchisees are different from single-unit franchisees in that respect, Indeed, they are just like single-unit operators, except that they have more money to invest.
(2) Multi-unit operators believe that, because they are entering in a bigger way, they can ‘beat the system’ by garnering advantages inherent in larger, geo­graphically dispersed operations.
(3) The same ‘experts’ who have argued that multi-unit operators, on the other hand, have also argued that ‘entrepreneurship’ has no place in the study of franchisees. Why would anyone who has any entrepreneurial spirit want to take on a role that is almost indistinguishable from that of an employee? However, research suggests that the entrepreneurial spirit lives in multi-unit operators and, specifically, in those that develop sequentially.

Entrepreneurship as a motivator

The franchising literature has borrowed from fields such as entrepreneurship (Knight, 1984) and psychology (Felstead, 1991; Mescon and Montanari, 1981) to suggest various reasons for entering into the franchise business from the single-unit franchisee’s perspective. Franchise owners often vehemently deny that their franchisee engagement is based on the monetary earning potential. The opportunity to become one’s own boss and the hands-on work experience is a type of entrepreneurial self-faithfulness, bolstered by the perceived security of the franchisee’s proven business format, trademark and assistance, is a common justification for single-unit operators (Elango and Fried, 1997). The fact that the financial aspect of franchising is truly secondary is supported by the fact that it is often previously highly paid executives who leave their jobs to become franchisees. Most of the research (Anderson, Condon, and Dunkelberg, 1992; Knight, 1984; Mescon and Montanari, 1981) is inconclusive in terms of distinguishing franchisees from independent entrepreneurs based on personal traits, social and economic variables (see also Ginsberg and Buchholz, 1980) for a comparison of entrepreneurs with non-entrepreneurs). One issue that has not been researched, however, is the distinction of different conceptual frameworks (i.e., this research has focused on the franchisor’s perspective. The empirical testing of multi-unit franchising research is just emerging, and has so far answered questions that are very limited in scope, such as issues of growth or system-wide adaptability (see Table I). Bradach (1995), Kaufmann and Dant (1996) and Kaufmann and Kim (1993 and 1995) found that franchisees, such as issues of growth or system-wide adaptability (see Table I). Bradach (1995), Kaufmann and Dant (1996) and Kaufmann and Kim (1993 and 1995) found that franchisees, such as issues of growth or system-wide adaptability (see Table I). Bradach (1995), Kaufmann and Dant (1996) and Kaufmann and Kim (1993 and 1995) found that franchisees, such as issues of growth or system-wide adaptability (see Table I). Bradach (1995), Kaufmann and Dant (1996) and Kaufmann and Kim (1993 and 1995) found that franchisees, such as issues of growth or system-wide adaptability (see Table I).
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Authors
Brandt (1995)

Table 1. Major findings of multi-unit franchising studies.

<table>
<thead>
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<th>Major findings</th>
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<tr>
<td>130 semi-structured interviews with corporate and unit personnel of the large franchise systems</td>
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<td>Multi-unit franchisees offer single-unit franchisees, most importantly in terms of unit growth and unit-wide adoption to the competition</td>
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<tr>
<td>Single-unit franchises previult compared with multi-unit franchisers in terms of local responsiveness</td>
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<td>Both types meet the challenge of uniformity equally well</td>
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Kalnins and Lafontaine (1996)
Survey of 3,400 restaurants of the six largest fast-food chains
Geographic distance and sharing of market boundaries increases likelihood of multi-unit franchising
Differences in demographic characteristics decrease likelihood of multi-unit franchising

Kaufmann and Kim (1993)
Survey of 125 International Franchise Association franchisors
The greater the proportion of a system's multi-unit franchisers, the faster it grows compared with traditional franchise systems
Level of a franchisor's continued commitment to franchisees is negatively related to the number of outlets per franchisee and the ability to obtain capital elsewhere
Combination of agency and capital acquisition arguments as partial explanation for franchising

Kaufmann and Kim (1995)
Survey of 160 International Franchise Association franchisors
Area development franchising and subfranchising are associated with higher growth rates than single-unit franchising
Systems employing area development have a higher proportion of franchisee-owned stores than those employing sub franchising

Puchtfchaus, Dant, and Kaufmann (1994)
Survey of 160 multi-unit franchising systems: status and strategies
Chains within chains: the prominence of entrepreneurship-related research across business disciplines, the exploration of the emergence of such persuasive marketing institutions as franchise businesses of different types appears to warrant attention by scholars of entrepreneurship and franchising issues in particular

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Franchising has neglected to a large extent the franchisee's perspective, and her/his motivation to engage in this endeavour. Hence, at this time no theoretical framework is known which exposes reasons that lead to multi-unit franchising from the franchisee's point of view. One can plausibly conjecture that asserting a single theoretical framework for predicting whether certain multi-unit franchisors or certain advantages as sainitons to franchise would be a very difficult task, since a large number of situational, personal and economic correlates are likely to influence such perceptions. Such a framework can only be isolated gradually, and this article is meant to encourage research in this direction.

In the future, research in this area needs to provide empirical insights into the suggested 'entrepreneurial drive' as a motivator for franchise owners. Such efforts need to combine qualitative efforts in order to gain a better comprehension of multi-unit franchisee

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fast-food industry, which has not only served as a sample for most of the published research on franchising, but also seems to provide the required variety of ownership patterns to compare area developers and sequential operators. The frequent use of the fast-food industry in the franchising studies ought to promote valuable, yet few findings could be validated in the face of prior studies. Considering the recent rise in prominence of entrepreneurship-related research across business disciplines, the exploration of the emergence of such persuasive marketing institutions as franchise businesses of different types appears to warrant attention by scholars of entrepreneurship and franchising issues in particular.

Entrepreneurship and Innovation

Conclusion

To summarize, it has been argued that multi-unit franchisees in general, and sequential multi-unit operators in particular, represent a growing proportion of the franchising industry. From the franchisee's perspective, multi-unit franchisees do not seem to make a lot of conceptual sense, except that they seem to follow for faster growth of the system. However, sequential multi-unit operators do not seem to represent that same advantage since sequencing is a strategy most often found in relatively well-established systems. In addition, the franchisee's perspective has received very little attention in the academic franchising literature. Given that franchise systems inherently give the franchisee only limited control of her/his own business, no opportunity to retrieve any goodwill that the business may have exchanged with the franchisor. Further, most empirical research on franchisees, and on franchising in general, was system-specific, i.e., it was restricted to the operation of one particular franchise system (Kaufmann, 1989; Kaufmann and Lafontaine, 1994). Future research in this area needs to address these issues and an effort to enhance the generalizability of findings across system variables.

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The greater the respondents' perceptions of franchisee and franchisor management agreements, the higher the likelihood of franchise system growth rates. However, sequential multi-unit franchisees do not seem to make a lot of conceptual sense, except that they seem to follow for faster growth of the system. However, sequential multi-unit operators do not seem to represent that same advantage since sequencing is a strategy most often found in relatively well-established systems. In addition, the franchisee's perspective has received very little attention in the academic franchising literature. Given that franchise systems inherently give the franchisee only limited control of her/his own business, no opportunity to retrieve any goodwill that the business may have exchanged with the franchisor. Further, most empirical research on franchisees, and on franchising in general, was system-specific, i.e., it was restricted to the operation of one particular franchise system (Kaufmann, 1989; Kaufmann and Lafontaine, 1994). Future research in this area needs to address these issues and an effort to enhance the generalizability of findings across system variables.
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