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**Contribution of franchise research to entrepreneurship: a  
review and new opportunities**

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# **Contribution of franchise research to entrepreneurship: a review and new opportunities**

## **ABSTRACT**

This paper examines the relationship between franchising and entrepreneurship. The paper begins with a review of studies on franchising in leading entrepreneurship and management journals over a 12 year period. It illustrates how although the franchisor, franchise and the franchise organization are important elements of entrepreneurship, there has been only a tenuous link in the contribution of studies in franchising to entrepreneurship theorising and vice versa. The paper suggests fruitful new avenues for franchise research which would integrate franchising as an important, yet heterogeneous, form of entrepreneurship, namely: opportunities, networks and social capital and entrepreneurial learning.

## **Introduction**

This paper sets out to review the franchising literature in order to identify: a) the progress of research in franchising and b) the potential relationship between franchising and entrepreneurship. Franchising plays an important role in the creation of new businesses worldwide (Dant 2008). The franchisor, franchisee as well as the franchise organization have been recognised important elements of entrepreneurship (Kaufmann and Dant 1999). For over forty years franchising research has appeared in leading entrepreneurship journals. We would therefore expect there to be evidence of how franchise research has contributed to our understanding of entrepreneurship and vice versa.

In order to examine the relationship further, the paper begins with a critical review of the contribution and main themes of franchise research from leading entrepreneurship and management journals over a twelve year period from 1996-2007. Based on this review, the paper then investigates the contributions of franchise research to entrepreneurship. In doing

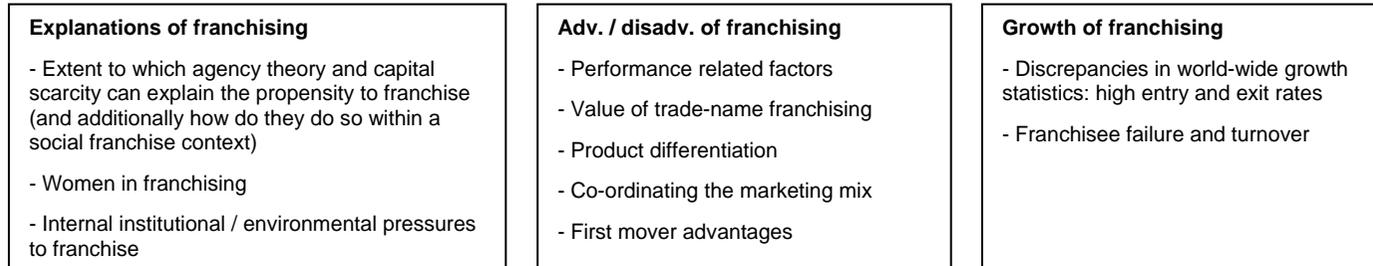
so, it identifies research gaps and illustrates how franchise research struggles to legitimize itself within entrepreneurship research. This is followed by a discussion on fruitful areas of future research which would enable franchise research to more clearly contribute to our understanding of entrepreneurship.

### **Review of the literature 1996-2007**

The selection process for those studies included in this review follows that used by Busenitz et al. (2003) and Jack (2010). Articles were selected for inclusion using Proquest/ABI inform data on the basis of five criteria. First, fifteen academic journals have been identified as prominent entrepreneurship and management journals within Europe and the United States (Busenitz et al. 2003, Fried 2003, Jack 2010). Second, key words related to franchising (franchise, franchisor, franchisee) were used to identify appropriate articles. Third, the research had to focus on franchising in some depth, i.e. mere mention of franchising, or franchising used as a mere context (examples: (Usher 1999, Crossan and Berdrow 2003), was not sufficient. Fourth, publication of the article had to be between 1996 and 2007 inclusive. Twelve years was felt to be an appropriate time period. 1996 was chosen because the last comprehensive review of the franchise literature in *Journal of Small Business Management* was published in 1997 (Elango and Fried 1997). Fifth, articles had to be non-invited and peer reviewed, the review therefore did not include editor notes, book reviews, review articles and replies to published articles. In total 65 articles met these criteria. The main themes of research are illustrated in Figure 1 on the following page, broadly categorised through their focus on different areas of franchising: a) papers which focus on overarching questions of franchising, such as the propensity to franchise, the advantages / disadvantages of franchising and the growth of franchising in society; b) franchisor perspective and the challenges in managing a franchise organization; c) franchisee perspective and the decision to choose a franchise.

Additionally, Table 1 below illustrates how these articles are distributed amongst the leading management and entrepreneurship journals. This table also highlights the number of papers which were predominantly quantitative, qualitative or conceptual and also highlights the main themes of research.

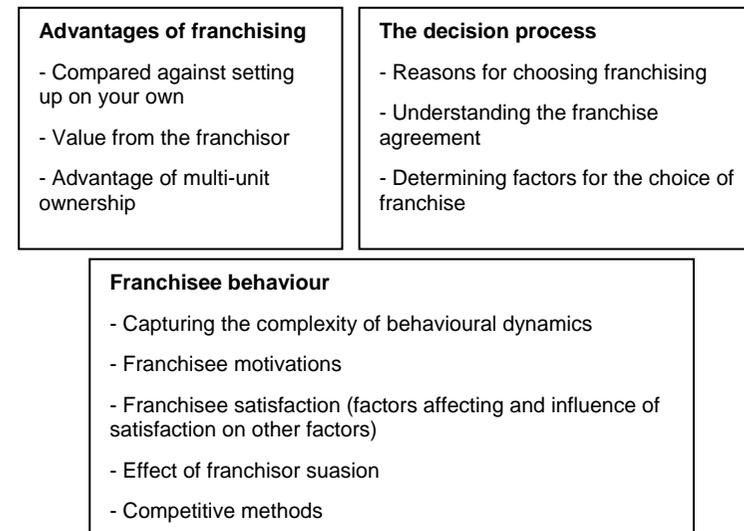
## OVERARCHING QUESTIONS ON FRANCHISING



### FRANCHISOR PERSPECTIVE



### FRANCHISEE PERSPECTIVE



**Figure 1: Key themes in franchise research 1997-2008**

	<b># articles (1996- 2007)</b>	<b># quantitative</b>	<b>Themes of research</b>
Academy of Management Journal	2	2 quantitative	1 overarching 1 franchisor
Academy of Management Review	0	0	0
Administrative Science Quarterly	0	0	0
American Journal of Sociology	0	0	0
Entrepreneurship and Regional Development	0	0	0
Entrepreneurship: Theory and Practice	3	2 quantitative 1 qualitative	3 overarching
Journal of Business Venturing	30	23 quantitative 6 conceptual 1 qualitative	11 overarching 12 franchisor 7 franchisee
Journal of Management	2	2 quantitative	2 overarching
Journal of Management Studies	0	0	0
Journal of Small Business Management	15	13 quantitative 2 literature reviews	6 overarching 4 franchisor 5 franchisee
Management Science	6	5 quantitative 1 conceptual	4 franchisor 2 franchisor & franchisee
Organization Science	2	2 quantitative	2 franchisor
Organization Studies	0	0	0
Small Business Economics	1	1 quantitative	1 overarching
Strategic Management Journal	4	4 quantitative	4 franchisor
<b>Total</b>	<b>65 (100%)</b>	<b>54 (83%) quantitative</b> <b>7(11%) conceptual</b> <b>2 (3%) literature reviews</b> <b>2 (3%) qualitative</b>	<b>22 (34%) overarching</b> <b>29 (47%) franchisor</b> <b>12 (18%) franchisee</b> <b>2 (3%) franchisor &amp; franchisee</b>

**Table 1: Articles on franchising in key entrepreneurship and management publications**

The table clearly illustrates that whilst articles on franchising have appeared in core business and management journals, the main journals publishing franchising research over the last twelve years (in this review) have been 1) *Journal of Business Venturing* and 2) *Journal of Small Business Management*. There have been surprisingly few papers on franchising in other leading management journals. This review is by no means exhaustive, for example there are many other areas in which studies on franchising are regularly published, for

example in the field of marketing, law and economics. Nonetheless, for the purposes of scholars in entrepreneurship, it provides an indication of the extent to which, and an overview of, articles on franchising which are published across management journals.

### **Themes of franchise research**

#### *Overarching questions on franchising*

Articles in this category seek to examine questions about the existence of franchising. The three most popular areas of research have been: explanations for the existence of franchising; the reasons why companies would look towards franchising as a strategy for growth, and the growth of franchising world-wide.

Explanations of franchising have historically been dominated by two theories: agency theory and resource scarcity (Rubin 1978, Oxenfeldt and Kelly 1968). These two theories still play an important role in explanations of franchising today. Michael (1996), for example, developed a model based on agency theory to allow entrepreneurs to identify whether franchising would be an appropriate choice in their target industry. Yet the findings from studies based on agency theory or resource scarcity remain ambiguous (Combs and Ketchen 2003, Combs and Ketchen 1999). This has led some to look for other explanations, such as how both environmental and internal institutional pressures also influence firms' propensity to franchise (Combs et al. 2004b).

Studies looking at the reasons to franchise aim to identify the key advantages and disadvantages of franchising as a strategy for growth. Franchised locations have been shown to provide: higher average sales than similar independent businesses (Bronson and Morgan 1998); product differentiation (Michael 1999); and first mover advantage (Michael 2003). Trade name franchising has also been found to offer value other than as a supplier of low-cost merchandise (Litz and Stewart 1998). Yet the advantages of franchising do not spill over into staff training (Litz and Stewart 2000); and some chains may not be able to take

advantage of the brand value through higher prices than independents (Wu 1999).

Additionally franchise chains may find it more difficult to coordinate price, advertising and quality as well as corporate chains (Michael 2002).

The final area in this category is the growth of franchising as a phenomenon world-wide.

Statistics often illustrate high growth rates of franchising world-wide, but a study by Lafontaine and Shaw (1998) suggested that the perception of rapid growth may be due to the high number of entry and exit figures of franchise organizations. Additionally, franchisee failure rates have also been a key topic for some time, with many believing franchising may be more risky than setting up on your own (Bates 1998, Stanworth et al. 2001). This is backed-up by a recent study which suggested that franchisee turnover rates appeared to have increased noticeably over a 4 year period (1994-1997) (Holmberg and Morgan 2003).

## *2) Franchisor perspective*

The franchisor perspective predominantly explores the challenges for management in running a franchised business. These can be sub-categorised into: growth and survival; franchise organizational structure; relational issues; and decisions over international franchising.

### *Growth and survival*

The growth of a franchise firm has been found to be related positively to both strategy and context (Castrogiovanni and Justis 2002), thus the more a firm emphasises franchising as its expansion strategy it has a significant, positive effect on its growth and survival (Shane 1996a). Additionally, it has also been shown that the more a chain engages in multi-unit franchising, the faster it grows, faster than franchise systems generally (Kaufmann and Dant 1996). Yet high growth franchisors are not perceived as high risk takers but do follow other entrepreneurial strategies (Falbe et al. 1999). Studies have also looked into how franchise organizations change as they grow, Shane et al. (2006), for example, examined how variables within a franchise system change over a period of growth; they found that

franchisors that grow larger: lower their royalty rates as the systems age; have low up-front franchise fees that rise over time; and lower the proportion of owned outlets (Shane et al. 2006). Performance of franchise chains is also closely related to growth. One study looked at how performance relates to resource scarcity and agency theory and found that restaurant chains most influenced by resource scarcity exhibited poorer performance than those who use franchising to minimise monitoring costs (Combs et al. 2004a).

Understanding the factors which contribute to the survival of franchise organizations is important, particularly given the alarming statistics in the section above on franchisor and franchisee failure rates (Lafontaine and Shaw 1998, Holmberg and Morgan 2003). Factors which are believed to contribute to the survival of franchise systems, include: the adoption of exclusive territories (Azoulay and Shane 2001), organizational structures that economise on agency costs (Shane 1998); better management of contracting problems (Shane 2001); and institutional legitimacy (Shane and Foo 1999).

#### *The franchisor-franchisee relationship*

The franchisor-franchisee relationship is central to the franchise organization and it is what makes franchising unique to other organizational forms (Spinelli and Birley 1996). Most work within this area assumes that in order to work effectively, the franchise organization needs to promote a healthy two-way relationship between franchisor and franchisee. Studies have thus looked into a variety of factors which can affect the relationship or can contribute to conflict: the role of communication in reinforcing franchisees' trust and satisfaction (Chiou et al. 2004), the willingness of franchisees to provide information (Dant and Nasr 1998); the attribution of competitive methods (Baucus et al. 1996); the fulfilment of franchisor-provided services as a contractual obligation (Spinelli and Birley 1996); dispute resolution through more relational contracts (Leblebici and Shalley 1996); the selection of inexperienced franchisees and lengthy training programmes (Michael 2000). Some researchers have focused on specific areas of conflict, for example: encroachment (Vincent 1998); franchisee

free-riding (Kidwell et al. 2007); tensions in standardisation-adaptations (Kaufmann and Eroglu 1999).

### *Organizational structure*

The proportion of franchised outlets has been shown to be: positively related to size and geographical scope as well as negatively related to the rate of growth and level of investment (Alon 2001); as firms initially grow, the proportion of franchised outlets decreased, yet the proportion increased over time (Castrogiovanni et al. 2006a).

Additionally, Castrogiovanni et al. (2006b) demonstrated how research has shown that the integration of resource scarcity and agency theory offers a more complete understanding of how the proportion of franchised outlets changes over time (Castrogiovanni et al. 2006b).

Yin and Zajac (2004) also illustrated how certain governance structures are better matched with particular strategies than with others. Additionally, the choice of governance structure has also been shown to influence the process of organizational learning (Sorenson and Sorensen 2001).

### *International franchising*

Expanding franchising networks internationally offers franchisors additional new markets, particularly once domestic markets are saturated (Elango 2007). Over the period 1996-2007, research has pointed to how the capabilities needed to franchise internationally are different from those required in the domestic context (Fladmoe-Lindquist 1996). Yet one of the key skills which has been found to be important to franchising internationally is the ability to effectively monitor potential franchisee opportunism (Elango 2007, Shane 1996b). Welsh et al. (2006) helpfully provided a summary of main research on international retail franchising and identified key research gaps (Welsh et al. 2006).

### *3) Franchisee perspective*

The start-up phase has been limited to analyses of the decision process for franchisees and the advantages of franchising over independent business and employment. The first area focuses on the decision process for prospective franchisees. Individuals have been shown to typically choose the sector first, then the trade name, then franchising (Guilloy et al. 2004). The second area has highlighted how prospective franchisees are more likely to choose franchising depending on: the industry risk and capital available at start-up (Williams 1999), the emphasis that they place on the financial issues relating to franchising (Kaufmann 1999).

Studies have explored factors affecting franchisee satisfaction, although these studies are often aimed at informing the franchisor. Higher levels of franchisee satisfaction have been found to positively influence performance, organizational commitment, franchisor relations and intention to remain (Morrison 1997), but not all franchisees have been happy with franchising. Morrison (1996), for example, found that half of franchisees had a relatively low level of job satisfaction and appeared to not attain expected outcomes. As a word of advice, Blair and Herndon (1999) noted how franchisees should protect themselves by obtaining all relevant facts before signing the franchise agreement. Moreover, franchisees have been found to change their perceptions of value received from the franchisor over time (Grünhagen and Dorsch 2003). Similar conclusions were also raised by Baucus et al. (1996) who believed that dissension arises as franchisees accumulated local experience. Yet the franchisor must be careful because as franchisees perceive attempts by franchisors to use suasion, it has been found that lower levels of profits resulted (Phan et al. 1996). Dant and Gundlach (1999) offered help to franchisors by identifying four categories of franchisees with distinct gestalts, to aid franchisors in managing their diverse portfolio of franchisees and to help capture more fully the rich behavioural dynamics of franchisees. Such typologies may prove useful, as Grünhagen and Mittelstaedt (2005) also found that sequential multi-unit franchisees were more likely to seek entrepreneurial goals whereas area developers viewed franchising as an investment. The franchisor has been shown to play an important role in the success of the franchisee's business. Knott (2001), for example, concluded that in the

absence of the franchisor, franchisees behaviour drifted away from organizational routines and their establishments failed to adopt innovation. As a word of advice, Blair and Herndon (1999) stated how franchisees should protect themselves by obtaining all relevant facts before signing the franchise agreement. As covered within the 'overarching questions on franchising', there has also been a word of warning about the success rates of franchised outlets. In an important study, Bates (1998) concluded that the purchase of a franchise is unlikely to reduce the risks facing a new business start-up; he began to criticise some of the ways failure had been defined previously.

Multi-unit franchising has also become more prevalent and has thus become an increasingly fruitful avenue for research. Kalnins and Mayer (2004) found that the units of multi-unit franchisees benefitted from their owner's local congenial experience; moreover, these franchisees also benefitted from the franchisor's local experience in reducing failure rates.

### **How can franchise research contribute to entrepreneurship?**

#### Relationship between franchising and entrepreneurship

Franchising research has for over 40 years been appearing in small business and entrepreneurship journals. Yet franchising has had to fight to legitimise itself within the wide body of research on entrepreneurship. Some suggest that this may be because it does not sit comfortably within one single academic discipline (Stanworth and Curran 1999). Others believe that this may be because franchising as an area 'peripheral' to entrepreneurship (Venkataraman 1996) and most entrepreneurship research has focused on independent businesses (Scott A. Shane and Frank Hoy 1996).

There have been numerous calls for a closer integration of theories of franchising and entrepreneurship (Kaufmann and Dant 1999) which have emphasised the importance of franchising within entrepreneurship research (Scott A. Shane and Frank Hoy 1996, Hoy and Shane 1998). Kaufmann and Dant (1999), for example, argued that the study of franchising, franchisors and franchisees were integral to entrepreneurship research. Furthermore, its

important place in entrepreneurship research has been marked by special editions in *Journal of Small Business Management* (1995 [33,2]) and *Journal of Business Venturing* (Scott A. Shane and Frank Hoy 1996, Dant and Kaufmann 1999b, Dant and Kaufmann 1999a). As a cooperative form of entrepreneurship (Scott Shane and Frank Hoy 1996), an entrepreneurial partnership (Kaufmann and Dant 1999), or entrepreneurial team (Clarkin and Rosa 2005) franchising involves the cooperation of two key actors: the franchisor and the franchisees. Franchising is thus not simply a strategy for growth for small business; it is about the creation and management of a very different enterprise which brings with it its own complexities which are embedded within entrepreneurship (Kaufmann and Dant 1999).

#### The contribution of franchise research to entrepreneurship theorising

The review in this paper, also summarised in Figure 1 and Table 1, reveals how there has been little cross-over between theories of franchising and those of entrepreneurship. This is made more evident given that out of the 65 articles reviewed in this paper, nearly one quarter (14) were published in special issues on franchising. It is argued here that franchise research remains periphery to mainstream entrepreneurship research. The consequence of this is that despite franchising being an important area of entrepreneurship, research on franchise organizations has so far provided little contribution to furthering our understanding of entrepreneurship.

This begs the important question as to how franchise research can contribute to entrepreneurship research. Moreover, and in order to provide a structure for discussion, it is argued that a closer relationship between franchising and entrepreneurship would enable key areas of entrepreneurship research to also be able to contribute to our understanding of the franchise organization. The discussion below looks at three key areas of entrepreneurship research where research on franchising has great potential to contribute to our understanding (and vice versa): opportunities, networks and social capital, and entrepreneurial learning.

### *Opportunities*

Despite opportunity recognition (Kirzner 1973), information search and resource acquisition being the first critical steps in the entrepreneurial process (Ucbasaran et al. 2001) there has been little discussion of 'opportunities' in the franchise context. What represents an 'opportunity' in the franchise context is also open to debate.

Franchising presents a two-fold process of opportunity discovery. For the franchisor, franchising is an opportunity for business growth and the transformation of their business into a franchise organization. Yet we know little about how business owners recognise these opportunities, and more importantly how do they gather information to help inform the decision process? For the franchisee, franchising presents an opportunity to start a new venture, albeit under the jurisdiction of the franchisor. Although there have been studies on the decision process for franchisees (Guilloy et al. 2004, Williams 1999), typically based on large scale questionnaires, there has been no detailed examination of what the opportunity actually is for these franchisees, and how they go about the identification and evaluation of these opportunities. Moreover, there are a number of overarching questions on how the 'opportunity' is constructed for the franchise context. Yet how do these 'opportunities' work together under the guise of what has been termed 'co-operative entrepreneurship' (Hoy and Shane 1998)?, what is the relationship between the franchisor's opportunity and the franchisees'? Whose opportunity is it? Moreover, how do prospective franchisors / franchisees recognise these opportunities, and importantly, how do they gather information to help inform the decision process?

### *Networks and social capital*

The evaluation and exploitation of opportunities requires the acquisition, assimilation and management of information and resources. Within entrepreneurship research there has been a growing body of research which has examined the role of networks and social capital (Jack 2010). The franchise organization represents a formalised network of franchisor and

franchisees, working together towards common goals. Yet we know little about how networks contribute to entrepreneurship within the franchise organization and more specifically in what ways these networks become bounded by the organization itself.

Additionally, from the franchisor's perspective, this would include how entrepreneurs, wishing to use franchising as a strategy for growth, build and develop their social capital and knowledge of franchising; moreover, the processes through which they launch their new venture. How do franchisors gather resources (tangible and intangible) for the creation (or transformation) of their business into a franchise organization? This is particularly relevant for those organizations who know very little about franchising prior to the creation of their business. For franchisees, how is the resource acquisition stage different to that of independent entrepreneurs, and what role does the franchisor perform in this process? What role do the franchise community, the formal network of the franchise organization and other informal networks play within this process?

### *Entrepreneurial learning*

The final area is entrepreneurial learning (Cope 2003a, Cope 2003b, Rae and Carswell 2000). There are two areas which are worthy of discussion. The first is learning within the franchise organization and the presentation of a franchising system as a formalised environment for entrepreneurial learning (Cope 2005). How do franchise organizations provide a formalised environment for learning? In a tentative link to learning, the franchise organization has been termed a half-way house to entrepreneurship (Hoe and Watts 1999), yet we know little about how entrepreneurial learning takes place within that environment. How can franchisee learning be constituted as entrepreneurial learning and additionally, can the formalised environment of the franchise organization be a fruitful arena for entrepreneurial learning. From a franchisor's perspective, how do franchisors learn to operate a franchise organization, which is very different to the management of a single enterprise. How do franchisors learn to become franchisors?

The second area links to a relatively new body of literature in entrepreneurship and the link to Lave and Wenger's (1991) notion of communities of practice and legitimate peripheral participation (De Clercq and Voronov 2009). Entrepreneurship, with the franchise organization, is a socially embedded process connected to structures of power relations, particularly those constituted through the formalised structure of the franchise organization. We know little about what constitutes communities of practice within franchising and how these overlap with entrepreneurship communities of practice. Moreover, this area links closely to entrepreneurial networks and how they cross the boundaries of the franchise organization. Developing this further, we can then begin to ask questions of not only how franchisors legitimize themselves as franchisors within the wider practice of franchising, but also how franchisees legitimize their roles as franchisee entrepreneurs both within the franchise organization (working alongside 'newcomers' and 'old-timers') and at the same time within their wider social and family networks?

### **Opportunities for future research - methodologies**

The three areas above provide a plethora of new and promising areas of research. Yet in order to begin researching these areas we need to also think about the broadening of research methodologies. Franchise research has been heavily criticised for its over-reliance on quantitative techniques based on large-scale questionnaires, and its use of secondary data sources (Elango and Fried 1997, Dant 2008; Table 1 above). Statistical techniques, although useful in many contexts, fail to capture the situation-specific and idiosyncratic nature of everyday experiences, which has already been argued to be needed in order to more fully understand the phenomenon of entrepreneurship (Steyaert 2004).

In order to gain insight into these important areas of research, there is a need for researchers to begin to embrace richer forms of analysis, integrating 'new paradigms' (Dant 2008) to augment and extend our understanding of the phenomenon of franchising as a heterogeneous form of entrepreneurship. At the same time these new methodologies should

focus on understanding the heterogeneous nature of franchising itself (Elango and Fried 1997) and be able to capture the idiosyncrasies or prosaic (Steyaert 2004) of entrepreneurship within franchise organizations. There are a plethora of different approaches to research and methods of analysis which broadly fit under the banner of 'qualitative research' (see for example, Denzin and Lincoln 2005). These approaches are slowly gaining ground in entrepreneurship research, particularly through special issues on qualitative research (Gartner and Birley 2002) and recent books (Neergaard and Uihøi 2007).

At the same time there is also a need for more primary data collection in the form of in-depth interviews, longitudinal studies, ethnography and in-depth case studies. Other than the work of Birkeland (2002) and Tracey and Jarvis (2007), ethnographic and longitudinal studies are rare in franchising research, yet offer a way of capturing the idiosyncrasies of the franchise organization and the everydayness of the practices of franchisor and franchisee.

## **Conclusion**

The aim of this paper was to review the franchise literature to identify the progress of research in franchising and to further identify the potential relationship between franchising and entrepreneurship research. Franchising plays an important role in entrepreneurship (Kaufmann and Dant 1999), moreover the franchise relationship has been described as co-operative entrepreneurship (Scott A. Shane and Frank Hoy 1996), an entrepreneurial partnership (Kaufmann and Dant 1999) and an organization where franchisor and franchisees work together within entrepreneurial teams (Clarkin and Rosa 2005). Additionally, franchise research has been appearing in entrepreneurship journals for more than 40 years. The review in this paper, however, reveals how franchising research remains peripheral to mainstream entrepreneurship research. Furthermore, a review of the literature demonstrates how studies in franchising have provided little insight and contribution towards our understanding of the phenomenon of entrepreneurship. Additionally, a high proportion of

franchise research focuses on the franchisor perspective, providing an insight into some of the challenges faced by those managing a franchise organization.

The paper argues that a more integrated approach, which links more closely some of the areas of franchise and entrepreneurship research, opens a number of fruitful new areas of research that would not only provide new insights into the franchise organization, but at the same time would inform theories of entrepreneurship. The paper explores three such potentially fruitful avenues of franchise research: opportunities, networks and social capital and entrepreneurial learning.

In presenting the franchise context as an interesting organizational form, the paper encourages researchers to look to the franchise organization as one which embraces all the challenges of entrepreneurship and small business ownership, with the additional layer of complexity added by the franchisor-franchisee relationship.

Additionally, as scholars move towards these new areas of research, the goals should be to not only reveal the heterogeneity of franchising and entrepreneurship, but to reveal the idiosyncrasies and complexities involved in the everyday practices for both the franchisor and franchisees. Over a decade ago, it was declared that franchising research's reliance on course-grained approaches had led to a failure to capture the complexity and subtlety of actual business practice (Elango and Fried 1997). In order to achieve this, there is a further call for the embracing of 'new paradigms' (Dant 2008) which would include a move towards more qualitative research.

This review strengthens further the need for researchers to legitimise franchising as an important area of entrepreneurship research (Hoy and Shane 1998, Tuunanen et al. 2005).

In so doing, this paper illustrates how researchers can look towards existing theories of entrepreneurship to not only identify gaps in current understanding, but to discover the idiosyncrasies of franchising as a heterogeneous form of entrepreneurship and to provide new directions for research on franchising.

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