FRANCHISE NETWORK RESTRUCTURING: PRESSURES, CONSTRAINTS AND MECHANISMS

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ABSTRACT. Franchised businesses operate on the basis of granting individual franchisees trading rights to serve territories or market areas on either an exclusive or non-exclusive basis. The design of these territories is generally undertaken during the roll-out phase of the franchise. However, these territories and market areas may become sub-optimal over time, necessitating restructuring. But if the franchisor has granted exclusive rights to a territory then this is likely to involve a breach in the franchise contract. In cases where existing franchisees do not have exclusive territories they may nevertheless make a legal challenge to the creation of additional franchises on the grounds of encroachment. This paper – which is based on a study of 40 franchisors in the United Kingdom - examines how franchisors go about network restructuring in constrained and non-constrained situations. Franchisors typically did not act on their legal rights, echoing findings of earlier franchising studies which reveal a divergence between contractual rights and operational behaviour. This focus on network restructuring also provides new perspectives on the reasons for ownership reversion and the growth of multi-unit franchisees.

Key words: franchising, growth, territories, encroachment, conflict, ownership reversion, multi-unit franchising

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1. INTRODUCTION

Franchising is a type of business organisation which takes the form of a legal contract between the owner of a trademark (the franchisor) and independent business owners (franchisees) to operate under the owner's trademark to sell products or services in accordance with the owner's 'blueprint'. It is most common in sectors where there is a significant service component that must be performed near the customer and therefore requires outlets to be replicated and dispersed geographically (Combs et al, 2004).

Firms typically adopt franchising in order to pursue growth. A firm is likely to expand initially by opening company-owned outlets. Once the format is proven then the expansion of the system is likely to be achieved primarily through franchising to penetrate new markets. This typically involves the creation of 'territories', or market areas, which individual franchisees will be given trading rights to serve. The advantages of basing growth on franchising are twofold. First, agency theory suggests that franchising avoids problems associated with the supervision problems associated with geographically dispersed outlets in a chain. Because franchisees are residual claimants their goals are more closely aligned to the franchisor, encouraging them to put in greater effort and reducing their incentive to engage in opportunistic behaviour. Second, resource theory proposes that the use of franchising is a means of raising financial capital (in the form of an up-front fee for access to the trademark and services required to open the outlet, including training and the operating manual, and an ongoing royalty fee for ongoing support and services, such as marketing) for growth without selling equity. The

franchisee also brings valuable human capital in the form of their own managerial labour and local knowledge of customer markets, labour markets and location.

One of the key strategic challenges for a new franchisor is to identify the optimum number of outlets and size of territories. The problem is that the designation of territories is made under conditions of imperfect information. It is generally undertaken during the roll-out phase of a franchise system when full information on market demand is unlikely to be available. Individual franchisees may be unable to fully exploit demand if they are given territories that are too large. On the other hand, they may be unable to achieve a satisfactory return if their territory is too small and they are too close to other franchisees. Moreover, markets are not static. Opportunities may arise to establish additional units at some point in the future, requiring existing territories and market areas to be refined and restructured, with consequences for existing franchisees. This need may occur on more than one occasion. Restructuring of the original franchise territories that were determined at the roll-out of the system can be a significant source of franchisor-franchisee conflict (Fock, 2001). If the franchisor has granted exclusive rights to a territory – which may be necessary to attract initial franchisees – then this will be a breach of the franchise contract. In situations where franchisees do not have exclusive territorial rights they may complain of encroachment if the franchisor creates new franchised outlets in the same vicinity (Kalnins, 2004) – which may end up in the law courts.[1] However, as Vincent (1998: 39) observes: "the problem will not be effectively resolved in the courtroom nor through legislation or regulatory efforts …. Thus, a critical issue for franchisors is to find a way to grow while controlling the conflict with their franchisees that might arise

because of … expansion. Systems able to find an equitable balance between competing interests will prosper. Unfortunately, those that do not are likely to flounder.”

It is therefore clear that the design of franchise territories and market areas has a significant influence on the performance – and even the survival - of a system. Yet neither the scholarly nor the practical literature has given much attention to either the initial design of territories nor to methods of restructuring territories and market areas that minimise conflict with franchisees. As a consequence, there is a significant gap in the scholarly literature on how franchise systems evolve spatially and temporally. Moreover, there is little advice in the practitioner literature which advises nascent franchisors on how to design the initial territories in a way that will minimise difficulties in the future.

This paper makes an initial contribution to addressing this gap in our understanding by examining three closely related questions that are central to the issue of how the territorial basis of franchise systems are designed and evolve over time. First, what techniques and criteria do franchisors use to define and delineate their initial franchise territories (section 4)? Second, how does this initial design of franchise system affect the ability of franchisors to restructure their networks (section 5)? Third, if the need to restructure territories arises, as is likely, how do franchisors go about network restructuring in constrained situations (i.e. where franchisees have been given exclusive rights to a territory) and non-constrained situations (section 6)? The next section considers the twin issues of territory design and restructuring from a conceptual perspective. Section 3 describes the nature of the empirical evidence that was collected

for this paper. Sections 4 – 6 address the research questions. The paper concludes by suggesting that a focus on network restructuring has wider significance for the understanding of franchising, notably by providing new insights on two issues of contemporary debate in the franchising literature: the growth of multi-unit franchisees and ‘ownership redirection’ in which franchisors bring previously franchised units into company ownership.

2. FRANCHISE NETWORK ALLOCATION AND DYNAMICS

One of the fundamental features of franchising is that the franchisee is allocated rights to trade in a specific geographical space. In some cases the franchisor will formally assign franchisees to specific geographical territories. In other cases the franchisor will define market areas, for example on the basis of population, in which to locate franchise outlets (Barrow et al, 1999). The design of territories and market areas is therefore a fundamental aspect of business format franchising and is specified in the franchise contract (Mendelsohn, 1991; Stanworth and Smith, 1991). If franchisors allocate territories that prove to be too large for individual franchisees to fully exploit then the franchise system will not be able to maximise its potential returns, resulting in conflict between the franchisor and its franchisees (Michael, 1996; Price, 1997; Pratt, 1997). Moreover, leaving parts of a territory under-exploited could also attract competitors (Spinelli, 2004). Conversely, small territories and market areas may lack sufficient market potential, putting the survival of franchise outlets at risk (Mendelsohn, 1991).

The ‘how to’ literature on buying a franchise does recognise the significance of the territory/market area issue. For example, Barrow et al (1999: 26) recommend potential franchisees to examine “the rationale behind the territory assignment … Has the franchisor picked it out arbitrarily or has he conducted – as he should have done – market surveys to indicate that the franchise is likely to be viable in that territory? These should cover aspects of traffic flows, access, population mix by age and class, and so forth, and they should be available to the franchisee.” However, this concern with territory/market area issues is not paralleled in academic studies. In one of the few studies which does consider how franchise territories are defined (although this was not the main purpose of the paper) Zeller et al (1995) indicate that in the USA territories have typically been defined in one of three ways: using predetermined geographical boundaries (such as county boundaries); using minimum distances between outlets; and using market and population measurements. Bush and Tatham (1976) find that the most important defining criteria for territory allocation in the USA is population-related. Spinelli et al (2004) outline some of the *siting* considerations used by US franchisors to locate franchise units: these include population estimates, patterns and volumes of traffic, visibility and ingress and egress). The first research question is therefore as follows: *what techniques and criteria are used by franchisors to define and delineate territories/market areas in order to locate their franchise units?*

One of the biggest challenges for a franchisor in defining territories or market areas is that it is normally undertaken at one point in time, at the initial or roll-out stage of the system. However, markets are dynamic. As Spinelli (2004: 365) observes: “a territory

suitable for one site today may support three sites tomorrow.” Shifting demographics, competition, growing visibility and awareness of the franchise brand and local infrastructure developments (e.g. new roads, shopping centre developments) all have the potential to change the market potential within a territory or market area. The consequence of such changes is that the original allocation and definition of franchise territories and market areas may become outdated as a franchise system matures. For example, franchisors may find that there are opportunities to establish additional units in a territory or market area because market potential has exceeded expectations at the roll-out stage and may therefore want to restructure the territories or market areas both to take advantage of such growth opportunities and to minimise the threat of ‘me-too’ competitors (Ghosh and Craig, 1991; Spinelli, 2004; Stassen and Mittelstaedt, 1995; Zeller et al, 1995). These expansion opportunities may be restricted to specific parts of the franchise system and therefore affect only a small number of territories or market areas. Alternatively, it may be that scale of demand requires a restructuring of the entire franchise system.

Franchisors face two constraints on their ability to respond to market changes which render their existing distributions of units sub-optimal. First, unlike multiple outlet businesses, where all of the units are owned by the company and managed by its employees, franchisors have to consider the effects of network restructuring on its existing franchisees and the businesses that they own and operate. Because of the different incentive structures, franchisor and franchisee goals rarely coincide and may even conflict (Azoulay and Shane, 2001; Bush and Tatham, 1976; Current and Storbeck,

1994; Fock, 2001; Ghosh and Craig, 1991; Kaufmann and Rangan, 1990; Spinelli and Bygrave, 1992; Zeller et al, 1995). Franchisors earn their income on the basis of fees paid by franchisees. These are normally linked to sales volume – either a turnover-based fee or on supplies that franchisees have to source from the franchisor. Franchisors therefore have incentives to maximise system-wide sales by opening additional units. Opening new units not only increases system-wide revenue but it will also increase economies of scale, increase the visibility and awareness of the system, leading to greater customer recognition, and reduce competitive encroachment – and even the attractiveness of market entry - by competitors. However, this may not be in the interests of the franchisee (Fock, 2001). This is because franchisees derive their income from profits net-of-royalties from the outlet(s) they operate. The consequence of extra units being added to the system may be to cannibalise the sales and profits of one or more existing franchisees (Mayfield, 1997; Ryans et al, 1997). The primary concern of franchisees is therefore to maximise unit profit in order to maintain the value of their investment. Not surprisingly, encroachment and cannibalisation is a significant cause of franchisor-franchisee conflict and litigation (Barkoff and Garner, 1993; Fox and Su, 1995; Vincent, 1998; Fock 2001, Combs et al, 2004). This problem is most common in mature franchise systems and saturated markets such as fast food (Vincent, 1998). Thus, franchisors have to balance the economic benefits of adding additional units with the tangible and intangible costs[2] arising from the conflict that may arise with existing franchisees (Stassen and Mittelstaedt, 1995).

These difficulties are compounded by the practice of many franchise systems in granting exclusive rights to a territory (Mendelsohn, 1991). In other words, the franchisee has contractual assurance that a new unit (either franchised or company-owned) will not be located within its territory. According to Felsted (1993), 49.4% of franchise contracts guarantee exclusivity, a further 16.9% have qualified exclusivity and just 33.7% have non-exclusive territories (UK data). From a franchisor's perspective, offering exclusive territories has certain advantages. First, by making the franchise more attractive it should attract better quality franchisees. Second, exclusive territories should be more valuable, enabling the franchisor to charge a higher fee which, in turn, induces greater effort and investment on the part of the franchisee, with benefits for the system as a whole. Third, exclusive territories should reduce the potential for franchisor-franchisee conflict, making it more attractive to a new franchisee. It will also reduce the likelihood of costly litigation (Michael, 2000; Azoulay and Shane, 2001). New, and therefore unknown, franchises may have little choice but to offer exclusive territorial rights in order to recruit franchisees, with the rights to exploit an exclusive territory offsetting the risks involved in buying a franchise from a new system (Bradach, 1995; Kaufmann and Rangan, 1990; Vincent, 1998; Zeller et al, 1995). Azoulay and Shane (2001) find that exclusive territories have a negative impact on the failure of new franchise systems. However, granting exclusive rights for the length of the franchise contract (which may be for 10 years or more) may mean that a franchisor is unable to alter territories or restructure the network in order to take advantage of growth opportunities. A franchisor which attempts to add a further unit(s) into a territory in which the franchisee has been granted exclusive rights will be in breach of the franchise contract. Franchise systems which do not allocate franchisees to

fixed territories might appear to have greater freedom in adding additional units. However, as noted above, existing franchisees may legally challenge the opening of new outlets close by on the grounds of encroachment (Vincent, 1998; Kalnins, 2004), although in the USA judicial decisions concerning encroachment have overwhelmingly favoured the franchisor (Vincent, 1998). The second research question is therefore as follows: *How significant are these various constraints on the ability of franchisors to restructure their territories?* This leads to the third research question: *How do franchisors overcome these constraints in order to achieve the restructuring of their territories and market areas?*

In summary, the definition of territories and market areas and the decision whether to grant these on an exclusive basis are fundamental issues in franchising. Although the literature has identified the problems that franchisors face in adding additional units to an established system there has been little effort to examine how this has been resolved.[3] The virtual impossibility of defining an optimal system of territories at system roll-out, combined with the dynamic nature of markets, means that as franchise systems approach maturity they will be faced with the need to restructure their systems. The contribution of this exploratory paper is to examine how franchisors approach the issues of territory and market area definition, the granting of exclusive territories, how they respond to the need to restructure the system when the original territories and market areas become sub-optimal, and the complexity and subtlety of the processes involved.

3. METHODOLOGY

Much of the franchise literature uses a quantitative methodology. However, as Elango and Fried (1997: 18) comment, although this approach "often results in generalisable findings with statistical significance, it often fails to capture the complexity and subtlety of actual business practice. The result can be research with limited practical relevance … We feel it is important for some franchising research studies to use more fine-grained research methods … [that] … capture details of content by studying the phenomena in detail." In similar vein, Forward and Fulop (1997: 619) criticise quantitative studies for their "neglect or omission of factors and relationships, often crucial in franchise decision-making and a failure to take account that franchising is more heterogeneous than might be first thought." Accordingly they also argue that qualitative studies are needed "to capture more detailed insights into franchising."

The focus of this study on how and why questions and the need to capture the complexity and subtlety of the actual practices of franchisors clearly suggested the adoption of a qualitative approach to information gathering based on in-depth face-to-face discussions with a sample of franchisors as being the only way to answer the research questions. The selection of franchisors was dictated by two considerations. First, the sample was deliberately restricted to established franchisors who would, by definition, have experience of expanding, operating and, in some cases, restructuring franchise systems. Accordingly, franchisors had to have at least 10 franchise units in order to be considered for inclusion. Second, in order to reflect the diversity of franchising activity, the sample was constructed so that it included approximately equal numbers of firms across six

sectors: retail; fast food; personal services; distribution; business-to-business; and industrial and commercial. In most cases firms were identified from the *UK Franchise Directory*. A handful were approached on the basis of recommendation or pre-existing contacts.

Interviews were successfully conducted with 40 UK-based franchisors (which includes the UK master franchisee for some international franchise systems) from 80 that were approached. All of the franchisors were more than five years and most had between 10 and 49 franchised outlets (37.5%) or 50-99 franchised outlets (35%) (See Appendix for details of the sample characteristics). Non-responses were related to difficulties in making contact with the Managing Director or Franchise Director and the general 'interview fatigue' amongst the bigger franchisors in particular.

Most of the questions were open-ended. Interviews were recorded and transcribed. The transcripts were analysed in three stages. The first stage involved the conversion of the answers to the closed questions into frequency counts. The second stage involved a careful and fine-grained reading and marking up of the transcripts using open coding to conceptually organise and make sense of the material. The third stage involved the sifting, sorting and development of the ideas that emerged from this open coding into themes and issues. This process of 'analytical induction' (Crang, 1997) involved several iterations of going from the material, to ideas and back to the material to develop and redefine and re-categorise of the themes so that the final interpretation was robust and coherent.

4. APPROACHES TO TERRITORY/MARKET AREA ALLOCATION

The first research question concerned the techniques and criteria that franchisors use to define and delineate territories. Our evidence uncovered considerable heterogeneity, with the sample providing three different approaches to territory/market area allocation. The majority of firms (32) adopted the conventional approach of allocating territories with fixed boundaries to franchisees. This included all of the distribution system franchisors (n=10) and all of the mobile-based systems (n=16). Six franchisors licensed unit locations to its operators and so allocated market areas rather than territories in which to locate units. These tended to be systems in which the consumer travels to the outlet (e.g. fast food). The remaining two franchisors (a cost management consultancy and an executive recruitment agency) did not operate on the basis of either territories or market areas. Instead, each franchisee operated nationally/internationally but because they had different specialisms they were not in competition with one another for clients. These franchise systems were therefore 'spaceless' and so are not included in the remainder of the discussion.

4.1 Defining territories

The standard technique for delineating territories (amongst those firms which allocated territories for their franchisees to operate within) was postcodes (19/32: 59%). Other methods were roads (2 firms), city/town boundaries (2 firms) and Yellow Pages

territories (one firm). The approach of the remaining 8 firms (25%) was to arbitrarily define territorial boundaries. These territorial definitions and boundaries were specified in the franchise contract. The franchisor would provide the franchisee with a map of its operational area and/or a list of postcodes, roads or addresses which covered the franchisee's territory. Whereas the use of 'official' boundaries worked quite well, the use of roads or arbitrary approaches to define territorial boundaries could be problematic. Three firms admitted to later boundary disputes because of their approach. One firm which had used an arbitrary approach to establishing its boundaries commented as follows:

> *"In the early days, the maps were pretty broad brush and we would use a magic marker which was probably in itself about five hundred yards wide when you got it down to the size of a map. It became a problem at a later date, because that five hundred yards could have included a factory and suddenly one guy has got it and then the other guy has got it also"* (Distribution Sector, Firm G).

Another firm noted the problem that arose by using a road as a boundary:

> *"There was a hospital on a road on a boundary and the same road was the boundary for two shops. An argument arose as to who could deliver to the hospital, because they were both entitled to it. They very nearly took each other to court - they very nearly took me to court - because the hospital was worth over £300 a week and they were both leafleting it and they both argued it was their delivery area"* (Fast Food Sector, Firm B).

4.2 Approaches to Territory and Market Area Definitions

The techniques used to establish the size of individual territories/market areas were mainly population based (Table 1). Five firms allocated territories using population as the only criterion, dividing each territory into areas containing 600,000 population. However, most franchisors supplemented population-based techniques with additional demographic or market information. Several firms took socio-economic composition into account. Others factored in the degree of competition and a few used demographic, geographic

and business community measures to estimate projected sales or customer base targets. But only four firms sought external advice to aid territory/market area definition, in most cases from CACI Information Systems which produces ACORN, a geo-demographic profiling system. The following example is one of the most sophisticated approaches

> *"When the company was launched, because we had the right level of funding ..... we spent a lot of money researching the UK market and dividing the territories into territories that could deliver £10 million per annum of greetings cards sales. This was based on population, which was then broken down into socio-economic groups. So, for example, you could have a territory - and by the way, further broken down into postcodes – you could have a territory that might have three quarters of a million people, but a higher proportion of [socio-economic groups] D's and E's than another territory that might have 500,000 but higher proportion of A's and B's. So there was quite a lot of thinking in the design of the areas in the first place and no two areas are the same…but the underlying structure says that each territory can deliver a minimum of £10 million cards per annum (Distribution Sector, Firm A).*

It is also important to recognise the dynamic nature of the process. In most cases the techniques used by franchisors to allocate territories/market areas had evolved over time as their operational experience increased and enhanced demographic and market information and more sophisticated analytical techniques became available.

TABLE 1 ABOUT HERE

Almost half of the sample (18) visited potential territories/market areas to the assess their 'geography' in terms of natural boundaries, accessibility and communication networks. In some instances the local knowledge of franchisees was utilised, particularly if the franchisee was local to the area and the franchisor used a franchisee-led growth strategy (i.e. franchisees were attracted to the system and the territories were defined around

them). There were no systematic sectoral differences in the approach to defining territories or market areas.

Thus, the definition of market areas was dominated by rather unsophisticated approaches, making it likely that variations in market potential would exist across territories and market areas. Just one firm (see previous quote) employed a sophisticated range of techniques in an attempt to ensure that all territories across the network were equal and theoretically able to deliver the same amount of sales. No other firms went to such lengths to ensure that all territories were equal. Most franchisors accepted that geographical variations were inevitable, regardless of the approach or technique, and market areas would be unequal in terms of their market potential. Indeed, fifteen franchisors admitted that some territory definitions or unit locations had proved to be unsuitable, resulting in severe operational difficulties for the franchisee and sometimes the failure of the unit. These franchisors admitted that the franchisees simply had to work harder, although in most cases they had also made concessions to expected performance targets. However, the majority of franchisors attributed operational difficulties of individual franchise outlets to the inadequacies of the individual franchisees rather than to geographical factors. This echoes other studies which have noted that franchisors attribute franchisee failure to their under-performance (Price, 1996; Shane, 1996). One franchisor commented as follows:

> *"It is definitely a problem of the franchisee … Why can one person rise to the occasion and another can't? We have had the situation where a different person*

comes in and takes over the business. Same location. Same equipment and sometimes with the same employees and they fly."

Another commented in similar vein.

"The main reason for a franchise failure comes down to the individual because the market research we do – a lot of groundwork goes into finding the right location. Once we have the right location, you can put a very good franchisee in a secondary location and still have a very good business. You can have a very good location and put an average business person in there and you can have a poor business."

Consequently, all of the franchisors in the sample set performance targets to ensure that franchisees met minimum performance targets (usually expressed in terms of 'X' amount of sales, turnover or customers) and adequately exploited the area. Franchisors who consistently failed to meet the minimum performance targets would be regarded as being in breach of contract which would enable the franchisor to terminate the contract.

4.3 Summary

The nature of the franchise was a key influence in the decision whether to allocate territories or market areas. Franchisors who opted for territories used a variety of approaches for defining their size and boundaries. In most cases these approaches were relatively unsophisticated, mainly based on postcodes and population. This, in turn, resulted in geographical variations in the market potential of different territories. However, franchisors tended to attribute variations in the performance of individual franchise outlets to the inadequacies of the franchisees rather than to variations in market potential.

5. SYSTEM DESIGN AND TERRITORIAL RESTRUCTURING

The problem with territory/market area definition is that it is undertaken by the franchisor in the early stages of expansion. However, market dynamics will often result in such definitions becoming sub-optimal, necessitating the establishment of new units and a restructuring of original territories and market areas to take advantage of market potential. This creates real problems for franchisors as the following quotes make clear:

> *"How do you know what the ideal penetration is? Well the answer is, you don't know. I can put a mark in the sand and put various experienced people around the table and we will all disagree. And they will say no it's 1:50,000 population and another will say, no, it is 1:30,000 population, and you can make a case for any one of those. You won't know what it is and it will change over time"* (Fast Food Sector, Firm C)

> *"We didn't know what the saturation point would be…we originally thought 50 depots and now we know that we can have 100 or more"* (Distribution Sector, Firm G)

> *"Clearly, territories evolve…20-30 years ago, no one had heard of Milton Keynes. So obviously, territories themselves evolve upwards and outwards. Birmingham was a thriving manufacturing town 20 years ago and is a lot less so these days. So one's view of the optimum size of territory, business potential etc. moves."* (Personal Services Sector, Firm E)

The second question that this paper addresses is what are the constraints that franchisors encounter in restructuring their networks. Twenty-three firms in the sample (58%) had either been, or were currently in the position of needing to restructure their network at the time of the survey. These firms had designed their networks in different ways: as exclusive territories (8 firms), as non-exclusive territories (9) and market areas (6). These three network designs have different implications for the network restructuring process. For the remaining 17 firms, currently in roll-out or early consolidation, there continued to

be a good fit between the territories/market area and demand, so network restructuring was not yet an issue. [4]

5.1 Franchises with exclusive territorial networks (n=8)

All of these franchises were either mobile franchises or delivery-based networks. However, not all of the mobile and delivery-based franchises in the sample operated on the basis of exclusive territories.[5] The franchisees serviced customers within their defined geographical territory. Without this territorial exclusivity franchisees could potentially operate anywhere with the danger that more proactive franchisees would poach customers from neighbouring franchisees or cherry-pick the more desirable customers in other locations.[6] Thus, as the following quotes indicate, granting exclusive territories was primarily influenced by two considerations: first, exclusive territories were integral to the successful operation of the network (cf. Current and Storbeck, 1994) as a means of avoiding potential conflict between franchisees as a result of changes in market penetration levels (Kaufmann and Rangan, 1990; Pratt, 1997; Zeller et al, 1995); and second, they were thought to help attract and retain franchisees who were reassured that intra-system encroachment would not arise.

> *"The reason for granting exclusive territories is that it is the basic strategy of running this business. We want our franchisees to operate within defined territories. The thought of them going into other franchisees' territories would be a minefield, and it could not work if you follow it through – where do you draw the boundary? A franchisee in Glasgow could operate in Manchester, it would be an absolute nightmare" (Distribution Sector, Firm A)*

> *"It's the way the business works –we couldn't have franchisees going into other franchisees' territories and poaching customers" (Distribution Sector, Firm D)*

> *"Although the franchisees have the same product, they are assured that their territory is theirs, there is no competition from other franchisees or the company within their territory. Exclusivity allows that." (Distribution Sector, Firm C)*

> *"Exclusivity is attractive for the franchisees entering into franchising – it offers them protection for their units" (Personal Services Sector, Firm B)*

> *"Exclusivity is important because it gives potential franchisees the reassurance that they will be protected and that encroachment is not an issue with us…" (Retail Sector, Firm C)*

Clearly, the ability of franchisors to take advantage of new market potential is constrained by granting exclusive territories to franchisees. In all eight cases the original territories had become outdated. Not surprisingly all of the franchisors wanted to embark on restructuring schemes. However, they were contractually prevented from doing so. Having granted franchisees exclusive territories for the length of the franchise contract placing new units into franchisees' territories was not permitted. Such changes could only occur when the contract had expired or was up for renewal. But with contracts lasting for 10 years or more, this was rarely a satisfactory solution when the need for restructuring was often identified within five years of operation. Even at renewal, restructuring was not always a straightforward process. In all eight cases the contract contained, or previously contained, a roll-over renewal clause[7] which entitled the franchisee to operate for an additional period of time after the original contract had ended provided that the original terms and requirements of the contract were met. Indeed, the only way in which franchisors can legally restructure territories that have been granted on an exclusive basis would be in the event of performance failure by franchisees. This is defined as a situation in which a franchisee consistently under-exploits its territory and fails to meet the minimum performance targets set by the franchisor. For this reason franchise lawyers

advise that if networks are to be allocated on the basis of exclusive territories then performance criteria must be set (as all eight firms had done). However, this only enables restructuring on an individual territory basis and not on a system-wide basis.

Franchisors who grant exclusive territories are therefore making a trade-off. The advantage is that it increases the attractiveness of the system to potential franchisees in its start-up and early roll-out phases. The potential downside is that they are unable to subsequently alter territories to take advantage of new opportunities. Indeed, some of the franchisors in this group admitted that they had lost the opportunity to tap unexploited markets because of their decision to offer exclusive territories.

5.2 Franchises with non-exclusive territorial networks (n=9)

Those franchises which granted non-exclusive territories did so for two reasons. In six cases territories were deemed to be integral to the way in which the franchise operated. Five of these franchises were mobile operations in which the franchisee travels to the customer. Territories were allocated to define the area of operation. The sixth franchise was an area franchise so territories were required as a mechanism to allocate customers to the franchisee. In this case territories were granted on large scale in which to develop several units. The other three franchises were location based so territories were not integral to effective operation. However, creating territories was a means of carving up the country to ensure that key market areas were served. The franchisors also believed that granting territories would help in the recruitment of franchisees. Territories were granted on a non-exclusive basis because franchisors thought that this gave greater

flexibility and allowed greater control over the development of the franchise network. For example, with non-exclusive territories franchisors could operate national contracts across several territories or the entire system. In one case a non-exclusivity clause allowed a franchisor to negotiate for prime retail sites on either a regional or national basis.[8] Non-exclusive territories therefore gave firms greater spatial flexibility than would be the case with exclusive networks. Some franchisors in this category also argued that non-exclusive territories gave them greater operational control over network growth and facilitated the process of network restructuring. For example, they could respond to new market opportunities by adding extra units. All of these franchisors claimed that granting exclusive territories could restrict network growth.

Four franchisors had originally granted exclusive territories to franchisees at the roll-out stage. These franchisors had altered the exclusivity of the territories at the contract renewal stage when it is possible for franchisors to change the terms and conditions of a franchise agreement (as suggested by Zeller et al, 1995). Although these franchisors acknowledged that this was sometimes a difficult process (as the franchisees obviously would not want to lose their exclusivity status) they ultimately had the contractual power to alter the franchise contract. Moreover, these franchise systems had been operating successfully (but not necessarily efficiently from the point of view of network design) for some time and were all at the mature stage and the franchisees had all established successful businesses. The franchisors believed that because of this they were unlikely to lose any franchisees following the renegotiation of the contract. However, as the franchisors acknowledged, the franchisees were not necessarily satisfied with the new

conditions. The other five franchisors were aware from the outset of the inflexibility of exclusive territories, either as a result of previous experience as a franchisor or franchisee or on account of advice received from franchise consultants or lawyers.

Although these nine franchisors were in a position to add units, alter territories or embark on restructuring at any time, only one actually fully exploited this power. This franchisor had a fairly autocratic approach towards its franchisees which operated with only one year contracts (the shortest length in the sample). It would add new units and consolidate the network at any time in response to market gaps, offering financial compensation to franchisees to facilitate the process. The remaining eight franchisors (plus two others which had not yet needed to restructure) had an explicit policy that they would not make any changes to territories until existing franchise contracts had ended or were up for renewal. At that point territories would be redefined to reflect changing market dynamics. In effect, these franchisors operated as if their franchisees had been granted exclusive territories. As one franchisor commented: *"a franchisee buys on trust and if a guy has bought a territory then he is quite entitled to keep that territory until his full term is finished and then to renegotiate when his term comes up again for renewal."* These franchisors were concerned that encroachment would affect the franchise relationship, believing that encroachment or alteration of a territory's boundaries was not only unethical but also could also destroy trust between themselves and their franchisees. They were concerned about the effect of such actions on the reputation of the franchise system as a whole, the risk that franchisees may become disaffected and leave the system, and the costs involved in resolving potential disputes. Other franchisors made the same point:

> *"Our precedent is to our existing franchisees. It is not fair to say to them we have given you these postcodes, now we want to take part of them back when they have built up a good business with good established contracts. No. We would not do that" (Business-to-Business Sector, Firm B).*

> *"In the contract it states non-exclusivity, but it is exclusive in theory and we will not encroach upon a franchisee's territory" (Business-to-Business Sector, Firm D)*

> *"Exclusivity isn't implicit in the contract, but it is implied to franchisees" (Industrial and Commercial Sector, Firm E)*

> *"If a franchisee is performing legally you are in pretty hard water if you try to redefine the territory but morally it makes no sense. If the guy is performing why disturb him?" (Personal Services Sector, Firm E)*

5.3 Non-Exclusive and Non-Territorially Based Networks (n=6)

The remaining franchise systems defined market areas in which to locate units. The operational areas for its franchisees were therefore not confined by exclusive agreements or delineated by territorial boundaries. These franchisors argued that it was impractical and unnecessary for the type of operation to allocate exclusive territorial rights to franchisees because customer patronage of individual units could not be dictated and delineated. This group of franchisors additionally recognised that creating territories constrained growth and made the process of taking advantage of new market opportunities potentially difficult contractually. These views are reflected in the following quotes:

> *"My reasoning was because when I opened the second shop in London, the guy said to me [the first franchisee in London] 'you have taken half of my market away.' In Houston, Texas at the time, [where the US franchisor was based] with 2 million population, they had 80 Kall Kwiks. So I said 'why do I need to franchise an area?' It will probably allow us to do a higher density than maybe a franchisee might want…but a lower density is not necessarily in the interests of the franchisee because if you have strong brand awareness and strong brand attributes then I think you make more money and you can get more business" (Industrial and Commercial Sector, Firm C).*

> "W*e think there are a lot of opportunities out there and we don't want to miss an opportunity. Whilst we like to have areas of geographical clusters – we don't think that there is a lot of benefit in assigning territories to people. We think that if we gave territorial rights in development (and there are lots of other examples of people being given territorial rights in other markets) you can actually constrain your ability to grow. And what we want is to be able to grow at a maximum pace that is possible out there - profitably - and to develop the brand. It is easier to do that if you can avoid formal agreements" (Fast Food Sector, Firm C).*

> *"We don't want to restrict ourselves to future opportunities. If you give people exclusive territories, then you do…We, as a company, don't see the sense in that as it is not necessarily for the good of the network in the long run" (Personal Services Sector, Firm A).*

> *"It's a restrictive business. I believe it is a grey area anyway. Does a franchisor or anyone have the right to say 'this is your business territory and you cannot go out of it.' Surely that is restricting business? So we never say to someone this is you business but you can only do business in this area and nowhere else. Why restrict it?" (Retail Sector, Firm E).*

By not assigning territories these franchisors were able to maintain spatial flexibility to develop new outlets in response to market opportunities and to adjust in response to changes in market penetration levels. Network restructuring could therefore occur at any time, rather than being confined to the end of the contract period. Indeed, all of these firms had undertaken restructuring in response to original market areas becoming outdated by new opportunities.

However, the development of additional outlets in such networks where franchisees do not have the protection of an exclusive agreement or a territory could be a source of potential conflict between the franchisor and franchisee because of the potential for intra-system competition and encroachment. In practice, however, both ethical and operational

considerations constrained franchisors from *deliberately* placing new units too close to existing ones, as the following quotes indicate:

> *"Although there is nothing in writing to say that 'this is your territory', there is an unwritten law where we will not put franchisees close enough to impact. It is not viable for us, unlike a corporate company, where everything is going into one pot. For us, if we put stores so close, it would just dilute everything and therefore it is not beneficial for the franchisor, i.e. us, and it's not beneficial for the franchisees. It is better to have one strong business than two weak businesses."* (Retail Sector, Firm E)

> *"I knew that we would be responsible franchisors, we would not franchise 'willy nilly'...I also thought that we would always have clever franchisees and they would not accept a system where you franchise willy nilly…I also believe it is better to have one successful franchisee and not two unsuccessful franchisees"* (Industrial and Commercial Sector, Firm C).

> *"We do have a planned distribution policy where we don't open up against franchisees. At the end of the day we would put the franchisee out of business. In the long term we wouldn't gain anything, but we would just gain the reputation of being not a very responsible franchisor and in the long term the franchise would just die"* (Retail Sector, Firm B).

> *"We don't benefit and they don't benefit if we open up a second one in the same town, unless the business is there - there is no way - because we may lose that franchisee for the sake of it and it's to the detriment of the system. It doesn't make economic sense to do it* (Personal Services Sector, Firm A).

These franchisors recognised that encroaching upon an existing unit would be detrimental to the franchise system, causing conflict between franchisor and franchisee and the established and new franchisee. The franchisor would incur costs in resolving such disputes and might also suffer reputational damage which might affect the ability to recruit new franchisees in the future. Moreover, if a new unit was located too close to an existing unit it is likely that neither unit would achieve their full commercial potential, affecting the franchisor's business. Nevertheless, even though franchisors do not deliberately set out to encroach on the territory of existing franchisees, three franchisees

did concede that there were situations in which new units did encroach on existing units, cannibalising their sales and profits at least temporarily.

(iv) Summary

This section has demonstrated that there are various ways in which franchisors can design their networks: as exclusive territories, non-exclusive territories and market areas. Each of these approaches tends to be favoured by franchisors in different sectors, although not exclusively. These designs provide franchisors with different degrees of freedom to restructure their networks. When designing their network franchisors are making a trade-off between their ability to attract and retain franchisees against their flexibility to respond to growth opportunities. What emerges from this study is that those franchisors with the least restrictions on their ability to restructure their networks have generally not exploited this power because of their concerns about the negative impact that it would have on their franchisees. The first and second groups could not add new units because of contractual and ethical obligations of exclusivity and/or the geographical constraints of franchise territories. Operating considerations also prevented firms in the third category which operated without exclusivity clauses - and so had the contractual freedom to add units to networks as new market opportunities arose – from exercising this power. However, the risk of not responding to new market opportunities is that market gaps would be exploited by competitors and therefore detrimental to system-wide sales and individual unit profitability. Thus, it is essential that franchisors have the ability to restructure their networks in response to changes in market potential. The next section

examines how franchisees overcome legal, operational and ethnical constraints on network restructuring.

6. MECHANISMS FOR FACILITATING NETWORK RESTRUCTURING

This section addresses the third question: what mechanisms are used by franchisors to facilitate the restructuring process and enable locations of new market potential to be exploited without causing conflict with existing franchisees? To answer this question – which has not previously been examined in the academic literature – we need to look separately at each of the three types of system design identified in the previous section because each of these systems offers a different set of opportunities and constraints for the franchisor.

6.1 Mechanisms to restructure territories: systems with exclusive and non-exclusive territorial networks (n=17)

Franchisors in this category have a choice of three potential mechanisms to facilitate restructuring. The first mechanism is *to offer new units to existing franchisees* to enable them to expand their territories. This mechanism was used by 10 franchisors, either as a build-on (i.e. responsive) or a build-in (i.e. planned) mechanism (8 firms and 2 firms respectively). The advantages were that this mechanism could be implemented during the term of existing franchisees' contracts and did not require any territorial restructuring.[9] However, the mechanism of offering new units to existing franchisees is

not feasible or appropriate in every situation where a market gap arises (Zeller et al, 1995; Bradach, 1995). Opening new units as a build-on mechanism may require a franchisee to develop new managerial skills and competencies (untested when the franchisees were recruited to the system) and they need to be motivated to want to run an additional unit. Not every franchisor is therefore capable of establishing an additional and managing an additional unit. Moreover, even if a franchisee is capable of running an additional unit s/he may not want to do so. Thus, in practice it is likely to be possible in only a small number of situations where the franchisee has demonstrated exceptional potential, key competences and a willingness to expand. Indeed, only four franchisors opened additional units by offering them to existing franchisees. However, for two franchisors in the study the multi-unit franchisee mechanism was integral to their approach to expansion. Both firms operated as area franchisees and were using the mechanism as a built-in strategic mechanism. In other words, it had been planned from the start of the roll-out that existing franchisees would become sequential multi-unit franchisees. These franchisors had therefore developed large-scale territories for this purpose and the franchisees selected accordingly.

A second approach is to *buy-back* all, or part, of the territory where a new market potential has arisen from the franchisee in order to sub-divide it into smaller geographical territories to establish new franchisee territories. Thirteen franchisors had either used, or were in the process of using, this approach as a mechanism to restructure their territories. Some of the more mature franchisors had undergone several rounds of buying back territories which needed to be restructured. However, buying back part, or all, of a

territory from a franchisee entails a process of negotiation requiring management time and effort and the payment of financial compensation. Recruiting new franchisees and modifying existing franchisees' contracts with amended maps of territories imposes further costs. For these reasons franchisees approached the negotiation of territorial buy-backs with reluctance as the following quotes illustrate:

> *"It is not a thing I am looking forward to doing because … we will …end up in some degree of negotiation or conflict. And it might actually put the agreement to the test, which we don't particularly want to do … So it will be a matter of persuasion and commercial negotiation to get those places back that we know and will have stand-alone centres"* (Distribution Sector, firm G).
>
> *"It's going to be difficult to achieve our goal because we need the co-operation of a number of players who have to give up something they have got and that has been sold to them. So, we don't think it will be an easy job … because franchisees don't want their territories split"* (Distribution Sector, firm A).

A third approach adopted by just one franchisor (Personal Services sector) was to add new units to the territories of existing franchisees *during* their contracts. However, this was only possible by *paying financial compensation* (a percentage of the new franchisee's fee) to those franchisees who were affected. This strategy was planned and implemented from the start. This strategy enabled this franchisor to build a management

hierarchy within the system to strengthen its internal structure and create managerial opportunities whilst consolidating the franchise network.

6.2 Mechanisms to restructure territories: systems with non- territorial networks (n=6)

The firms in this category did not allocate exclusive territories and therefore did not have the same contractual obligations as the other franchise systems. As they allocated market areas which were not fixed by geographical boundaries these franchisors did not have to wait until the contract renewal period to add new units to their networks. Nevertheless, these franchisors had to consider the effect that establishing new units could have on their existing franchisees. Units that were located too close to existing ones could cause encroachment and cannibalisation of their customer base and create conflict within the network. Accordingly, these franchisors adopted a number of mechanisms to enable the opening of new units to occur.

The first approach, used by all six of the franchisors in this group, was to seek to *open new units by negotiation* with the franchisees that were likely to be affected. This was felt to be a way in which potential conflict and dispute could be avoided, the franchisees were able to influence the decision and good working relationships be maintained. These franchisors had all either added, or were planning to add, new units into their networks which would be located close to (and in some cases impacted upon) their existing units. The franchisees were all informed through discussion and meetings of the franchisor's intention to add extra units. Inevitably franchisees raised concerns at these meetings

about the effect of these new units on their trade. Franchisors, in turn, wanted clear evidence on how the franchisees would be affected. For example:

> *"a franchisee said if you are going to open there, you will take a lot of my business. So we said show us how much business you have there [in the new market area], make a map, put pins for every one of your clients, where they are, and then we can see the concentration. But he said he is not going to do that. So we said you can't just stop us, you have to show us and if you* ***prove*** *that you have a substantial part of your business there, we will consider what you are saying. But he didn't and we opened and it didn't affect his business at all." (Industrial and Commercial Sector, Firm E, emphasis added).*

In two cases the franchisors developed locational models which could monitor sales and profitability and predict any cannibalisation effects under different locational scenarios in order to assess the effect of new unit introductions on existing units and the network as a whole (as suggested in the literature: for example, Current and Storbeck, 1994; Ghosh and Craig, 1991; Kauffman and Rangan, 1990; Stassen and Middelstaedt, 1995; Zeller et al, 1995). Significantly, these two franchisors were internationally renown networks that have been operating for many years and had the financial resources to develop and use such models. These models only *predicted* possible outcomes so franchisors still had to use their judgement and skills to assess whether a new unit would severely encroach on a franchise and if it was likely, to come up with solutions to minimise the effect of cannibalisation. If it was concluded that severe encroachment would occur then the franchisor would not open a new unit in that location as it would not benefit the system as a whole. However, this rarely happened and proposals for new units nearly always went ahead. Indeed, it was the perceived threat of potential encroachment which caused disputes: it was rare for a new unit to cause actual encroachment.

The second mechanism, used by four franchisors in this group, was to *offer new units to existing franchisees*, thereby enabling these franchisees to become multi-unit operators. Thus, new units were offered in the first instance to the nearest existing franchisee in the area where the proposed new unit was to be located. The franchisors argued that if the new unit did encroach on the franchisee's original unit then any losses would be balanced by the new unit. As well as providing a solution to encroachment, multi-unit franchising has several further advantages for the franchisor. There was less risk involved in offering a new unit to an existing franchisee than taking on a new franchisee who is unknown and unproven (Bradach, 1995). Moreover, the franchisee is likely to be operating in a contiguous market and so is likely to have expertise in operating in that particular market (Kalnis and Lafontaine, 2004). Other advantages of multi-unit franchising include the following: it provides incentive for the best franchisors; it minimises the costs of monitoring; it reduces the free-rider incentive by franchisees; it reduces intra-chain competition; and it has production and marketing efficiencies, However, there were a number of limitations with this approach:

- changing from a single to a multi-unit franchise could affect the profitability of their existing unit, at least in the short term.
- franchisees may not be willing to take on an additional unit because of the time, effort and resources needed.
- some franchisees lacked the managerial capability of operating multiple units.
- in some cases the new units were proposed to be located at the borderline of a number of market areas, meaning that they would impinge on more than one

existing franchisee, but only one franchisee could be offered the opportunity to run the new unit.

A third mechanism, also used by all six franchisors, was to *develop new units as corporate-run operations*. This tended to be a fall-back used in situations when existing franchisees had been offered but turned down the opportunity to run the new unit, or if the franchisor considered the franchisee to lack the skills to run an additional unit. On its own this strategy does not prevent encroachment from occurring since company-owned units may also cannibalise the revenues of incumbents (Kalnins, 2002). However, it enabled franchisors to avoid conflict occurring between existing and new franchisees.

What is most evident from a consideration of these mechanisms used by franchisors in this category is that they would not lose development opportunities for fear that this would create the potential for competitive encroachment, a scenario which franchisors argued would leave franchisees in a worse position. The addition of a new unit would have been discussed with, and offered to, an existing franchise. If the franchisee did not want to take on the new unit then the franchisor would develop the location as a corporate unit even at the risk of causing encroachment and conflict. Franchisors argued that the restructuring actions were undertaken for the benefit of the system as a whole even if this caused difficulties for particular franchisees.

TABLE 2 ABOUT HERE

6.3 Summary

Franchisors use various mechanisms to restructured their networks, regardless of whether they offer exclusive or non-exclusive territories or whether they operate on the basis of territories or market areas (Table 2). Once again the key theme is the heterogeneity of responses. Offering new units to existing franchisees is a common approach in all cases. The use of other mechanisms varies depending on whether the franchise system is territory-based or not. It is also clear that there is no ideal mechanism for restructuring networks, with each approach having limitations.

7. CONCLUSION

Franchising is an inherently geographical business model. It involves creating territories or market areas which individual franchisees will be given trading rights to serve on either an exclusive or non exclusive basis. The aim of this exploratory study has been to examine how franchisors go about restructuring their networks in response to the changing geography of market opportunities, an issue which despite going to the core of the franchising model has not been addressed in the academic literature. Based on a survey of 40 franchisors in the UK, the paper posed three questions: (i) what techniques and criteria do franchisors use to define and delineate their franchise territories? (ii) what how does the design of the system affect the ability of franchisors to restructure their networks? (iii) what strategies do franchisors use to restructure their networks? This final section serves two functions: first, to summarize the answers to these questions and indicate how they make a contribution to enhancing our understanding of some key aspects of franchising, and second, to draw out the implications of the study for practice.

7.1 Summary and scholarly contribution

First, the study reveals considerable variation in practice, underlining that franchising is much more heterogeneous than is often appreciated. Three types of network allocation were identified:

- Networks allocated on the basis of exclusive geographical territories
- Networks allocated on the basis of non-exclusive territories
- Networks which involved neither exclusivity or territories.

Thus, contrary to the common perception of franchising by no means all franchisees are granted exclusive geographical territories within which to operate The study failed to identify any common sector characteristics which were shared by the franchisors who used each of these different approaches to network allocation. This suggests that the decision may be made on prior knowledge or experience of franchising, external advice, strategic objectives or the market environment. Moreover, the network allocation process does not necessarily remain constant over time as the system grows and develops, as illustrated by the franchisors in Group 2 which altered network exclusivity status.

Second, these three network allocation models have different contractual and operational implications for the ability of franchisors to restructure the network by adding new units. Firms which allocated networks on the basis of exclusive territories could not add new units until existing franchisees' contracts had expired or were up for renewal. Thus, the contractual locus of control regarding the restructuring process rests with the franchisee. For franchisors that did not grant exclusive territories (or did not grant territories at all), exclusivity was not a contractual constraint on network restructuring, so they could add

extra units even if they impinged on the market areas of existing franchisees. In contractual terms the locus of control regarding the restructuring process in these cases rests with the franchisor.

Nevertheless, these contractual differences did not show up in terms of different operational behaviour of the different types of franchisor. The majority of firms with non-exclusive territorial networks did not act upon the full flexibility afforded to them by the terms of their contracts. Whilst the absence of exclusivity implied that the franchisor could, in theory at least, alter and add new units to a network at any time, regardless of their effect on existing franchisees, in practice for a combination of practical and ethical considerations existing franchisees were offered the opportunity to run the new units. So, at the operational level the locus of control regarding the restructuring process resided with franchisees. Franchisors which operated without exclusivity clauses or geographical territories had both contractual and geographical flexibility to add new units over time if opportunities arose. However, new units could encroach on an existing franchisee's business. Therefore, in practice, the franchisors either modified their behaviour, for example by establishing franchisor-franchisee working groups to find solutions, create multi-unit franchisors or establish corporate units, to minimise the effects of potential encroachment on existing franchisees and to minimise any potential conflict from this situation. The locus of operational control for this group of franchise systems in the restructuring process shifts towards the franchisee, although the franchisor retains control over new network expansion. This provides another example to complement that of

Curran et al (1984) and Stanworth (1995) which illustrates that franchisees have greater autonomy than is suggested by the contractual context.

Third, franchisors use several approaches to restructure their networks, including offering additional units to existing franchisees and developing new units as corporate-run outlets. This is an important and original conclusion which provides an alternative perspective on two current, and widely debated, trends in franchising. First, offering new units to existing franchisees to enable territorial restructuring to occur is an overlooked but significant driver behind the growth in multi-unit franchising, which is now the most important form of franchising (Kauffman, 1992; Kauffman and Dant, 1996; Grünhagen and Mittelstaed, 2002; 2005; Lafontaine and Shaw, 2005; Weaven and Frazer, 2006). It also challenges the rather simplistic view that franchisees start-out as either single or multiple units owners. Second, the use of buy back strategies as a means of understanding of the mechanisms used to achieve territorial restructuring, gives an alternative perspective on the 'ownership redirection' phenomenon, whereby franchisors bring previously franchised units into company-ownership, resulting in a growth in the proportion of company-owned outlets, even to the extent that they cease to franchise (Dant et al, 1996; Shane and Spell, 1999; Dant and Kauffman, 2003). There is evidence of a curvilinear link between system size and ownership which suggests that franchise systems which initially favour franchised units begin to prefer company ownership once they reach a certain size (Shane, 1998). Castrogiovanni et al (2006) suggest that the growth in franchised outlets tapers off after about seven years. This would be consistent with the resource-based view of franchising which explains the choice of franchising in

terms of access to financial and human resources (Dant and Kauffmann, 2003). The proportion of franchised units rises initially as resources are scarce but then taper off as resources permit expansion through company-owned outlets as resource scarcity diminishes (Dant et al, 1996; Dant and Kaufmann, 2003; Shane, 1998; Castrogiovanni et al, 2006). This includes both the increased financial resources of the franchisor and also increased experience, the effect of which is to reduce the value of franchisees' local market assets (Windsperger and Dant, 2006). This study suggests that another key driver in the growth in the proportion of company-owned outlets over time is the buying out of existing franchisees as a means of territorial restructuring. The point in the development of a franchise system when restructuring is likely to occur is consistent with when the tapering off in the growth of franchised units occurs.

7.2 Implications for practice

The study has two implications for practitioners. First, it highlights the need for new franchisors to plan from the outset for the dynamic element of franchise system expansion and to include this in the franchise contract. Failure to do so may involve considerable time and expense (in terms of management time and compensation to franchisees) to solve, or even prevent the franchisor from exploiting new market opportunities which may be to the detriment of the network as a whole. Of the 17 franchisors in the study that were still in their roll-out or early consolidation, just six had developed strategies in anticipation of the need to restructure their networks to take advantage of any new market opportunities if they arose in the future. The second implication of the paper for practitioners is to provide some insights into the mechanisms

used by franchisors in an attempt to resolve the issues caused by new unit introductions. The key point is that none of these mechanisms were completely effective because they all involve trade-offs. Franchisors therefore have to balance, on the one hand, the benefits of creating exclusive territories (e.g. to attract franchisees) against the limited flexibility to act on development opportunities and, on the other hand, the benefits of maintaining spatial flexibility from not granting exclusive territories against the effects operational and ethical considerations. Getting this balance right will minimise franchisor-franchisee conflict (Fock, 2001). There is a significant opportunity for franchise associations, banks and specialist franchise consultants to provide new franchisors with advice and tools for the design of territories.

Acknowledgements. The research, of which this paper forms part, was undertaken in the Department of Geography, University of Southampton while Juliet Cox was in receipt of an ESRC Research Studentship.

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Appendix. Characteristics of the Sample Franchisors

Franchise age (year of first franchise)	N (total = 40)	percent
0-5 years	0	-
6-10 years	13	32.5
11-15 years	10	25.0
16-20 years	8	20.0
21-25 years	4	10.0
26+ years	5	12.5
Sector		
retail	5	12.5
fast food	5	12.5
personal services	10	25.0
distribution	10	25.0
business-to-business	5	12.5
industrial and commercial	5	12.5
Size (number of franchise units)		
10-49	15	37.5
50-99	14	35.0
100-149	4	10.0
150-199	3	7.5
200+	4	10.0
Location of HQ		
South East	30	75.0
South West	5	12.5
North	2	5.0
Midlands	2	5.0
East Anglia	1	2.5

Table 1. Techniques and Criteria used for territory/market definition[1]

Techniques/Criteria[2]	*Number of firms*[3]	*(%)*
Demographic Measurements		
Population	38	100%
Postal code data	18	47%
Socio-economic groupings	5	13%
Visual Assessment and Geographical Measurements		
Assessment of Competition	7	18%
Accessibility/Communication Networks	6	16%
Franchisee Local Market Knowledge	5	13%
Natural boundaries	2	5%
Business Community Measurements		
Business Counts	9	24%
Estimated Business Potential	9	24%
Predictive Measurements		
Projected Sales/Customer Base Targets	7	18%

1. Used at the time of the interview
2. Categories are not mutually exclusive
3. Percentages have been calculated using a total of 38 firms, therefore excluding the two firms, which did not define territories or market areas

Table 2. Mechanisms for restructuring franchise networks

Type of system	Mechanisms
Systems with exclusive and non-exclusive territorial networks	• Offer new units to existing franchisees • Buy back part or all of the territory where new market potential has arisen to create new territories
Systems with non-exclusive and non-territorial networks	• Open new units by negotiation with existing franchisees • Offer new units to existing franchisees • Develop new units as corporate-run operations

END NOTES

[1] For a recent example, see the case of Quiznos, a US sandwich chain, which has been accused by its franchisees of opening too many franchises in a single market, leading to the cannibalisation of revenues of its existing franchisees. However, the franchise contract does not restrict the company from opening new franchises within the proximity of existing locations (Inc, 2005).
[2] Kaufmann and Rangan (1990) found that one US franchisor spent 40% of its time on resolving group conflicts which have arisen from new unit openings.
[3] There are some mathematical models which are designed to help franchisors in their location decision-making by helping to identify optimum sites for new units which will cause minimal cannibalisation to existing franchisees' sales and profits (see Current and Storbeck, 1994; Ghosh and Craig, 1991; Kaufmann and Rangan, 1991; Stassen and Mittelstaedt, 1995; Zeller et al, 1980). However, none have been tested empirically (Elango and Fried, 1997).
[4] Ten of these firms were still in the roll-out phase and the remaining seven firms were in the early stages of consolidation where the priority was to fill the remaining territorial gaps.
[5] To reinforce the point that there is considerable diversity in practice *within* sectors, 13 other firms, in various sectors, also granted exclusive territories to their franchisees.
[6] That is not to say that exclusive territories eliminates poaching and cherry-picking. The eight franchisors in this category conceded that that a 'few' 'minor' cases did occur but that this was either 'accidental' or due to 'misunderstandings'. These franchisors argued that such competitive behaviour was discouraged because it was against the ethos of the franchise. Franchisees were encouraged to work together for the good of the system as a whole. If disputes did occur then franchisors would resolve them by means of arbitration and ultimately by issuing official warnings or firing franchisees.
[7] Here again this was a mechanism to attract franchisees to a system.
[8] This area-based franchisor commented that *"one of the reasons why we are non-exclusive is that it gives us the ability to negotiate on a national basis" (Retail Sector, Firm A).* On a number of occasions it had identified suitable retail sites and premises that it wished to acquire and redevelop on behalf of its franchisees. However, these could be located across a number of its franchisees' territories and so with exclusive territories there would have to be separate negotiations between the acquisition target and each franchisee. By not granting exclusive territories the franchisor could undertake the negotiations on behalf of its franchisees and if these were successful the sites could be offered to the franchisees.
[9] Combs et al (2004) note that allowing franchisees to own multiple outlets appears to reduce their need for autonomy, thereby reducing conflict.