Geographical Pressures To Deviate From Franchise Formats: Some Evidence From The UK

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Abstract. There is a tension in business format franchising between, on the one hand, standardisation and uniformity and, on the other hand, geographical variations in market conditions and resource availability. Previous research has demonstrated in the case of independent small firms that local geographical conditions influence business strategy. This paper examines whether variations in the local geographical environment, notably in terms of demand and supply side conditions, affect format implementation and whether franchisors permit franchisees to make local adaptations of the format in response to local environmental conditions. The study is based on interviews with 40 UK-based franchisors, all of whom were at the later stages of roll-out or in the consolidation stage of network development. Local variations in the business environment do create a conflict with the need to maintain the uniformity of the franchise format. Adaptation was restricted to peripheral format components. No changes were made to the core format components. Most franchisors recognise that their franchisees are an important source of new innovation. However, implementation of franchisee ideas across the system is found in only a minority of cases.

Key words: franchising, geography, adaptation, standardisation

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1. Introduction

Business format franchising operates on the principle of 'cloning' a standardised tried and tested business format based around a trade name or trademark product or service, in different locations (Julian and Castrogiovanni, 1995; Kaufmann and Rangan, 1990; Stanworth et al, 1996). Although there are several definitions of franchising, Curran and Stanworth's (1983: 11) definition achieves broad agreement:

> "a business form essentially consisting of an organisation (the franchisor) with a market-tested business package centred on a product or service, entering into a continuing contractual relationship with franchisees, typically self-financed and independently owner-managed small firms, operating under the franchisor's trade name to produce and/or market foods or services according to a format specified by the franchisor."

Franchising is therefore based on combining the economies of scale associated with the franchise system with the benefits derived from small-scale, local operations.

Standardisation and uniformity are cornerstones of franchising. This arises for two reasons (Kaufmann and Eroglu, 1999). First, standardisation is a means of achieving cost minimisation for both the franchisor and franchisee, notably in terms of purchasing (as a result of scale economies), marketing and implementation. In addition, it reduces the franchisor's costs of monitoring its franchisees. Second, standardisation enables the concept to be communicated consistently across space in order to build and maintain a distinct image amongst customers. This uniform image leads customers to "expect the same product or service at every location" (Falbe and Dandridge, 1992: 48). This will attract customers who "seek the common consumption experience that the trademark represents" (Michael, 2002: 328). System uniformity and consistency are therefore imperative to attract and retain customers and maintain the integrity of the brand (Dandridge and Falbe, 1994; Michael, 1996; Price, 1997). Because customers will "transfer goodwill they associate with the quality of one outlet to others operating under the same trademark" (Michael, 2002: 320) this creates an inter-dependence between units in the franchise system. Building and maintaining a uniform image of their concept across the system is therefore critical because each franchisee has a potential impact on other franchisees in the system (Kaufmann and Dant, 1999). However, if franchisees deviate from the system's standard model in pursuit of their own self-interest this will lead to trademark erosion and a deterioration in brand quality. The fundamental challenge for the franchisor is therefore to achieve 'controlled predictability' – assuring the quality of the consumption experience represented by the trademark that is owned by the franchisor and used by the franchisee, with quality defined not just as product quality but also conformance to the franchisor's operating instructions for both production and delivery of the standardised product (Michael, 2000). Franchisors seek to enforce standardisation and conformity by means of an operating manual and through the training, inspection and monitoring of their franchisees. However, in practice franchisees are likely to enjoy considerable *de facto* operational independence (Dant and Gundlach, 1999).[1]

The central role of standardisation creates a tension for business format franchising. This tension arises for two main reasons. The first is due to the entrepreneurial behaviour of franchisees. Independence is a major appeal of franchising. Indeed, it is

[1] There are several reasons for this: contracts can never anticipate all future contingencies; the infeasibility of perfect behaviour control by monitoring due to the costs and effort of implementation and human imperfections in monitoring; the legal impossibility of total *ex ante* control; the unwillingness of franchisees to engage in certain activities; and the need to cultivate and maintain a climate of civility, goodwill and trust with franchisees (Dant and Gundlach, 1999).

promoted as a means of 'being your own boss' (Dant and Gundlach, 1999). However, the reality is that franchisors are unlikely to tolerate departures from the standard franchise contract. Thus, franchisees are "not given much room to develop their own initiative" (Michael, 1996: 173). Their autonomy is limited to decisions regarding local operating policies such as location, pricing, hours of service and the hiring of labour. The franchisor, in contrast, makes decisions concerning the system's trademarks, its operating procedures, the product, suppliers of inputs (other than labour) and advertising and promotion material (Michael, 1996). While some franchisees will be happy to conform to the franchisor's stipulations, others view their ownership of a franchise unit "as giving them the right to exercise entrepreneurial initiative" (Baucus et al, 1996). Deviation may also occur as a result of franchisee opportunism to pursue different goals to those of the franchisor. For example, if the franchise fee paid by the franchisee to the franchisor is based on sales then the franchisor will want franchisees to pursue revenue maximisation. However, because the consequence of following this strategy may be to depress their profits (Phan et al, 1996) franchisees may prefer to seek other goals, such as cost minimisation.

The second source of tension, and the focus of this paper, arises from the geographically differentiated nature of markets – both for inputs and outputs. Most franchise units are territorially based and therefore operate in a range of diverse geographical environments with different market and resource conditions. Places differ from one another in terms of income levels, consumer tastes and preferences, and the level of competition. There are also geographical variations in the availability, cost and quality of factors of production, notably labour and premises. In the wider small firms literature there is clear evidence that small and medium sized enterprises

(SMEs) develop geographically-specific strategies in order to adapt to their local business environments. For example, North and Smallbone (1995) noted that because of differences in local labour market conditions small firms in Inner London were more likely than their counterparts in remote rural areas to minimise the amount of direct labour that they use, preferring instead to invest in capital equipment and to outsource. Local and regional environmental conditions “may [also] have implications not just for the way in which products are produced and sold but also for the precise nature of firms’ activities” (Smallbone and North, 1993: 127). In similar vein, Vaessen and Keeble (1995: 503) observe that “many SMEs do not remain passive towards external pressures and constraints imposed by their regional environment. Instead [they] … work to develop strategies to overcome these constraints.” However, if franchisees are forced by their franchise agreement to maintain system standards this will force them to operate in such a way that they may be unable to fully exploit local market opportunities.

Franchisees are likely to be more familiar with local market conditions than the franchisor. As Stanworth et al (2002: 1526) note: “franchisees are the system’s eyes and ears in local markets where the franchisees may have deep social and domestic roots but which remain little understood territory to the franchisor.” Indeed, franchisors depend on this local knowledge of their franchisees to promote local sales (Kaufmann and Dant, 1999). However, for the reasons noted earlier, individual franchisees are expected to follow standardised business formats which make no allowance for adaptation to local circumstances. This creates a constant tension in business format franchising:

> "The franchisor desires market standardisation for consistent corporate operations and economies of scale. On the other hand, the franchisee demands adaptation for sub-optimal market satisfaction" (Fock, 2001: 173).

The challenge for franchise management therefore "involves the accommodation of the franchisor's desire for standardisation, consistency, quality control, and the presentation of its goodwill and brand equity, and the franchisee's quest for autonomy" (Dant and Gundlach, 1999: 36). The implication is that "to succeed in its role as creator, builder and guardian of its business format … the [franchisor] must resolve the constant, yet evolving, tension between the two strategic imperatives of standardisation and adaptation" (Kaufmann and Eroglu, 1999: 70). Too much standardisation and control by the franchisor is costly, creates post-contractual agency problems and precipitates motivational and moral problems amongst franchisees. However, if franchisees have too much autonomy to adapt to local conditions this will result in the loss of corporate identity and brand equity (Dant and Gundlach, 1999).

A further potential effect of excessive standardisation is that it may discourage experimentation and innovation by franchisees. Through their local adaptation efforts franchisees are frequently the source of innovations (e.g. developing new offerings, modifying existing ones and finding solutions to system wide problems). As Stanworth et al (2002: 1520) note, "some of the most cited examples of franchisee-led innovation result from experimentation by franchisees that was not only not sanctioned by franchisors but was, on occasion, actually discouraged." However, some forms of innovation may damage the overall system. In particular, if franchisees adapt to local conditions they decrease the similarity of operating routines across the system, which reduces the potential for cross-fertilisation of ideas for identifying and implementing new offerings (Kaufmann and Eroglu, 1999: Sorenson and Sørensen, 2001).

It is also important to note that ~~The~~ the nature of the tension between standardisation and adaptation varies according to the maturity of the franchise system. The circumstances which prompt adaptations to the format are most likely to occur amongst franchisors in their initial roll-out stage of development where the features of the system may not have been clearly defined yet and there may be uncertainty over what elements are sacrosanct. In addition, formats in their early roll-out will incur few costs in deviating from uniformity because they will not be well-known, so changes to are likely to have minimal impact on demand because there is little or no customer expectation of the product/service (Bradach, 1998). Furthermore, as Stanworth et al (2002: 1522) suggest, the benefits of franchise experimentation and innovation are greatest when franchise systems are in their earlier stages of development. This is because "so many franchise systems, far from being 'tried and tested' in their early years, still have much to learn, and the role of franchisees can be crucial." However, Kaufmann and Eroglu (1999) argue that standardisation is critical in the early stages in order to project a relatively large set of common elements in the format that are distinctive of the system as a whole rather than specific outlets. Their reasoning is that even relatively minor differences may interfere with the ability of consumers to generalise from outlet to system.

In mature franchise systems the pressure to deviate from the format will arise from the growing self-confidence of the franchisees in their own abilities. This is likely to result in a growing frustration over the constraints on their freedom of action, an increasing resistance to standardisation and an increased desire for independence (Oxenfeldt and Kelly, 1968-69).[2] Indeed, Tuunanen and Hyrsky (2001) report evidence of increasing franchisee dissatisfaction over time, while Floyd and Fenwick (1999) note that franchisees demand greater autonomy as systems mature. Franchisees also become increasingly knowledgeable about the specific local markets that they serve and develop an expertise in assessing and responding to the idiosyncratic needs of their customers.[3] Their local market knowledge may exceed that of the franchisor. Franchisors may have enough confidence in the abilities of particular franchisees to permit some local adaptations. As the franchise system matures, and the business environment becomes more competitive, so the need for entrepreneurial activity amongst franchisees in the form of experimentation and innovation increases dramatically to keep the system competitive (Tuunanen and Hyrsky, 2001). Appropriate strategies may require market segmentation and differentiation involving increased adaptation at the expense of standardisation. A mature system is likely to be more resilient to potential brand image distortion that arises from local deviations.

Changes to format standardisation have been examined in studies of international franchising. These studies note that adaptation does occur in response to local (i.e.

[2] This leads Oxenfelt and Kelly (1968-69) to argue that franchising is a transitional form of business organisation to mobilise financial capital, local geographical knowledge and local entrepreneurs, and to secure first mover advantage (see Michael, 2003). Thus, over time local franchised units might be expected to be re-acquired and converted to company-owned outlets. However, Michael (2002) suggests that franchise chains may have strategic or competitive advantages which offset this disadvantage.

[3] Kaufmann and Eroglu (1999: 80) make this point as follows: "As their experience grows … the same franchisees who sought the security of the franchise system as a method of going into business increasingly become experts (perceptually or actually) with respect to their local markets and the operation of the business. This leads to a growing temptation to forego standardisation and search for the optimal fit even though they had agreed to forego that privilege."

national) conditions.[4] However, our concern in this paper – a case study of the United Kingdom - is with adaptation *within* individual countries to differences in local geographical conditions which has attracted little previous attention. Kaufmann and Eroglu (1999) provide a valuable conceptual review of standardisation and adaptation in business format franchising. The only empirical evidence is provided by Bradach (1998), in a study of US fast-food systems, who suggests that the local geographical environment does affect format implementation, with franchisees seeking local responses.

This paper seeks to address two related questions:

- Do variations in local geographical conditions affect format implementation?
- Do franchisors permit local adaptations in response to local environmental conditions?

Its contribution is to engage with Kaufmann and Eroglu's conceptual paper by offering some empirical insights on the questions they raise concerning "what are the appropriate limits of uniformity" in business format franchising (Kaufmann and Eroglu, 1999: 69)? It is important to note that our concern here is only with local geographical pressures on franchisees to deviate from standardisation. There is a larger literature which looks more generally at the role of the franchisee in contributing to format variation (see Bradach, 1998; Dandridge and Falbe, 1992; 1994; English and Hoy, 1995; Kaufmann and Eroglu, 1999; Michael 1996; Price, 1997; Rosenbloom, 1995). We also exclude deviations that are imposed by outsiders such as planning authorities. The sample contained ten cases where planning

[4] For example, McDonalds introduced a special Philippines-style 'McDough' burger in its Manila location to compete with the local Jollibee chain (Ryans et al, 1997). Hoy et al (1998) attributed the demise of a Mexican franchisor who expanded into the USA to its failure to take account of US tastes and preferences.

authorities required changes in signage, colour or décor (or all three) because the premises were located in conservation areas.

2. Data Sources

The qualitative nature of the information required to address this issue indicated a survey methodology. The paper is based on face-to-face interviews with 40 UK-based franchisors (which includes the UK master franchisees for some international franchise systems). The selection of franchisors was dictated by two considerations. First, because the focus of the wider study (Cox, 2002), of which this paper forms part, was on the spatial expansion and rationalisation of franchise systems the selection of 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. Stanworth et al (2004) note that this is likely to be the minimum number of outlets necessary to achieve break-even. Second, in order to reflect the diversity of franchising activity, the sample comprised 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. A total of 80 franchisors were approached: 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.

TABLE 1 ABOUT HERE

The characteristics of the sample are shown in Table 1 (see Cox, 2002, appendix 3, for further details). The absence of franchisors less than five years old reflects the requirement that firms should have at least 10 franchised units. The majority of respondents had between 10 and 49 franchised outlets (37.5 percent) or 50-99 franchised outlets (35 percent). However, the size of some of the respondents is understated because these figures do not take into account master franchises which have their own franchisees. For example, one of the retail franchises had 36 area franchises which together operated approximately 1,500 units. The majority of the respondents had their head office in London or the rest of the South East of England.

The nature of the sample needs to be borne in mind when considering the empirical evidence. The franchisors were predominantly in the later stages of roll-out or in the consolidation stage, filling gaps in their networks. A further limitation is that the paper is based on self-report data gathered from franchisors who may have either been unwilling to admit to significant examples of local adaptation because it would indicate that their authority has been undermined or may not be aware of actions by their franchisees to adapt to local circumstances. The implication of these methodological limitations is that the extent of local adaptations may actually be greater than those reported in the following sections.

3. Franchise formats: core and peripheral components

Business format franchising comprises a contractual relationship between the franchisor and the franchisee. This gives the franchisee the rights to trade under the franchisor's name and use the franchisor's product/service, confidential process or specialised piece of equipment in accordance with the franchisor's format or blueprint, which describes the procedures and regulations relating to the daily operation of the business. The franchisee will also have access to the support systems necessary to implement and operate the business. In exchange, the franchisee makes an initial payment and also ongoing fees or royalties to the franchisor. Kaufmann and Eroglu (1999) suggest that the various elements that comprise the franchise format can be grouped into four distinct components:

- *Product/service deliverables*: these are the unique features of the format which make up the 'concept' of the business (such as a unique menu in a fast food franchise) and give the format its competitive niche in the market place.
- *Benefit communicators:* these are the intangible and unobservable benefits for the consumer, such as quality, reliability and professionalism which create the confidence in the product/service (e.g. clean uniforms in fast food outlets).
- *System identifiers*: these are visual and auditory elements that link the individual unit within a system or chain (e.g. trade name or trademark, colour schemes, décor, architectural features, uniforms).
- *Format facilitators*: these are the policies and procedures which enable the format to function efficiently at both the individual unit level as well as at the system level (i.e. the managerial and operational infrastructure necessary for format implementation, covering store level elements such as specification of equipment, layout and design plan, plus the system level elements like

financial reporting systems, royalty payment methods and training procedures). Format facilitators are largely invisible to the consumer except for their indirect effect on the other components, but are critical because they comprise the management and operational infrastructure for the entire franchise system.

FIGURE 1 ABOUT HERE

However, these elements are not of equal importance (Kaufmann and Eroglu, 1999). For example, amongst those elements that contribute to the system identifier component, the trade name or trademark is more important than the colour scheme of a unit. It is therefore possible to make a distinction between the core and peripheral elements of each format component (Figure 1):

- core elements: "those whose standardisation must be enforced across all franchisees without exceptions since they are deemed indispensable for the system's survival;
- peripheral elements: "where the franchisor must balanced the system-wide benefits of standardisation against the benefits of adaptation to the idiosyncrasies of local demand" (Kaufmann and Eroglu, 1999: 72).

The core elements of each of the four format components give the franchisee a competitive advantage over independent firms. Franchise systems will differ in terms of what is core and what is peripheral. Distinguishing between core and peripheral elements of the format components provides a useful conceptual framework to examine the standardisation vs. local adaptation strategies of franchisors in response to local geographical differences in the operating environment.

4. Standardisation vs. Adaptation To Local Environmental Conditions

All of the franchisors in the study acknowledged that the business environment varied across the UK, resulting in their franchisees encountering different local environmental conditions. As a consequence all of the franchisors faced the conflicting pressures to maintain the uniformity of the franchise format but also to allow adaptation to local conditions.

Franchisors identified three main sources of local variation. First, local markets differed in the level of consumer demand reflecting both consumer tastes, preferences and culture and also socio-economic composition (incomes, age, etc). Second, the degree and type of competition vary from place to place. Third, there are differences in the availability and standard of factors of production (e.g. premises). In some cases, the nature of local conditions are sufficient to compromise the successful implementation and performance of the format.

4.1 Adaptation of Peripheral Components of Format

For the reasons discussed earlier, all of the franchisors in the study were under pressure to standardise the franchise format and maintain uniformity across the system. However, pressures to make adjustments in response to local conditions were also high. Adaptation amongst franchisors to local environmental circumstances was exclusively in the form of adapting the peripheral components of their formats in specific operating areas to ensure a better fit with market conditions. These local adaptations took the following forms:

- Product-mix variation
- Pricing structures
- Local marketing
- Human relations practices

All five of the fast food franchises and four of the retail firms in the sample were product-based franchise operations. In response to local differences in market conditions these franchisors permitted their franchisees to vary the product mix and add different product lines to the core product[5] (Figure 2). Bradach (1998) describes these responses to local conditions as being tactical. The changes were pre-approved by the franchisors who regarded them as consistent with the franchise format and did not involve significant variation of the core product component of the franchise format.[6] Fast food franchises therefore offered different side dishes, accompaniments and optional products. In the case of one pizza delivery franchise, franchisees had the flexibility to put additional pizzas on the menu to suit local customer preferences (e.g. halal meat in areas of high ethnic concentration). These franchisees could also use locally-based suppliers provided that proprietary ingredients (dough, pizza toppings – which were the core components of the product) continued to be supplied by the

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[5] It is illegal in the UK for franchisors to dictate suppliers to franchisees unless for proprietary goods or services. Franchisors in this sample did recommend suppliers to their franchisees or had final approval of local suppliers.

[6] A good example of this type of adaptation to local conditions is provided by Paul Bunis, who was winner of the Best Franchise Award from the Glasgow Chamber of Commerce in 2001. The citation reads as follows. "He opened his first Domino's Pizza franchise five years ago, his second store in 1999 and his third in 2001. From a starting point of virtually zero, he has successfully helped to build the brand both locally and nationally [i.e. in Scotland]. Paul has done what all good franchisees do, and taken the best of a big brand with a proven system and applied it locally. Capitalising on the training, operational and marketing expertise available from the franchisor and undertaking masses of market research, Paul insisted on local pricing, local pizza flavours, new side orders and of course the introduction of Irn Bru [a cola-type drink popular in Scotland] to his menus. In turn, Paul is one of the most successful franchisees in the Domino's Pizza system."

franchisor. Because of this flexible response to local differences in demand, this franchise system therefore had different menus at each of its outlets. In the case of the retail franchises, franchisees altered the product mix to take account of local and regional consumer tastes and to take advantage of local suppliers).

FIGURE 2 ABOUT HERE

In the case of service-based franchisors the intangible nature of their output means that any adaptation to their 'product' takes the form of deviations in the service offering. Just over half of the franchisors (16 out of 31) required that their franchisees follow a standard format to ensure consistency across the system. However, the remainder allowed their franchisees varying degrees of flexibility in how they delivered the service (Figure 3).

FIGURE 3 ABOUT HERE

Under EU regulations franchisors are not permitted to stipulate prices to franchisees and can only *recommend* minimum or maximum pricing structures. Thus, franchisors were legally required to allow their franchisees to set their own pricing structures for products and services. The franchisors in this study made this restriction into a virtue by arguing that by not fixing prices franchisees were able to act responsively to the conditions in their local markets (Figure 4).

FIGURE 4 ABOUT HERE

Franchisors also allowed franchisees to conduct their own local marketing. However, all marketing material had to be approved to ensure that the core components of the 'system identifiers' (i.e. the brand image and the trade name) were not compromised. Franchisees could use the most appropriate types of marketing (e.g. leaflets, TV and radio advertisements) to achieve the most effective results in their local market. The franchisees of some of the retail and fast food franchises in the study used 'two for the price of one' promotions in response to aggressive local competition.

Some mature, well-established systems had large marketing departments that were available to support the needs of their franchisees to generate new marketing ideas and promotions in response to aggressive competitors. However, in the case of franchise systems that were in their early stages of expansion (or 'roll-out') it was the franchisors, and thus the system as a whole, that benefited from the local experiences of franchisees in using different marketing ideas and promotions.

Franchisees, as independent businesses, are responsible for the recruitment of staff, setting wages and operating hours. Local labour markets vary in terms of occupational skill structures. In some cases franchisees had difficulties in recruiting staff with suitable skills and had to respond with recruitment and training initiatives to combat this problem. Recruitment was a particular problem for some of the professional service-based franchise systems because of the high skill levels or specialised knowledge required of employees. Job specific training was the usual response to such difficulties. In the case of retail firms, a combination of the low skill nature of the work, low pay and long opening hours, which necessitated unsociable shift work, created considerable recruitment and retention difficulties which franchisees attempted to respond to by means of local adaptations to standardised recruitment procedures.[7]

In summary, there is evidence that peripheral format components are modified in response to local conditions (Table 2). There are four reasons for this. First, the franchise contract requires or permits franchisees the autonomy to exercise local control in some operational aspects (such as pricing and local marketing). Second, franchisors recognise that franchisees are operating at the 'front-end' with (in most cases) intimate knowledge of their local markets which could be used to achieve better product/service-market fit and therefore increased revenues. Third, franchisors also recognised that if the rigidity of the franchise format prevented franchisees from using their local knowledge to benefit their business then that could potentially lead to operational difficulties and, in turn, generate resentment, distrust and conflict between the franchisee and the franchisor. Finally, as agency theory contends, the contract also gives franchisees the economic incentive to be responsive to local conditions because they will benefit from the increased profitability of the unit.

TABLE 2 ABOUT HERE

4.2 Core Format Components

Whereas some franchisors granted their franchisees a greater or lesser degree of autonomy in the areas of product-mix, suppliers, pricing, marketing and labour

[7] For example, in response to recruitment difficulties one retail franchisor had developed a recruitment policy which assisted franchisees with the interview process, recommended open days for prospective employees and established a job incentive loyalty scheme. In addition, employees could progress to more skilled and responsible jobs, including a management training scheme. However, the franchisees found that the most effective way to reduce labour turnover was to have flexible shift systems so that individuals could work the hours that suited their personal circumstances.

recruitment in order to be able to respond flexibility to local trading conditions, the franchisor retained authority over operational aspects which had potential implications for the core format components which affected uniformity and the maintenance of standards. Thus, none of the franchisors in the sample permitted the adaptation of core format components. The sample is weighted towards established franchise systems. As a consequence, the franchisors were concerned about the potential effect of any relaxation in the uniformity, consistency and replication of the system on competitive advantage, brand image, customer association, loyalty and patronage. However, reflecting the earlier discussion on adaptation and the maturity of the system, 16 franchisors (40 percent)[8] acknowledged that they did adapt the core components of their format in the early stages of their development (Figure 5).

FIGURE 5 ABOUT HERE

Agency theory contends that franchising is a method which aligns agent effort and compensation and thereby reduces monitoring costs. However, this expectation is not bourne out in practice. All of the franchisors have long-established monitoring mechanisms to ensure the consistency of franchise formats and the maintenance of standards. Clearly, franchising does not completely eliminate the need for the franchisor to monitor the franchisee (Kirby and Watson, 1999; Shane, 1995).

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[8] All of these firms were formats which originated in the UK. None of the franchisors that were based on international concepts engaged in core format adaptation. Adjustments of this type would have been made well before such firms internationalised their formats. Thus, nearly two-thirds (64 percent) of UK originating franchisors had made adjustments to their core format in the early stages of development.

Monitoring took a variety of forms and varied by industry sector, type of operation (location or mobile), maturity of the format system and franchise method (area or multi-unit). Confirming the findings of Bradach (1998), the more formal forms of monitoring centred on financial auditing, on-site/field visits and mystery shopper audits. Financial auditing, which was used by all of the firms in the study, was necessary to establish sales and profits from which royalty rates were calculated. Operational aspects such as health and safety standards, sales approaches, quality of product/service offering, layout of equipment and degree to which format procedures were being followed were mainly monitored by overt field or on-site visits (used by 90 percent of firms). In contrast, only 12 percent of firms (all in retail and fast foods) used mystery shopper audits. Informal methods of monitoring franchisee performance, such as customer feedback, were also used as a means of monitoring quality and service.

Franchisors have a number of options for dealing with franchisees that are not reaching the required standards or are not conforming to the franchise format. The first step in most cases is an informal discussion to attempt to resolve the difficulty. The next stage is to issue a formal written warning. Franchisees which still did not conform would be subject to a financial penalty or fine. The final step to invoke conformity would be to terminate, or threaten to terminate, the franchise contract. However, this is costly, and franchisors stated that it rarely occurred, with the threat of termination usually sufficient to achieve an improvement in standards or conformity.

4.3 Franchisee-inspired innovations

The emphasis which franchisors put on maintaining system uniformity risks stifling the creativity of franchisees who have the potential to generate ideas that would benefit the system. However, many of the franchisors in the study recognise the importance of franchisees as sources of ideas (Figure 6). Indeed, one-quarter of the franchisors in the study use competitions amongst franchisees to generate new ideas and hold award ceremonies with cash prizes for the best ideas. Some longer established franchisors also had formal committees with franchisee involvement to generate ideas for the future development of the format.

FIGURE 6 ABOUT HERE

However, although franchisors are willing to listen to the ideas that their franchisees have, and in some cases to reward the best ones, this does not mean that every idea is adopted across the system. Franchisors were unresponsive to ideas that were idiosyncratic to a particular market or location and if they unnecessarily eroded the integrity of the core format components and system. Conversely, ideas of franchisees that had the potential to improve or benefit the format would be considered for development and implementation across the system. These ideas would normally be trialed by a small group of franchisees to test for viability and then reviewed for their suitability to be implemented across the system. Amongst the franchisors in this study only 22 percent had implemented ideas from their franchisees that had led to system-wide adaptation. Most of these ideas related to improved ways of operating the system (e.g. production, marketing campaigns, IT) which resulted in changes in the operation system and operating manuals – that is, to the core format facilitators component.

There were just two franchisors in the study (5 percent) which had implemented ideas from franchisees that involved the system-wide adaptation of the core product/service deliverable component. In the first case, a fast food franchisor secured a deal with a soft drinks manufacturer and distributor to sell the product in its units. This innovation had started as a peripheral format component adaptation (adding new products to the product menu) by a franchisee, but the idea of promoting soft drinks with its core product offering appealed to the franchisor and was successful when subjected to a trial. In the second case, a franchisee in a distribution system invented a display stand for storing cards and wrapping paper which was easy to construct, took up little room and was relatively inexpensive to manufacture. Implementation of this innovation across the system led to core format component adaptation as the franchisor began to produce and distribute its own wrapping paper as a core service offering. It is therefore evident that franchisee innovations may be implemented across the system if they meet with the approval and ratification of the franchisor.

However, franchisees who implement innovations which affect the core format components and thereby erodes system uniformity and brand value will create difficulties for the franchisor. The resulting deviation from the format may also incur costs to the franchise (financial, brand consistency, customer patronage) and to other franchisees in the network. In such circumstances franchisors will seek to enforce conformity but the franchisee may continue to operate in a way that significantly deviates from the format.

5. Conclusion

Franchising operates on the principle of replicating a tried and tested business format in new market areas (Julien and Castrogiovanni, 1995). However, in this process of market expansion franchisors have to balance the two strategic imperatives of format uniformity and format adaptation to local variations in environmental conditions. The stable image of the franchise concept is essential for its integrity and mass promotion. However, there may also be pressure from some franchisees to innovate, and in so doing to adapt format components in order to compete effectively in their local markets (Dandridge and Falbe, 1994). Thus, as Kaufmann and Eroglu (1999: 69) observe, "of the many types of management issues faced by franchisors, perhaps the most difficult is …. maintaining the required level of uniformity for the system to obtain economies of scale, while avoiding the danger of stifling local market adaptation."

Using the framework developed by Kaufmann and Eroglu (1999), this paper has contributed some empirical evidence on the extent and nature of franchisee adaptation to local environmental conditions. First, the premise of the paper has been confirmed. Variations in local market and factor conditions does put pressure on the maintenance if format standardisation across the system. Second, the paper has established that the response of franchisors to local variations in market and supply conditions has been to permit deviation by franchisees in the peripheral elements of format components. Adaptation has been concentrated in the 'system facilitators' component – elements which comprise the infrastructure of a franchising system ensuring effective operation but which are largely unseen by the customer – and less often in the product/service deliverables component. Franchisees could act autonomously in response to local conditions by setting prices competitively and implementing local marketing campaigns and recruitment procedures and were permitted some freedom to vary the product mix because such adaptations of peripheral elements of format components were judged by the franchisors to benefit implementation of the format. However, franchisors enforced conformity in situations where franchisee adaptations would distort the core components of the format as this would endanger brand image, customer expectations and competitive advantage. Conformity was enforced by monitoring mechanisms (e.g. financial audits, field/site visits) and penalisation schemes. Third, the paper confirms that most franchisors recognise that franchisees, by virtue of their daily customer-interaction, are a source of innovative ideas which can benefit both the format and the system. In some cases franchisors did adopt adaptations by franchisees involving modification of core format components across the system. However, these were mainly core format facilitators. Innovations by franchisees that led to the system-wide adaptation of the core product/service component were extremely rare.

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Table 1. 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

Figure 1. Examples of core and peripheral component elements

FORMAT COMPONENTS

CENTRALITY*		Product/Service Deliverables	Benefit Communicators	System Identifiers	System Facilitators
	Core	Basic menu Accuracy of work	Clean uniforms Professional certification	System name Trademark Logo	Sales reporting procedure Operating manuals
	Peripheral	Hours of operation Parking	Mint on pillow Display of professional certificates	Colour scheme Décor of unit	POS equipment Local advertising

Note: what might be peripheral in one system could be core to another

Source: Kaufman and Eroglu (1998)

Figure 2. Franchisor reasons for permitting product mix adaptations

"the business is defined to satisfy local needs and reflect local or regional bias…franchisees have the ability to be able to tinker with the product mix" (Retail Sector, Firm A)

"clearly, [franchisees] have got to think local and act local in order to make a success of their shop. There will obviously be some slight tweaks and franchisees can influence their product mix…but once they are in a locality, then they have got to understand and tweak their individual store to meet the needs of their local market." (Retail Sector, Firm B)

"there are local market variations and our concept is built around that, it is a flexible concept within the defined product areas…we're market focused rather than product focused, we're based on a market and our product range is changing the whole time…the local market can differ, but we have 32 different product areas within the store, so the mix can vary depending on the local market" (Retail Sector, Firm D)

"We do have different products sold within our stores. We have very few stipulations. First of all our stores do not buy anything though us, apart from any branded items. After that they have the freedom to deal with whoever - the suppliers - who they want. What the franchisee promotes in the store is down to the individual franchisee, there is freedom there" (Retail Sector, Firm E)

Figure 3. Reasons Why Service-based Franchisors Allow 'Flexibility' in the Service Offering

"The system is the same but estate agency does vary from location to location - and the important thing about them being independently owed and operated which is different to a corporate agent - we don't say to them, this is what you have to do to get more business, they determine it themselves, they know their market, they will come to us and say I want a promotion on this, or I want to push to get more listings this month. At the end of the day its their business and somebody on the coast in Kent may be operating slightly differently to somebody in central London but no more so than any other agent would be. We have no control over how they conduct their business other than they must use our systems, because we want as far as possible everybody working the same way and therefore conspiring to keep to the same level of service." (Personal Services Sector, Firm A)

"The format describes very clearly the roles and responsibilities but it doesn't define, by and large, the methodology, because we are talking about delivering a service on a customers' premises and the customers' premises will themselves vary. Customers vary…its very difficult to define. It is obviously much easier if you have a retail based product franchise. You have got to be flexible within the bounds of common sense…we are not offering a standardised service, we are trying to offer a standard of service." (Personal Services Sector, Firm E)

"There are obviously local market variations and our concept is built around that, it's a flexible concept, within the defined product areas. Because we are market focused rather than product focused, we're based on a market and our product range is changing the whole time." (Personal Services Sector, Firm J)

"Certain aspects of the business format we rigidly adhere to – the corporate image is just one. Virtually everything else has a degree of flexibility in it" (Distribution Sector, Firm G)

"We are not like a McDonald's. The underlying principles of the core structure and format stay the same. However, different franchisees take on different elements of the corporate package. So for example, you could have a franchisee in Edinburgh and a franchisee in Bristol using two different training programmes and using different parts of the package. It depends on the franchisee and their time in business and their background." (Business-to-Business Sector, Firm B)

"I think any franchisor would love to say yes, the format is consistent, and I think that any franchisor who said yes, it is that exact is lying! Here we are dealing with an intellectual process. It is not a product based – it is not a McDonald's. If you own a McDonald's in Slough and go to a McDonald's in Portsmouth basically you know that the chips or whatever are going to be the same. The buns, the meat, the gherkins, the tomatoes will be the same. If you go into a McDonald's in Bangkok it's the same as in Slough - you can have uniformity of the product. You are talking about the business services here, which have got to be tailored to a greater or lesser degree by the owner manager and their consultants…by their personalities. So yes there is continuity of process, but is it a cookie cut franchise? No. It is not an intellectual straight jacket let's put it that way. They do have to put their personality into it. They do have to inject their individuality into it and it does have to adapt from market sector to market sector. If you are recruiting a finance director you have to go about it in a very different way to if you were recruiting a sales director. A finance director is a different 'animal'. So you have to even adapt the approach to different people to fit." (Business-to-Business Sector, Firm E)

Figure 4. Franchisor views on pricing structures

"We don't have standard pricing…it allows us to respond to local market conditions and it makes sure that individual franchisees are competitive" (Industrial and Commercial Sector, Firm D).

"One of our franchisees has been experiencing difficulties with one of our competitors as, unfortunately, the franchisee has the competitor's head office located on the edge of his territory. However, even though they are very strong…he can tweak his marketing campaigns and set his prices to undercut the competitor" (Distribution Sector, Firm A).

"Some of our pizzas go for £14 in London, but a franchisee operating up north – in Leeds or Liverpool, for example, – would never be able to get that price - £9 is about the most they can hope for." (Fast Food Sector, Firm B).

Table 2. Peripheral format component adaptation: a summary

Component (using categories from Kaufmann and Eroglu (1998)	Number of franchisors
Product/service deliverables	
• product mix variation	9
• flexible service offering	31
•	
Benefit communicators	0
System identifiers	0
System facilitators	
• Pricing structures	40
• Marketing strategies	40
• Recruitment policies	31

Figure 5. Early Life Cycle Stage and Core Format Component Adaptation – Sample Responses

"In the early days, we actively sought the franchisees opinions and they fed back to us their ideas…they helped to develop this business into what it is" (Retail Sector, Firm C)

"Our format has definitely improved and developed over time" (Retail Sector, Firm E)

"Our franchisees have driven quite a lot of what's new in the franchise" (Personal Service Sector, Firm J)

"Some of our earlier franchisees drove this business forward, they contributed to how the business was set up, what should be in the manual, the types of cards we should be producing" (Distribution Sector, Firm A)

"In the early days, it happened almost everyday, where franchisees came up with new ideas and we encouraged it and that helped the development of our format by taking on board their ideas and innovations. It was, and is, an important part of what we do" (Distribution Sector, Firm E)

Figure 6. Seeking New Ideas in Franchise Systems – Sample Responses

“if you don’t innovate, then the system will die” (Personal Service Sector, Firm E)

“a franchisor doesn’t necessarily have all the answers” (Personal Service Sector, Firm F)

“we have 70 odd franchisees working out there day to day, they feed back to us almost daily. We don’t always agree…but it is a very important part of what we do. If we don’t innovate, we are dead” (Distribution Sector, Firm E)

“they are at the ‘coal face’, dealing with customers on a day-to-day basis. So they know what is going on in their area better than ewe do. So yes, we listen to their suggestions” (Industrial and Commercial Sector, Firm A)

“we are pretty open to be honest, we don’t have the monopoly on good ideas…it is also a way for franchisees to add value back into the system. For us, it is part of using the network to its full extent” (Fast Food Sector, Firm C)