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Toward a relational perspective of franchising chains

Luis M. De Castro · João Mota · Sandra Marnoto

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Abstract In many professional and services industries, firms try to scale up their operations by reproducing practices in new locations through franchising arrangements, especially business format franchising. The classic but still prevailing explanations for franchising related phenomena, especially the initiative of franchising, the propensity to franchise, and the franchise performance, are mostly based on two orders of reasons (or a combination of them): franchising is either explained as a means to deal with resource scarcity or (and) as a mechanism for franchisor and franchisee to align incentives between themselves. However, empirical studies have shown limited support for both such claims, especially in face of the so called plural form, where proprietary and franchised units of the same franchisor co-exist. It may also be argued that the traditional literature on franchising has assumed a high level of homogeneity within and between franchising "networks," possibly due to the perception that they tend to be "dominated" by a high level of standardization and replication of practices, both operative and relational. However, learning processes in such "networks" have recently been brought in as an attempt to capture other mechanisms that may underlie their operation and sustainability. This article seeks to explore a third perspective to look at franchising "networks," by drawing from

L. M. De Castro (✉)
Departamento de Gestão, Faculdade de Economia, Universidade do Porto,
Rua Dr. Roberto Frias, s/n, 4200-464 Porto, Portugal
e-mail: mcastro@fep.up.pt

J. Mota
Departamento de Gestão, ISEG – Instituto Superior de Economia e Gestão, UTL – Universidade Técnica de Lisboa, Rua Miguel Lupi, 20, 1200-781 Lisbon, Portugal
e-mail: joaomota@iseg.utl.pt

S. Marnoto
Instituto Superior da Maia, CEL, UID 707-FCT, Av. Carlos Oliveira Campos,
Castelo da Maia, 4475-690 S. Pedro de Avioso, Portugal
e-mail: sandra.marnoto@netcabo.pt

the literatures on capabilities and industrial networks. Seen from this perspective, business format franchising may involve more than the mere replication or exploitation of a recipe, especially if we take into consideration the partly idiosyncratic nature of both the relationships between actors and their capabilities and intentions. Within this perspective, variety preservation, and not only uniformity, may be recognized by participants as relevant for the performance of the franchise chain. In other words, variety may reflect the need for the refinement of the "package" throughout time, in more than one ways, together with the gradual development of the network and the learning experiences that take place in that context.

Keywords Franchising · Business relationships · Firms' capabilities

1 Introduction

In many professional and services industries, firms try to scale up their operations by reproducing business practices in new locations through franchising arrangements, especially business format franchising. Through this process, a firm (the franchisor) sells to another firm (the franchisee) the right to use its brand name, operational systems, and product/services specifications. The visibility and economic relevance of this organizational form suggests that "franchising is a key expansion mode for US and European firms" (Combs et al. 2004, p. 908).

The traditional franchising literature has mostly focused on seeking justification or explanation for the emergence of these arrangements at business and unit level. Explanations have been drawn from two main streams, the resource perspective and the agency theory. According to these explanations franchising might be either a means for overcoming the scarcity of the firm's resources that limit its growth or a product of an elaborated trade-off of agency costs concerning the franchisor's well known brand name. As neither of these proposed explanations seemed to find sufficient support in empirical research, some authors suggested a combination of both. In fact, anecdotal evidence still shows some important contradictions. In particular, the co-existence of franchised and company-owned units in the same locations is still a puzzling question (Combs et al. 2004) and, in spite of the large quantity of studies undertaken, the "extant research can benefit from additional theoretical diversity" (Combs et al. 2004, p. 908).

This article seeks to explore another perspective for looking at franchising chains, by drawing from the literatures on industrial networks and capabilities which, hopefully, will allow explaining issues that the other perspectives dealt with somewhat unsatisfactorily. For that purpose, a relational, as opposed to an atomistic, perspective of the social actors involved in these arrangements has been adopted (Granovetter 1985; Grabher 1993). It is suggested that the heterogeneity of the social actors, regarding their capabilities and relationships, may matter as it may have a role in the innovation process (e.g., Dyer and Singh 1998; Hakansson and Snehota 1995). The first section, next, presents a brief revision of the traditional theories on franchising and notes the importance of acknowledging that some relevant heterogeneity may be found and condoned in franchising systems. The second section contends that the issue of heterogeneity has been central to recent approaches to franchising especially when more attention was given to learning and the preservation of the plural form. Then we try to look at franchising chains as networks of relationships and lastly we draw some conclusions.

2 Traditional franchising theories

Three main questions have been debated in the traditional literature about franchising: first, the grounds for its emergence; second, the reasons underlying the choice between keeping company-owned units and franchising them and, finally, the determinants of the terms of the franchise contract (i.e., franchise fees and royalty rates). We will focus on the first two only. Although there seems to be some consensus around the explanation advanced by the agency theory, some issues seem to remain open. According to Norton (2003, p. 1), "scholars of franchising have made remarkable progress in the past few decades in understanding franchising," namely the existence of franchising and its grounds, the decision between company-owned and franchised units, the contract terms (e.g., franchise fees and royalty rates), the nature of termination procedures and the role of capital structure. However, Norton (2003) concedes that, in spite of these advances, a number of important issues still remain unexplained. In fact, several limitations of these theories can be identified.

The first limitation is related with the very emergence of franchising. According to the resource view, a company that owns a newly developed concept or brand name must grow fast in order to protect those resources. However, it may face some sort of resource constraint that prevents its fast growth. This problem is especially prevalent in immature companies, which will often adopt franchising as a means to overcome those restrictions (Caves and Murphy 1976). In contrast, the agency perspective assumes that the franchisor-company holds a well known brand name, or reputation, recognized as valuable. Often these companies will have serious problems in controlling their agents' actions that might damage their brand names. By resorting to franchise contracts, they will hopefully be able to reduce agency costs by solving some incentive issues (Rubin 1978; Brickley and Dark 1987). However, anecdotal evidence supports neither of these explanations. On the one hand, the franchise contracts are not exclusively used by small, resource-starved companies (Brickley et al. 1991; Lafontaine 1992). Some mature and prosperous public companies, like McDonald's, use franchising intensively (Love 1986). On the other hand, franchising is also adopted by start-up/entrepreneurial firms that do not yet have a strong brand (Carney and Gedaglovic 1991; Marnoto 2000). More recently, some authors tried to reconcile both theories by claiming that early in their life cycles, firms that use franchising will do so as a mean to overcome some sort of resource constrain and, when mature, they will adopt franchising for agency concerns (Martin and Justis 1993).

The question of the franchising life cycle is not at all new. Indeed, one of the basic assumptions of the Resource View of franchising is the existence of a tendency toward the vertical integration of the units formerly franchised. As the company matures, it becomes easier to acquire the resources it needs to expand and, therefore, the franchisors buyback the previously franchised units (Oxenfeldt and Kelly 1969). Underlying this assumption is also the idea that franchisors prefer the company-owned units and, if it were possible, they would have wholly integrated chains (Lafontaine and Kaufmann 1994). Many empirical works have found this conversion tendency (Hunt 1973; Caves and Murphy 1976). Several authors supportive of the resource view found on those studies the evidence needed to sustain their predictions. Further, some criticisms to the agency perspective of franchising were also based on this evidence. If a company chooses to franchise in order to reduce agency costs, it will be expected that, as the company matures, it will use franchising more intensely, since the strengthening of the concept or brand name will increase the cost of the agent's shirking (Carney and Gedaglovic 1991). Brickley et al. (1991), however, have tried to explain the buyback phenomenon from the Agency Perspective. With time, in certain geographical areas, an increased concentration of franchised units is expected, which reduces the in loco monitoring costs and decreases the advantages of the franchise format. According to Lafontaine (1992), the tendency toward the vertical integration is a result of an increase in franchisor moral hazard which leads to an increase in the preference for company-owned units. Lafontaine's (1992) study, however, did not support this hypothesis.

In what concerns the emergence of franchising and the evolution of the chains throughout time it is worth noting that, although most empirical works supported the buyback prediction (Hunt 1973; Caves and Murphy 1976; Minkler 1990; Carney and Gedaglovic 1991; Lafontaine and Kaufmann 1994; Thompson 1994), some other studies found a tendency in the opposite direction that questions those theoretical proposals (Martin 1988; Lafontaine 1992; Scott 1995). Thus, there does not seem to be a clear tendency in either direction. Actually, there may be not one at all, which will make sense if only we admit that each chain may be unique regarding the capabilities involved. In this context, history may matter but empirical studies on franchising are usually of a cross-sectional type because usually there is not enough data available to perform time-series analysis (Lafontaine and Kaufmann 1994). Hence, not only a possible tendency of conversion into either direction, but also the reasons to explain it, might vary not only between industries (e.g., Norton 1988) but also between companies in the same industry and even regarding the same company over time (e.g., Oxenfeldt and Kelly 1969; Martin and Justis 1993). All this suggests the interest of studying how and why specific chains evolved over time, i.e., how their mixes of company-owned and franchised units changed and the reasons underlying those changes.

A very close and puzzling question is the existence of the plural or dual form. A company that adopts franchising may still keep some company-owned units. According to the resource view, the dual form can be seen as a transitory phase in the company's life cycle: when the firm matures, it overcomes its constraints to growth and converts itself into a wholly integrated chain. The agency perspective, on the other hand, has focused on the decision between to franchise and to integrate a particular unit. According to this theory, there is a trade-off of agency costs to be considered in this decision (see, for instance, Brickley and Dark 1987). However, neither of these theories seems able to claim adequate empirical support (Combs et al. 2004). We have already discussed the limitations of the life-cycle justification, regarding the Resource Perspective. As for the agency perspective, although its trade-off proposal is somewhat empirically supported, the reason why company-owned and franchised units co-exist in the same locations still remains unexplained (Minkler 1990). It can be said that by neglecting the production costs, the agency theory implicitly assumes that what a company may manufacture, another one can produce just as well (Demsetz 1988).

A few other issues beside the omission of the production side of the firm have been missed by traditional theories, namely heterogeneity within and among chains, the role played by the franchisees in the franchising relationship and the dynamics of a system of connected relationships. Let us begin with heterogeneity. Although franchising is used in very different companies, industries and economies, it can be said that the traditional theories are built on a homogeneity assumption: franchisors, franchisees, and franchising relationships are supposed to be homogeneous, and they are seen as aggregate entities. Regarding principals and agents, Combs et al. (2004, p. 920) noted that the agency theory "assumes homogeneity in their ability to perceive and act," which contrasts with the resource view that franchisors and franchisees may differ in their management skills or local knowledge (e.g., Oxenfeldt and Kelly 1969; Minkler 1990). The authors also suggest a link to the resource-based theory as a way to relax the homogeneity assumption and accommodate variety in the ways franchisors manage relationships with franchisees (Dant and Gundlach 1999). In this context, for example, firms (franchisors) with conflict management capabilities "might expand using franchising because such emphasis builds upon their relation-specific capabilities" (Combs et al. 2004, p. 924).

Loasby (2001, p. 11) also argued that "contemporary models of economic organization [such as the Agency Models] often depend on the concept of asymmetric information, which certainly corresponds to an aspect of reality. However, I suggest that the more important asymmetry is of interpretation and of perception, which leads some individuals and some organizations to take actions that others have dismissed, or never even thought of." Contrary to Loasby's standpoint, traditional theories tend to view the franchising partners as economic agents that belong to a particular group which determines their behavior, actions and decisions. In this sort of models, the social actors internalize certain pre-defined rules (which are appropriate for their belonging group) that they follow mechanically regardless of their individual will (Granovetter 1985; Grabher 1993).

By relaxing the assumption of homogeneity, it is also possible to acknowledge that heterogeneity may be present at two levels, namely heterogeneity among chains and heterogeneity inside each chain, e.g., among the chain's franchisees and among the relationships between themselves and between them and the franchisor. For example, the degree of control and autonomy exercised by a franchisor may differ from one franchisee to the next (Cochet et al. 2008; Pinzanti and Lerner 2003). Since the different actors in a franchising net (that is to say franchisor and franchisees) are heterogeneous, they have different characteristics; to be precise they have their own resources, capabilities, objectives, experiences, and perceptions.

As noted above, all these possibly idiosyncratic features have been more or less neglected by the traditional theories.

Somewhat related to the neglect of the heterogeneity issue is the question of the disregard of the role played by the franchisees in the franchising relationship. Indeed, the traditional literature has essentially focused either on the assumed franchisee's free-rider nature (Mathewson and Winter 1985; Brickley and Dark 1987) or its ability to supply capital or another scarce resource (Caves and Murphy 1976). According to Elango and Fried (1997, p. 76), traditionally the franchisor and the franchisee have a top-down relationship where the "franchisee is perceived to be a good franchisee if it does as the franchisor wishes. The franchisee is viewed as a user of the franchisor expertise and knowledge, not able to contribute to the system." Croonen (2003, p. 8) also considers the traditional perspective about the franchisee as "the antithesis of entrepreneurship and strategic thinking." Indeed, the franchisee is typically seen in the literature as a relatively passive party to the relationship. Although the franchisee's firm is an independent company, it is expected to be highly dependent on the franchisor's decisions. The franchisor may determine (or approve) matters such as the location of the unit, the design and layout of the outlet (including building materials), the average level of stocks, the suppliers of inputs, the exposition and decoration on the shop windows. Yet, some authors reported on important active roles played by the franchisee. According to Love (1986), the McDonald's franchisees can be important sources of ideas for the franchisor to develop new products or procedures that later may be spread throughout the chain. Minkler (1990, 1992) also pointed out that the franchisee can hold superior information about or knowledge of its local markets. As Dnes (1996, pp. 305–306) has put it, in Minkler's work, "franchising allows the use of the trade mark to be exchanged for the franchisee's local entrepreneurship, which is defined as noticing and acting upon opportunities." Combs et al. (2004, p. 918) noted that "Whereas many innovations developed by franchisees are not communicated to franchisors (Darr et al. 1995), franchisors with good franchisee relations might be better able to identify and implement local adaptations that will benefit the entire chain (Bradach 1997)." Thus, in such circumstances, both the exchange and combination of experiences and knowledge may be critical to the dynamics and performance of the franchising chain. More recently, as we shall see, several studies have tried to shed some light on this issue.

Finally, the traditional literature has also lacked a dynamic perspective of franchising, meaning that the analysis mostly refers to cross-sectional studies in particular moments in time. In Croonen's (2003) opinion, these theories do not analyze the dynamics of the relationship between franchisor and franchisee. The way the two parties interact, the way the relationship evolves over time and the effect of path dependence are not studied or even considered. Further, the importance of the development of the system itself, i.e., the development of the concept or brand name through an innovation process such as the development of new products, is also not considered. Thus, by introducing the time dimension, learning processes and relationships may matter in improving our knowledge on franchising system dynamics, including the persistence of plural forms.

3 Franchisees as sources of innovation in franchising chains

Within the franchising literature, some authors have been approaching issues related with the creation, maintenance, and diffusion of knowledge in franchise chains. It can be said that these studies overcame some of the previously mentioned traditional limitations by assuming heterogeneity, recognizing the franchisees' (potential) active role in the franchise relationship and taking a more dynamic view of franchising. In particular, learning processes and inter-firm relationships attracted the attention of several researchers.

As noted by Clarkin and Rosa (2005), the research on franchising firms tends to bestow the entrepreneurial role to the franchisors. Franchisees, operating subject to a uniform system of contractual obligations, are usually seen as having few opportunities for entrepreneurial creativity. By studying the entrepreneurial teamwork within several chains, Clarkin and Rosa concluded that creativity and adaptation are not always confined to franchisors and involve a complex and dynamic network of relationships between the franchisors and the franchisees. Also, according to Gorovaia (2003), the chain's performance depends both on the transmission of "system knowledge about the business and the brand" from franchisor to franchisee and of knowledge about the "local market conditions and country specific knowledge" from the franchisee to the franchisor.

Langenhan (2003) also addressed this issue. He defined the franchise package as the franchisor's organizational knowledge about the "successful management" of the business. For Langenhan, there are two sorts of knowledge in a franchising chain: the core knowledge and the decentralized knowledge. Core knowledge is contained in the franchise package and is transferred from the franchisor to the franchisee, while the decentralized knowledge is that knowledge held by each franchisee and not included in the franchise package. Since the franchisee is closer to the customers, this decentralized knowledge can be very important. However, noted Langenhan (2003), this knowledge it is not necessarily shared with either the franchisor or other franchisees, since they may not recognize its importance.

This literature also acknowledges the franchisee's (potential) contribution to the development of the franchised concept or brand. According to Sorenson and Sørensen (2001) franchisees may play an important part in this process for two reasons. First, because they are less risk averse than company managers, otherwise they would not have become entrepreneurs. Second, because they have larger time horizons which induce them not to be short-sighted and to be willing to invest in innovative projects that may only produce returns in the long run. Cliquet and Ngoc (2003, pp. 10–11) also consider that the franchisees are especially important for generating ideas, the initial phase of innovation processes. They are "a good source of local ideas" because they are closer to the customer and know the local market, they have "good intuition based on their experience," they have a higher incentive to improve the unit's performance and finally they push "forward company managers and the chain operator to be more dynamic and to generate more ideas." An empirical study of a fast-food franchising chain, reported by Argote and Darr (2000), actually found several innovations added by the franchisees to the production process of their chain.

In contrast to the traditional literature, and the agency perspective in particular, that focused on the understanding of the determinants of the franchisor's choice between integrating and franchising a particular unit, the emerging literature is more concerned with assessing the advantages of the plural form. Several authors agree that combining franchised and integrated units might be fruitful in managing March's (1991) exploitation and exploration paradox (Sorenson and Sørensen 2001; Croonen 2003; Bradach 1998). According to March (1991), a balance must be found between the exploitation of old certainties (production, selection, implementation, and refinement of present elements) and the exploration of new possibilities (research, experimentation, and innovation of future elements). Franchisees might be, for several reasons, more prone to exploration than company managers. In turn, these would have a higher incentive to exploitation, essentially due to both the franchisor's incentives and monitoring type (Sorenson and Sørensen 2001). In Cliquet and Ngoc's (2003) opinion, the plural form is preferred, in what concerns the innovation process. While the franchised units are seen as especially relevant in generating ideas, the company-owned units may have an important role in testing, implementing, and spreading the innovations.

That exploitation versus exploration paradox is somewhat related with another paradox: standardization versus innovation. Standardization is important because it ultimately ensures the chain's unified identity. It is one of the specific features of franchising, as it allows customers to easily recognize a chain's units in distant markets and associate to that recognition what to expect from their products or services. Also, without a high degree of standardization, it would not be possible to spread across the chain's units the costs of generating or acquiring new knowledge (Sorenson and Sørensen 2001). Further, local variations in the business environment may conflict with the need for uniformity in the franchise format (Cox and Mason 2007) while, at the same time, it may be necessary to develop the franchised concept or brand, starting somewhere. Still, the diffusion of innovations in a franchise chain may not be easy. It is suggested that the franchisees may lack the incentive to adopt the franchisor's innovations, either because they do not want to take the risk or they do not want to make the required investments and, typically, the franchisor cannot force on them those innovations that are not in agreement with the contract (Cliquet and Ngoc 2003). Conversely, when a franchisee produces a local innovation that is adequate to its specific context it may not be of interest to other franchisees. Even if it actually does, it may not easily spread through the chain because the innovative franchisee may not want to support the initial costs incurred in initiating the dissemination process (Sorenson and Sørensen 2001). He/she may be more interested in meeting the franchisor's performance indicators (Argote and Darr 2000) and may perceive the other franchisees as rivals rather than partners, especially if the market is saturated and/or there is significant rivalry between units.

Following the research above, it is possible to identify some advantages of franchised over company-owned units and viceversa. According to Sorenson and Sørensen (2001), the company-owned units are preferred when the market is homogeneous and its exploitation is more important, while the franchised units have an advantage when the market is heterogeneous and exploration is essential. Yin and Zajac's (2004) contend that the franchised units are preferred when the chosen strategy requires flexibility and local adaptation because they are more flexible and decentralized. The company-owned units are best suited for strategies that depend on forecasting and control.

The latter studies brought in new elements to the understanding of franchise systems. They are particularly interesting for understanding the role of the franchisees, newly seen as having their own idiosyncrasies and being an active part of the franchise relationship. They also suggest a link between the presence of the plural form and the degree of variety found between and within local markets. These studies forego to some extent the assumption of homogeneity of the abilities held by the principal and the franchisees thereby rising the issue of the importance of the learning processes for the performance of the franchising chain (Combs et al. 2004). We believe that such processes can be better understood by looking at franchising as a relational form for organizing and coordinating economic activities in an industry, which we attempt in the following section.

4 A relational perspective of franchising chains

Franchising as an organizational form can be described as a network of active and heterogeneous firms that interact within a context of business relationships (e.g., Cliquet and Ngoc 2003). None of these firms has by itself all the resources and capabilities needed to achieve its objectives (Axelsson and Easton 1992; Hakansson and Snehota 1995). Through the network, each firm, either franchisor or franchisee, accesses the resources and capabilities of the counterparts with whom it relates.[1] For example, the franchising relationship allows the franchisor to access its franchisees' know-how about the units' management and the ability to combine that with knowledge held about local specific circumstances. In turn, the franchisees access the franchisor's capabilities regarding its know-how about the productive process and technology, the definition of the product or concept positioning and image, the maintenance and development of the franchised concept through advertising and the introduction of new products. Franchisors should also have the capabilities required to attract new franchisees, to monitor them after the beginning of the relationship, to promote the creation and diffusion of knowledge, including the test and replication of successful routines, throughout the network.

The combination of the franchisor's and the franchisees' capabilities may have a role in helping to explain the emergence of franchise contracts, both at the business and unit level. At the business level, this question can be related to the definition of firm boundaries (Combs et al. 2004). Basically, it is a complex decision involving 'making,' 'buying,' or 'getting it through a franchisee.' At the unit level, the question concerns the decision between 'owing' and 'franchising' a particular unit

[1] Langlois and Foss (1999, pp. 207–208) define capabilities as "team-embodied and partly tacit production and organizational knowledge that can be employed by team-members for a strategic purpose." Dosi et al. (2000, pp. 207–208) describe them as "the know-how that enables organisations to perform (…) [their] activities."

and it is closely related with the issue of the plural form.[2] In both cases, a relational approach emphasizes that both each firm in the franchising chain and franchisor–franchisee relationships may display unique characteristics that may affect the initiation of franchising agreements and the subsequent propensity to franchise. Thus, the emergence of at least some franchise contracts might be explained by the franchisor's and franchisees' idiosyncratic capabilities and the specificity of the links between both.[3]

At the business level, three possible nonexclusive arguments should be considered. First, since the franchisor's and the franchisees' activities can be perceived (Loasby 2001) as closely complementary but partly dissimilar, there may be the need to coordinate them through inter-firm cooperation. According to Richardson (1972), an industry entails a countless number of activities that must be performed by organizations that have the adequate capabilities. Some of these activities are similar because they are based on the same capabilities. Other activities are complementary because they are linked by the production chain. Firms tend to specialize in activities that use similar capabilities while complementary, yet dissimilar, activities are supplied by other organizations. Inter-firm cooperation is a result of the necessity to coordinate closely complementary but dissimilar activities. Since these are not similar, they should not be coordinated through the firm. However, they should not either be coordinated through the market because there is a need to meet qualitative and quantitative requirements not just match aggregate demand and supply. This seems to be the case in franchising. In a franchise relationship, the activities performed by the franchisor and the franchisees may apparently be closely complementary but partly dissimilar. Typically, in a franchising relationship, the franchisor is responsible for the activities concerning the management of the brand or concept and the franchisees are responsible for the activities involving direct contact with the customers within particular locations.

This argument is somewhat implicit in the Agency rationale for the emergence of franchise contracts. As mentioned before, according to agency authors, franchising is more prevalent when firms have strong brands that provide for uniform quality of product and service (Brickley and Dark 1987). Since in these firms the brand management is centralized at headquarters and the customers are served at the decentralized units (Scott 1995), they have to be concerned with the level of effort made at the units in order to protect their brand value. For agency theory, this is a problem of moral hazard. Agents (either employees or franchisees) assume opportunistic behaviors because there is an asymmetry of information between them and the principal. We believe this may not necessarily be the whole story. Asymmetric information can be an aspect of reality (Loasby 2001) but the different

[2] As noted above, the plural form is the combination of company-owned and franchised units in the same network. The traditional theory has mainly focused on the option between franchising or vertically integrating a particular unit (e.g., Brickley and Dark 1987). More recent studies have tried to uncover the advantages of mixing both (e.g., Bradach 1998).

[3] For example, Luciano Benetton in Benetton (1990), especially in Chaps. 5 and 8, concerning the launching of franchised shops in Europe and the USA, respectively, is quite emphatic on the need for empathy and trust between both parties to a franchise agreement, deemed more important than formal contracts.

actors in a franchising network also hold different knowledge and perceptions. Therefore, the franchisor might not be facing moral hazard resulting from asymmetric information but, more importantly, may be dealing with an asymmetry of interpretation and perception (Loasby 2001) regarding what is required from the employees or the franchisees.

Second, the franchising alternative may conceivably confront lower dynamic transaction costs (Langlois and Robertson 1993) or otherwise it might produce benefits so considerable that firms chose to accept higher governance costs. Following Richardson's (1972) work, Langlois and Robertson (1993) assume firm heterogeneity and consider that this is due to the idiosyncratic, tacit knowledge each firm holds. In their opinion, the firm's capabilities might be of two different kinds: the core capabilities which are tacit and idiosyncratic and the ancillary capabilities that are easily transferable and imitated and, therefore, are common to several firms. To these authors, the choice between 'making' or 'buying,' between 'hierarchy' or 'market' is influenced by the cost of using other firms' capabilities, when these are needed. However, at that moment, the market might not offer that particular capability and, since tacit knowledge can only be attained through a long, time-consuming learning process, firms may face dynamic transaction costs (Langlois and Robertson 1993). Unlike Williamson's, these costs are not related to incentive issues but to problems of coordinating productive knowledge and can be defined as the costs of negotiating, coordinating, persuading, and teaching external suppliers.

The franchisors' dynamic transaction costs are then the costs of negotiating, coordinating, and teaching franchisees. Under this perspective, franchise relationships can be an outcome of lower dynamic transaction costs given the perceived availability of capabilities deemed adequate to perform a set of activities over time. This means that the decision to franchise might be the result of the costs of negotiating, coordinating, and teaching franchisees being perceived as lower than those of internally developing the capabilities needed to do the job, or those for getting those capabilities through other firms in the market, including other partners. Alternatively, it might also be possible that the governance costs of this option are higher than those presented by vertical integration or other external alternatives. However, the advantages resulting from the combination of the capabilities involved might be so significant that the franchisors choose to bear them (as in Loasby 1998). According to Loasby (1998, pp. 156–157), the advantages of some relationships are not those "of reducing transaction costs, but of increasing net benefits, and specially of increasing net benefits through the development of new skills, new methods, and new products (…). [These] advantages may justify increased costs of governance, and even new forms of organization (…)." In an important sense, the increased costs associated with relation-specific investments may reflect the franchisor perception and experience of the importance of franchisee' local market knowledge (Bradach 1997; Combs and Ketchen 2003).

Third, franchising arrangements and related dynamic transaction costs might be a function of the indirect capabilities of the franchisors (Loasby 1998). Langlois and Robertson's (1993) perspective is essentially based on the 'market versus firm' dichotomy. Yet, firms seem to differ to a large extent in their capabilities regarding the access not to an anonymous market but to a set of particular partners in that market (Araújo et al. 2003; Mota and de Castro 2004). As a result, the dynamic transaction costs would appear to be counterpart specific. Loasby's (1998) distinction between direct and indirect capabilities is an essential concept to draw this conclusion. According to Loasby (1998, pp. 156–157), as firms specialize, there is a "consequent need to know-how to get things done by other people," which might as well justify the need to build "relationships to manage closely complementary capabilities." In view of that, firms have direct capabilities which are related with the knowledge about 'how to do something,' and indirect capabilities that are associated with the knowledge about 'how to get something done.' These are means for accessing other firms' capabilities. Thus, the boundaries of the firm, i.e., the decision between performing the economic activity through the firm, the market or cooperation, depends also on the firm's indirect capabilities which may be tacit, idiosyncratic and dependant on the investment made for their development (Loasby 1998).

Thus, the capabilities perspective accommodates the notion that "firms that make investments in developing skills to manage franchisees will exploit those skills" (Combs et al. 2004, p. 923). For example, at an early stage, the franchisors' main indirect capabilities, which allow them access to the franchisees' capabilities, may refer to their ability to attract and motivate the new franchisees to adhere to a concept that may not yet be fully known. And this ability might depend on know-how about the creation of an attractive concept. Later, as firms mature, the franchisors' capabilities related with creating and maintaining a good reputation in the market may be extremely important for mobilizing new franchisees (Mathewson and Winter 1985). This indirect capability may depend on the performance of the concept in the market and the investment made by the franchisor on the present and past relationships with its franchisees (as in Mota and de Castro 2004). Furthermore, just as franchisors' investment in their present and past relationships may develop their indirect capabilities through the effect on reputation, so the franchisors' investment in their indirect capabilities may also influence the development of their (present and future) franchising relationships. It is expectable that as a franchisor develops its indirect capabilities, its costs of negotiating, coordinating and teaching franchisees will decline. Thus, the presence of variety in the firms' indirect capabilities is consistent with the notion that "some firms develop unique and valuable skills at managing franchisees and (…) this skills might form at least a partial basis for competitive advantage" (Castrogiovanni et al. 2006, p. 39).

If we admit, as we have said before, that the franchisors' indirect capabilities are a means to access the franchisees' capabilities, then these must be those capabilities that influence not only the emergence but also the maintenance of the franchising relationships. Therefore, these capabilities must also be related with the franchisors' know-how about the replication of routines, the codification and diffusion of knowledge in the network and the supervision of franchisees among several others. At this point, we specifically emphasize the replication of routines. It is a well-known fact that firms tend to replicate well succeed routines from one point to another in the organization. In the same way, the franchisors may want to replicate some routines throughout the network, i.e., within several if not all relationships. This replication strategy includes early experiments to test, evaluate, and decide which attributes might be advantageously replicated throughout the network (Winter and Szulanski 2001). However, since these relationships are partly idiosyncratic, sometimes some adjustments may be needed. In this context, the franchisees might have an important function. Being superior local-knowledge holders they might help the franchisors to contingently replicate and or adapt routines.

At the unit level, the decision between ‘owing’ and ‘franchising’ a particular unit may depend on the capabilities required to manage that unit and how those capabilities might be combined within the wider network. Thus, the plural form may be a result of perceived and partly specific advantages in the combination of franchisor’s and franchisee’s capabilities in a wider context. This is someway in line with the work of Bradach (1997, 1998), Sorenson and Sørensen (2001), and others who researched the advantages of the plural form. Plural forms, we suggest, may reflect the need to preserve or manage a degree of variety within the franchise network. The degree of diversity of franchisees may be an important issue, especially in what concerns knowledge creation and innovation. Not only the franchisees’ capabilities may have a part in explaining the emergence of franchising and the existence of the plural form, but might also they have a central role in the development of the network. The different locations, experiences and path dependencies of the franchisees might turn them into relevant potential sources of dynamic capabilities for the network. Apparently most franchisors seem to neglect this potential contribution (cf. Cox and Mason 2007). We may be facing one of the network paradoxes discussed by Ford et al. (2003). According to these authors, the actors in a network seek its control. However, actually achieving network control can be detrimental because this will set a limit to variety and therefore to the creation of knowledge and innovation. Since franchising actors and networks are heterogeneous, it is possible that one may find different levels of both franchisees’ role appraisal and franchisor’s control intensity. In this framework, the degree of valuation of the franchisees’ role and the extent of franchisor’s control might help explain differences in performance of some networks regarding their innovativeness.

Analyzing franchising from this perspective might also help us to understand the dynamics of the mix of franchised and company-owned units. Mota and de Castro (2004) consider that the evolution of firm boundaries is shaped by its set of direct and indirect capabilities which results from its investments and practice within the context of inter-firm relationships. According to these authors, the development of capabilities does not occur in an isolated manner but in a context of relationships. The firm is embedded in a network of relationships with other firms that hold different sets of direct and indirect capabilities. Hence, the development of the firm’s capabilities is influenced by the capabilities of those counterparts and their paths of development. In the same way, its own capabilities influence the development of the others’. The decision concerning firm-boundaries definition is therefore one of establishing, developing, or terminating links between capabilities (Araújo et al. 2003). According to Mota and de Castro (2004), the evolution of firm boundaries is not so much shaped by the market distribution of capabilities, as in Langlois and Robertson (1993), but much more by its set of direct and indirect capabilities, as in Loasby (1998), that results from its investments and practice within the context of inter-firm relationships. Thus, the network is both a result of its past and also a base for its future development (Axelsson and Easton 1992; Hakansson and Snehota 1995). The shared experiences in the network may change the advantages of combining those capabilities that originally were the foundation for the relationship. This interaction might also change the actors' perception of both the advantage of combining their capabilities and the related dynamic costs (Langlois and Robertson 1993). Hence, we might consider that the relationship and the system's dynamics are path dependent.

5 Concluding remarks

This article sought to explore a relational perspective for looking at franchising "networks," by drawing from the literature on capabilities and industrial networks. This combination of perspectives allowed us to ease the assumption (underlying agency theory) that actors are homogeneous in terms of perceptions and capabilities and also to emphasize the presence of variety in the relationships between the actors. Also, by mobilizing some perspectives about the organization of industry that emphasize the coordination of activities more than transactions, we tried to accommodate the rising interest on learning processes in franchising networks.

The relational perspective allowed us to approach franchising arrangements and dynamics as systems of connected relationships involving several actors with partly idiosyncratic capabilities, within and without the focal franchise network. In this framework, the dynamics of the mix of franchised and company-owned units are influenced by the development of the direct and indirect capabilities of franchisor and franchisees. That development is a result of the experiences shared in the network.

Seen from this perspective, franchising may involve more than the mere replication or exploitation of a recipe, especially if we take into consideration the partly idiosyncratic nature of the relationships between actors and their capabilities and intentions. In this framework, the experiences of the actors involved, which include those relative to relationships as mechanisms for the coordination and generation of new knowledge, may be relevant for a better understanding of the dynamics of a particular network. Additional sources of variety may be a response to the need for the refinement of the franchised concept in several ways, throughout time, together with the gradual developing of the network and the learning experiences taking place in that specific context. This allows franchising networks to differ substantially from one another regarding the degree of centralization, or selective distribution among actors, in setting the adequate combination of variety and standardization (cf. Dant et al. 2008). Indeed, the efforts to combine standardization with innovation, and exploitation with exploration, may be highly challenging for both the franchisor and the franchisees. For example, exploration may include both early experiments to decide which attributes should be replicated throughout the network (Winter and Szulanski 2001) and the participation of franchisees that might have an active role in the process of exploration and help decide with features to maintain locally.

Several studies suggest that franchising chains, as an organizational form, can be seen as focal networks that combine stability in some dimensions, e.g., retaining knowledge in the form of operational routines, contractual rules, with change in other dimensions, mainly because actors develop as they go their knowledge about activities and resources, including counterpart specific relationships. In this sense, direct and indirect capabilities co-evolve as actors learn in a context which, we contend, is partly specific and jointly created.

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