Franchise Systems as Strategic Networks:

Studying Network Leadership in the Service Sector

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Keywords: franchising, organization, management, network, structuration.

Abstract

Studying franchise systems as strategic networks directs attention to the relationships produced and reproduced under the strategic leadership of the franchisor. Such a perspective that is anchored in the theory of structuration highlights network processes without neglecting structures. Implications for the management of franchise networks and franchising research are discussed.

Franchising and the State of Franchising Research

Franchising has become extremely popular not only in the US but also in Europe and other parts of the world. Especially business format franchising has been used as a means to multiply the effect of entrepreneurial innovations, to found new and rather sustainable small- and medium-sized businesses (Stanworth, 1996), to restructure large organizations in a flexible way (Felstead, 1990), and to expand to foreign markets (Hopkins, 1996). Most recently, franchising has become a means to transfer knowledge across the boundaries of organizations, industries, and societies, the latter of which is particularly true with respect to developing and transitional economies.

With the rapidly increasing number of franchise systems and outlets, in particular in service industries which require highly decentralized operation at multiple sites (Michael, 1996), management is in desperate need of research-based knowledge about not only *when* to opt for franchising as a suitable strategy but also *how* to manage franchise systems. In the past, research on franchising, especially if based on a thorough theory, has concentrated largely on the question of when to prefer franchising over other organizational alternatives such as own subsidaries. Much of this kind of research has been based upon institutional economics (e.g., Brickley *et al.*, 1991; Lafontaine, 1992; Picot and Wolff, 1995). In contrast, research on how to manage existing franchise systems, if it exists at all, has hardly been based on theory.

This paper contributes to this latter line of research by reframing franchise systems as strategic networks and, thereby, linking the literature on interorganizational networks and relations (e.g., Oliver, 1990; Sydow, 1996; Oliver and Ebers, 1998) with franchising research. Such a strategic network perspective focuses on interorganizational relations and on those management practices that create and reproduce them. Many of these practices themselves are an outcome and medium of (strategic network) leadership by the franchisor. Concentrating on relationships and management practices that (re-) produce them in general and strategic network leadership in particular contributes to an applied franchising research that is dynamic rather than static, is sensitive towards tensions *and* contradictions, paying attention to action and structure as well as to their social embeddedness.

A suitable theoretical foundation of such a strategic network perspective on franchise systems is provided by the theory of structuration which has been developed by Anthony Giddens (1984) as a social theory and, in the meantime, amply been applied to the analysis of management, organizations and networks (e.g., Whittington, 1992; Kilduff, 1993; Ortmann *et al.*, 1997; Sydow, 1998; Sydow and Windeler, 1998). Anchoring this research in the theory of structuration ensures that this perspective is based upon an advanced theoretical understanding of practices, how they emerge in an embedded context and what effects they produce in firms, interfirm networks, or even more comprehensive social systems.

Before the foundations of structuration theory are outlined, the notion of strategic networks is explained. Then, central concepts offered by this theory are applied to the theme of strategic network leadership. A study of six franchise networks in the service sector of Germany (cf. Sydow and Kloyer, 1995) provides empirical data and examples to illustrate the theoretical argument with reference to the strategic network leadership of the franchisor. Finally, conclusions are drawn with respect to franchising research and managing franchise networks.

Franchise Systems as Strategic Networks

Research focusing on how to manage established franchise systems should start with the insight, provided especially by institutional economics, that franchising constitutes a form of governance or, more precisely, an organizational form (e.g., Williamson, 1991; Brickley and Dark, 1987; Norton, 1988). Given the principal choice between three basic organizational forms, i.e., market, hierarchy, and network (Powell, 1990), franchising is most suitably conceptualized as an (interfirm) *network*. This is because, on the one hand, the relationships established in franchise systems are, for the most part, too tightly coupled to be considered as market relations. Based upon a highly formalized and integrated procurement, marketing, and management concept, these relations are almost, but only almost, „organization-like“ (Sydow, 1997). On the other hand, the relationships in this kind of systems do not adhere to the hierarchical mode of coordinating *intra*firm relationships either. Franchise outlets, in contrast to subsidaries, constitute not only *inter*firm relationships but are more subject to the „market test“ (MacMillan and Farmer, 1979). Moreover, the franchisor cannot rely on fiat but rather has to consult and negotiate, although to a lesser extent than in more polycentric networks. Finally, the residual gain as well as the financial risk remain with the franchisee which, not only in these repects, keeps the status of an entrepreneur.

More precisely, franchise systems can be considered as „strategic networks“ (Jarillo, 1988). A *strategic network* is a long-term institutional arrangement among distinct but related for-profit organizations that is based upon extensive interfirm division of labor and intensive interfirm co-operation, and – as opposed to other, more polycentric types of interfirm networks – is led by a center or hub firm (Jarillo, 1988; Sydow, 1992). This organizational form that intelligently combines elements of market and hierarchy results either from intensified cooperation among independent firms (quasi-internalization) or from outsourcing of functions and activities (see Fig. 1) – more precisely, from „quasi-externalization“ (Sydow, 1992).

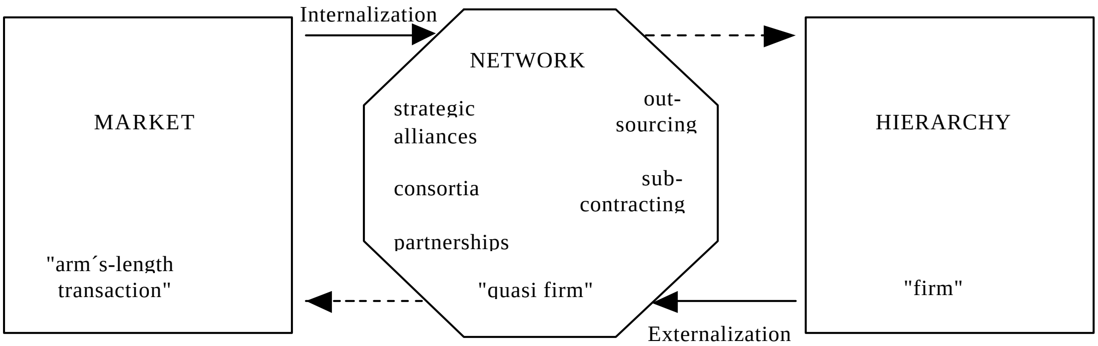

Figure 1: Networks as an outcome of quasi-internalization and quasi-externalization

In the case of franchising, strategic networks are usually formed through intensified cooperation either among (formerly) independent firms or among firms which are founded as franchise outlets straight away. Only more recently, franchise networks have also become popular as a means to downsize organizations via quasi-externalizing specific functions and activities and, thus, labor. In this latter case, the hierarchy, not the market, is substituted by the network.

Three further structural properties distinguish the network from any arrangement of firms. First, network relationships among those firms are the medium and outcome of rather intensive inter-organizational interaction. They are typically complex and reciprocal, rather co-operative than competitive, and relatively stable (Sydow, 1992). Second, the object of management’s signifying, organizing, and legitimizing is, in addition to the single firm, the network. The more managers, including franchisor and franchisees, reflexively refer to the network in their praxis, the more it loses its status as a pure analytical concept used only by (network) researchers (e.g., Wasserman and Faust, 1994) and, rather, becomes a social system in its own right. Third, and perhaps most importantly, interfirm networks operate on a logic of exchange that is very different from the logic of markets as well as from that of hierarchies. The network logic implies mutual cooperation and commitment between distinct and, at least to some degree, autonomous corporate actors. This cooperation is not only based upon mutual advantages but also on „reciprocity“ (Gouldner, 1960). This norm allows for greater time spans than markets, and puts more emphasis on mutual commitment than hierarchies. On the other hand, the network logic produces additional uncertainties and thus requires special forms of coordination including interorganizational trust (Sydow, 1998).

Conceiving franchise systems as (strategic) networks, above all, makes researchers aware of the importance of interorganizatinal relationships and the practices that produce and reproduce them. Such a network perspective transcends dyadic relationships by analyzing the broader (interfirm) network. If single relationships are investigated at all, this is done within the context of the broader network of relationships. The same network perspective, consequently, points practitioners to the importance of „relationship management“ and, respectively, „boundary-spanning roles“ from which most of these relationships are developed and managed (Adams, 1980).

Practice-focused research on franchising, even if not dealing with all the activities of boundary spanners and other network agents but focusing on network leadership, should provide answers to questions such as *how* to select appropriate franchisees and boundary personnell, to dismiss unsuccessful outlets, to divide up the functions between franchisor, franchisees, and other partners, to establish long-term relationships with franchisees, to implement participative decision-making processes, to facilitate network learning, to install interorganizational information systems, and, last but not least, how to measure outlet and system performance, and to renumerate it. This kind of research has necessarily to start with an empirical analysis of management practices ongoing in established franchise networks. Empirical findings should, then, be interpreted with the help of a theory which, like the theory of structuration, offers insights into the network processes without neglecting structure.

Franchise Networks from a Structuration Perspective

A structuration perspective on franchising systems as strategic networks highlights not only the importance of these (network) relationships but also of the practices that (re-) produce them and other structural properties such as interorganizational trust or the norm of reciprocity. Most of these practices, such as the regulation of a particular procurement procedure in the operations handbook, are *inter*organizational in character. These interorganizational practices do not simply result from voluntary action nor are they fully determined by structures. Rather, knowledgeable agents, in this case franchisor and franchisees (but also other network agents), refer to prevailing structures of the firm, the network, the industry, and the broader society. By doing this, agents reproduce these very structures.

Structuration theory, which considers actions and structures as related in structuration processes, labels this mechanism „duality of structure“ (Giddens, 1984). According to this theory, actions as well as structures of franchise networks (as of any social system) can and should be analyzed with respect to three aspects: signification, legitimation, and domination (see Fig. 2).

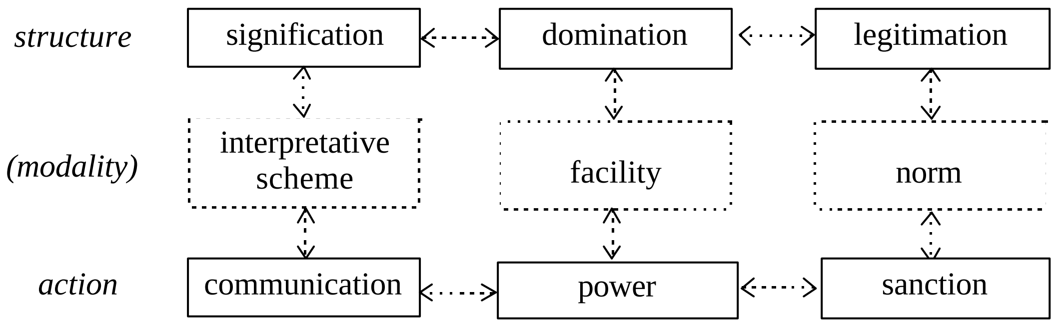

Figure 2: The duality of structure (Giddens, 1984, p. 29)

As far as the dimension of *signification* is concerned, agents refer via interpretive schemes to rules of meaning constitution. These rules enable them to make sense of a particular network event such as the change of the franchisees' incentive structure or the sanctioning of a particular network behavior. These very same rules, however, do not only enable a specific interpretation of this event, they also restrict it. The same reasoning applies to the other two dimensions of interorganizational practices: legitimation and domination. As far as the dimension of *legitimation* is concerned, agents refer to rules of legitimation via norms. Again their action, this time in the form of sanctioning, is enabled and restricted by these rules. In the case of a particular franchise network the behavior may aim at franchisees who do not conduct their business precisely according to the rules of the network which, for instance, may require them to provide a constantly high quality of service. Finally, as far as the dimension of *domination* is concerned, agents use a wide array of resources in order to powerfully intervene in ongoing network practices. For instance, while a franchisor is likely to control the more important resources, a franchisee may well use his or her position in a network, or critical relationships with external suppliers, to demand a fair share of the „network effect" (Uzzi, 1996).

In summary, a structuration perspective on franchise networks emphasizes (1) the importance of interorganizational relationships and practices, (2) the interplay of action and structure, whose outcomes are practices, and (3) the conceptualization of this interplay as structuration processes in which aspects of signification and legitimation are as constitutive as those of domination. All three aspects constitute – and are constituted by – economic efficiency and effectiveness (Sydow and Windeler, 1998).

Such a perspective, thus contributes to a processual understanding of management in franchise systems without neglecting structure. Moreover, it emphasizes – which will become clear in a moment – the simultaneous existence of cooperation with competition, autonomy with dependence, trust with control, change with stability, and hence of tensions and contradictions rather than economic and social equilibria. These moments are, from a structurationist perspective at least, as much outcome as medium of network management and leadership.

Strategic Network Leadership: An Application of the Perspective

Six franchise networks in Germany were studied: McDonald's (fast food restaurants), OBI (DIY superstores), Aufina (real estate agents), Schülerhilfe (providers of tutoring), ComputerLand (selling and servicing computers), Hyper Services (disguised service provider). All of these networks, as is typical of service industries, adopted the most sophisticated form of franchising: business format franchising.

As expected from a structurationist network perspective, the study reveals that five of these networks are without doubt strategically led by the franchisor (cf. Sydow and Kloyer, 1995, for details). It is the franchisor who has developed, formalized and implemented the procurement, marketing, and management concept and controls these and related resources (of domination): strategic know-how, respective management capacity and capability, information systems, and, last but not least, the brand. Consequently, the franchisor usually has the power to decide on the interorganizational division of work, to set and control strategic and operational objectives, to select and dismiss franchisees, to conceptualize and implement the quality control concept, and to determine the way and degree to which franchisees are involved in collective decision processes. From a structuration perspective, these resources are not only the result but also the medium of strategic network leadership.

As to be expected from a structuration perspective, this leadership is by and large exercised in accordance with prevailing rules of signification and legitimation which are not simply determined by the franchisor but recursively coproduced by the franchisees. The fact that the franchisees have joined the networks deliberately, that the franchisor is the author of the business concept and creator of the brand, and that, at least in their view, he or she has a know-how advantage legitimizes the strategic leadership in at least five of the six networks investigated. Network leadership appears to be recognized as legitimate by franchisees as long as the franchisor is able to keep this advantage and, thus, to contribute significantly to the success of the network.

Precisely this does not applys to Hyper Services (disguised). The center firm, in this case, controls almost no resources that are of significant interest to (potential) franchisees. One important reason for that is the institutional environment of the respective industry which, in Germany, is munificent with respect to qualified, professionally trained (potential) entrepreneurs who do not need much of the know-how provided by the franchisor. Another reason is that the brand is still relatively unknown in Germany. The weak position of the hub firm is demonstrated, for example, by the fact that it seems unable to use any rigid selection procedure. Rather, it tends to accept almost any applicant as a franchisee. This is very much in contrast to the McDonald’s case where the franchisor employs a very formal selection procedure embracing several steps, and where usually little more than 1 per cent of the applicants is accepted.

However, a closer look into the management practices of the five other networks reveals differences, not only in the way but also the extent to which network leadership is exercised. With the exception of Hyper Services, all interorganizational relationships in the franchise networks studied seem to qualify as network relations, since they are complex, reciprocal, cooperative, and relatively stable. Nevertheless an in-depth analysis of these relations along two dimensions, (1) tightness of coupling and (2) direction of interaction, reveals significant differences among the networks (see Fig. 3).

(1) The costs and benefits of loose coupling *versus* light coupling within and among firms has been discussed in organization science for quite some time (e.g., Orton and Weick, 1990). In strategic networks in general and in franchise networks in particular, the coupling of the relationships between the hub firm and the other network firms is relatively tight (if compared with other types of interfirm networks, for instance). This is, above all, due to the use of interorganizational committees, franchisee coaches, interorganizational information systems, exchange of personnel (not least for training purposes), and the development of a specific network culture.

(2) The interaction within strategic networks is, obviously, focused on the center firm. However, franchise networks seem to vary with respect to the extent franchisees interact with one another directly. This interaction, though not entirely under the control of the hub firm, may nevertheless be useful with respect to network effectiveness (e.g., product and process innovations generated by this kind of interaction). However, this kind of interaction, at least from a structuration perspective, always contains the seed of a countervailing power and, consequently, of instability and change.

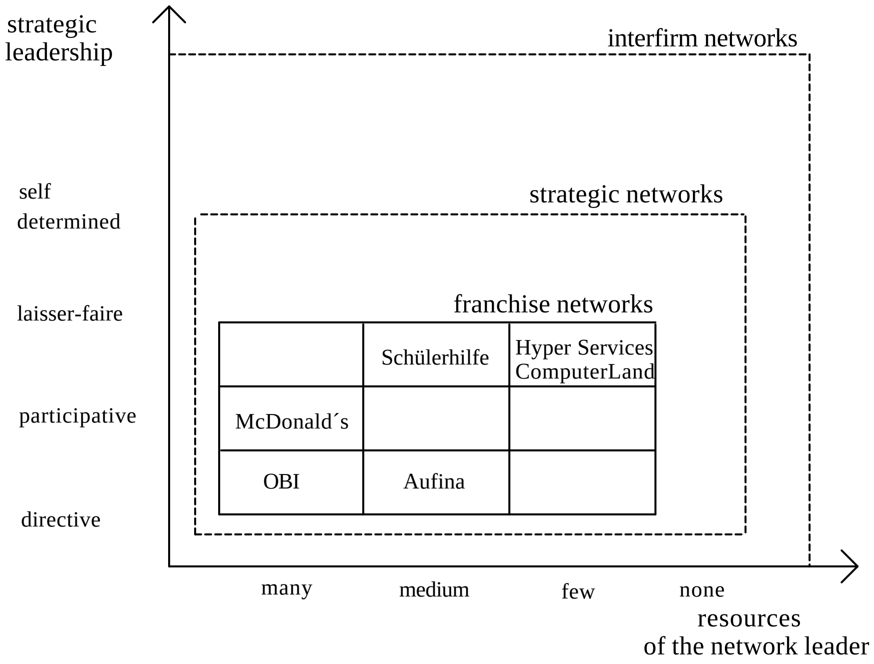

Fig. 3: Actual diversity of franchise networks

Only McDonald's (in Germany at least) and OBI exhibit rather tightly coupled network relations and interactions that are not focused on the center firm alone. Thus, these two networks adhere to more polycentric network structures (only in relative terms!). All others deviate from this particular pattern which, however, should not – especially not in all contexts – be considered to be an 'ideal'.

A significant diversity of institutional arrangements and management practices with respect to network leadership, is, at least from a structurationist perspective, anything but surprising. The tensions and contradictions mentioned above, which leave much room for distinct structuration processes, were in operation in all networks (cf. Sydow and Kloyer, 1995, for details). Moreover, the „dialectic of control" (Giddens 1984) operates in these franchise networks as in other social systems. That is, despite dominant structures – rules and resources – agents can always act otherwise. Franchisees, for instance, have the opportunity to interpret these rules, and their interpretations, individually or collectively, may well deviate from those of the franchisor. Moreover, franchisees, at least to some extent, can delay or even boycott the implementation of decisions. Finally, franchisees may use the possibility to participate in decision making, that has been granted to them in all networks, for counteracting the actions taken by the hub firm. Consequently, network leaders have permanently and actively to enlist support for their actions by presenting them as comprehensible and legitimate, i.e., as compatible with prevailing rules of signification and legitimation. If they are successful, as in the case of five of the networks investigated, the overall system success –network effectiveness – tends to legitimize and, thus, stabilize, the strategic leadership of the franchisor even further.

Conclusions

Franchise systems can and should be conceived as a specific type of interfirm network which is strategically led by a center or hub firm: the franchisor. Such a system is tied together by network relationships, shared rules of signification and legitimation, and a common usage of resources. The stategic network leadership by the franchisor is, above all, based upon an asymmetrical distribution of these resources. However, in order to explain and legitimate this leadership, the franchisor as well as the other network firms, draws upon rules of signification and legitimation via interpretative schemes and norms respectively, and reproduces these structures. The social character of this reproduction process, not only the formal chances for participation offered to franchisees in most networks, makes this process of system reproduction inherently somewhat instable, thus offering opportunities for change.

A network perspective that is anchored in structuration theory can thus enhance our understanding of management practices within franchise and other types of interfirm networks. Data collection in empirical research which applies a structurationist perspective should be longitudinal rather than, as in the six franchise networks studied, restricted to one point in time. This facilitates the discovering of the tensions and contradictions ascribed to social systems in general and interfirm networks in particular, and the explanation of how management deals with them in their (inter-) organizational practices. Moreover, future studies of franchise networks applying a structurationist perspective should not only concentrate on the issue of strategic leadership in general but investigating other how to-questions raised. Finally, it should not adhere to either a quantitative methodology or, as in the case of the service networks studied here, use only a qualitative method, but combine both.

Considering franchise systems from a strategic network perspective informed by structuration theory has several implications for management. First, management should pay more attention to the relationships in such systems, how they are created and reproduced, how this affects other relationships etc., i.e., managers should be more concerned with relationship management. Second, relationship management can and should be monitored with respect to all three dimensions of interorganizational practices: signification, domination, and legitimation. That is, managers of all network firms should reflect upon the resources of domination when they powerfully intervene into ongoing practices and upon the rules of signification and legitimation in their sense-making and sanctioning behavior. Third, the strategic leaderhip of the network in general and the respective management of the relationships in particular, in the face of ongoing structuration processes, should not be assumed to be able to control all network processes. On the contrary, any action, especially in the name of leadership, is likely to produce unintended consequences such as re-action, high member turnover, or system inertia. Finally, managers should take into account the tensions and contradictions between competition and cooperation, autonomy and dependence, trust and control, stability and change, all of which are typical of interfirm networks.

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