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Część IV

HANDEL ZA GRANICĄ

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Szkoła Główna Handlowa

The Role of Innovations in Franchising Cooperation in Retail Trade. Lessons for Poland

Summary

Exemplification of innovation creation and implementation in franchise systems is the purpose of the paper. The research approach is based on the study of variety desk research materials and literature. Key findings of the paper indicate that franchise chains struggle with the growing competition and the escalating market saturation with products offered by enterprises and networks of enterprises nowadays. To cope with competition franchise systems should create competitive advantage diversifying their offers with reference to competitors and satisfy needs of customers. It can be made by creating and implementing innovations to let the franchise to achieve competitive edges. Practical implications are strongly connected with the popularisation of innovations implementation in franchising systems both invented by franchisees and franchisors. Moreover, social implications are connected with improvement of franchise offer for customers and satisfaction of their needs and preferences. However, the paper has some limitations, mainly due to its exploratory and descriptive nature. Moreover, it contains only framework for further and deeper research.

Key words: franchising, innovations, retail market, Poland.

JEL codes: L26

Introduction

In the contemporary economy, the wholly autonomous business activity loses its importance due to the risk of elimination from the market and constantly growing competition. It is thought that cooperation and agreement bring benefits to all entities and give possibilities of taking advantage of synergy effects. Firms join their resources and efforts, build mutual distribution strategies and implement both technological and organisational innovations on the day-to-day basis. Moreover, a lot of small and medium-sized enterprises are not prepared to compete in various aspects such as broad and differentiated product portfolio, marketing, sales techniques, HR management, etc. In order to succeed in the market they need to engage in cooperation with bigger business entities. With respect to this, franchise is one of the innovatory business development strategies. It is a specific type of economic tie allowing strengthening the competitive positioning of the single enterprise (by doing its activities in a network) and providing growth opportunities to entrepreneurs with limited financial resources and low expertise on the market.

Franchise is thought to be one of the most effective forms of cooperation between enterprises. It consists of building networks of inter-related companies and benefiting from well-known brands which then help to develop and compete. One of the key aspects of a franchising agreement is creation of good relationship between a franchisor and franchisee. Cooperation of Polish companies with more experienced, mostly foreign, partners is of great relevance in order to achieve long-lasting competitive advantage (Pokorska, 2000, p. 13). It also gives better capabilities in terms of negotiations, supplies, logistics and development. Franchise is a universal method of cooperation because it may be used in all areas of production, distribution and services. It also contributes to the development of entrepreneurship and economic independence. Franchise allows the founders of the network to overcome the barriers connected with access to capital whereas franchisees can take advantage of great ideas, solutions, tested procedures and know-how. What is more, thanks to franchising firms, which are under restructuring, have the chance to operate continuously.

In general, according to the data provided by the European Franchise Association, numerous various franchise systems exist. Considering the number of networks the top countries are the USA, China, Australia, India, Brazil and European countries. Many franchise units operate both in developed and developing markets. In the USA, there are over 450,000 franchisees operating in 2,200 systems; in China – over 260,000 franchisees in nearly 4,000 networks; in India – 120,000 franchisees in almost 2,000 systems; in Brazil – nearly 100,000 franchise units in over 2,000 franchise chains; in Australia

– over 1,000 networks with 70,000 franchisors, and in Europe – over 600,000 franchisees in over 12,000 systems. The above data indicate the importance of franchise relationships and their impact on particular countries' economies.

Franchising is a relatively young business concept which has already been used in many enterprises operating in various industries and on diversified scale (both globally and locally). It highly contributes to the development of both entrepreneurship and competition. Nowadays, there is yet another type of business cooperation from which the companies can benefit in order to grow their operations and expand not only domestically but also internationally.

Essence of franchise relationship

Franchising can be described as a non-capital method of market development. Some people call it a form of cooperation by budding[1] which is considered to be one of the most effective ways to control specific market segments and economic development. Thus, franchising means the scope of economic relations in which the owner of a product, service or technology – franchisor, allows the other party to the contract – franchisee, to acquire the right to manage the product, service, technology, process and trademark in exchange for a specified fee.

Throughout the whole paper, the author refers to the interpretation of franchising based on the definition provided by the European Franchise Federation (EFF) in the European Code of Ethics for Franchising. It is said to be one of the most accurate and complete definitions as every National Association or Federation of the EFF (established in 1972) has actively participated in its preparation. The above being said, the definition states as follows: *"Franchising is a system of marketing goods and/or services and/or technology, which is based upon a close and ongoing collaboration between legally and financially separate and independent undertakings, the Franchisor and its individual Franchisees, whereby the Franchisor grants its individual Franchisee the right, and imposes the obligation, to conduct the business in accordance with the Franchisor's concept. The right entitles and compels the individual Franchisee, in exchange for a direct or indirect finan-*

[1] Budding – in biology, a sort of asexual reproduction in which a new individual develops from certain generative anatomical point of the parent organism. Sometimes buds can be produced from almost any point of the body; http://www.britannica.com/EBchecked/topic/83411/budding retrieved 3.04.2014.

cial consideration, to use the Franchisor's trade name, and/or trade mark and/or service mark, know-how, business and technical methods, procedural system, and other industrial and/or intellectual property rights, supported by continuing provision of commercial and technical assistance, within the framework and for the term of written franchise agreement, concluded between parties for this purpose" (The British Franchise Association).

In other words, a franchise network allows creating interdependent business relationships by sharing brand identification, a successful method of doing business, and a proven marketing and distribution system. This way the franchisee is able to obtain the rights to either distribute the franchisor's product, or to run a service business using a specified business model and operating methods of the franchisor. Having signed the agreement, both the parties are granted various rights and duties such as (among others) the obligation to pay fees to the franchisor or to provide support and share the franchisor's know-how to the franchisee.

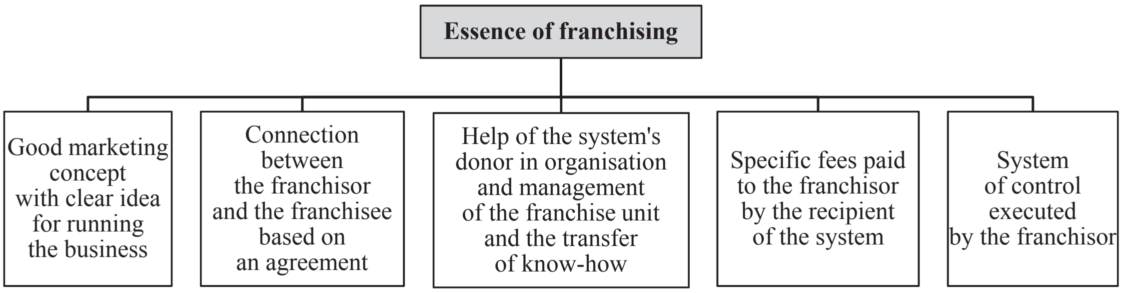
Generally this form of business activity consists of an organiser (franchisor) who has an already tested concept of a business based on a product or service and enters into a contract agreement with franchisees who run small enterprises (finance and manage them) and operate under the trademark of the donor within the concept previously defined by the system's organiser (Stanworth et al., 2004, p. 540).

Originality and uniqueness of the idea, on which the whole concept is based, are the elements that determine the essence of franchising. It does not always have to be the cutting edge technology but only, for example, simple organisational solution. The originality of franchising agreement consists of how different entities are structured to operate within a given network. Separate enterprises are managed in such a way that they form elements of a broader organisation which has its own brand, trademark and services.

In franchising cooperation, the franchisor contributes to the undertaking things like know-how, brand, set of commercial and advertising concepts, complete framework for running the business, staff trainings, advisory and favourable purchasing conditions. The second party to the franchising agreement contributes, above all, to its entrepreneurship and initiative, knowledge of the local market and showing the desire to achieve success. One of the main notions of franchising basics is the transition from centralised to decentralised way of thinking and from accumulation (concentration) to elasticity in which both parties need to show high engagement in a given undertaking.

Scheme 1

The essence of franchising



Source: Own work based on Ziółkowska (2010, p. 29).

This particular form of business cooperation has both advantages and disadvantages no matter whether we look either from the franchisor's or franchisee's perspective. The organiser of the system can expand their network without additional substantial financial investments, whereas the other party of the agreement is granted the right to run the business under the already well-known brand and, therefore, is more likely to succeed. On the other hand, the franchisor takes the risk of recruiting improper recipient, while the latter bears the responsibility of running a franchise unit on his or her own.

At the most basic, franchise agreement guarantees a licence to use the business name and the idea. Franchisors may offer sophisticated product and ongoing help through staff trainings, advertising in local media, installing control systems, etc. (Booth, 1990, p. 120-127). The franchisee engages in business using the name, brands, trademarks and other identifiers of the franchisor. Such cooperation relies on standardised methods of business among all the franchisees. With little investment and financial assistance from franchisee the company can rapidly expand territorial coverage. On the negative side, the franchisor has less control over operations in local outlets and some conflicts may occur between the partners (Bovee, 1992, p. 407).

The main advantage for the franchisee is that he/she buys the ready business idea which is usually known and advertised. Moreover, franchisors provide help and advice at any time. The franchisee is highly motivated because he/she invests own cash in the business and this factor contributes to high success rate.

Ideas generation and innovations implementation in the franchise retail chain

Few researchers have explored in-depth innovation in the context of retailing. Dupuis (1998) was the first one to consider this topic in the particular case of retailing. He proposed a classification of innovations adapted to the retailing sector. Dawson (2001) established a model for retail innovations as well. Nevertheless, in the particular sector of franchising, it seems that the different kinds of innovations have yet not been investigated. The franchising papers dealing with innovations were focused on the link between the organisational form of the chain and the innovation process (Bradach, 1997, 1998; Lewin-Solomons, 1999; Cliquet and Nguyen, 2004; Nguyen, 2005) and the sources of the innovations, i.e. the franchisor and/or the franchisees (De Albuquerque and Marccio, 1996; Sundbo *et al.*, 2001; Perrigot and Martinez-Ribes, 2008).

Having mentioned that, it should be noticed that franchising combines operating on a huge scale with functioning on a micro scale. Therefore, it works according with the saying: "think globally, act locally". This is the issue why franchisees are so important in the process of invention and implementation of new ideas and products upgrade.

Moreover, the sources of innovations within a franchising chain have also been studied in the literature. The two possible sources: the franchisor and the franchisees have been carefully explored. It appears that most innovations are usually introduced by the franchisors who develop, test and diffuse to their franchisees an original concept and know-how. Indeed, the franchisor is the initiator of the franchise chain, […], of which the franchisor is the long-term guardian (Code of Ethics of the European Franchise Federation). Usually, the franchisees acquire the concept from the franchisor and implement it as specified in the operating manuals of the franchisor.

It`s worth to mention that innovations driven by franchisees are very important for competiveness of the whole franchise chain due to the local knowledge about customers and the market, awareness of clients' needs. Franchisors are not able to improve and develop the system all the time, so franchisees can contribute a lot of ideas and improvements to the system. For every franchisor it is important to encourage franchisees to create and present new ideas on the daily basis to let the franchise system to survive in the saturated market. It is therefore evident that franchisee innovations may be implemented across the system if they meet with the approval and ratification of the franchisor.

Table 1

Examples and types of innovations in franchise systems

Types of innovations		New idea	Franchise example
Product	A good or service that is new, or has been significantly improved. This includes significant improvements in technical specifications, components and materials, software in the product, user-friendliness, or other functional characteristics.	Development of a new product adapted to the market: – new kind of hamburger – new product	– Big Mac (McDonald`s) invented by franchisee Jim Delligatti in 1967 – a new or upgraded product in the beauty-related sector, home ware goods
Process	A new or significantly improved production or delivery method. This includes significant changes in techniques, equipment and/or software.	Development of new commercial techniques for cross-channel or multi-channel business models.	– Multi-unit franchising (the apparel sector) – Multi-concept franchising (one unit in the grocery sector plus one unit in the beauty sector one by one franchisee)
Marketing	A new marketing method involving significant changes in product design or packaging, product placement, product promotion or pricing.	New commercial promotions, determination of the right recommended prices depending on the market. Mobile franchise concepts in retailing.	Shop in shop franchising (the apparel sector). Consignation model of business – franchisor owns the product till the final sale. New ways of selling flowers, pastries or chocolate in shops.
Organisational	A new organisational method in business practices, workplace organisation, or external relations.	Intercompany transformation from store manager to independent franchisee owning their franchise unit – conversion franchise.	Apparel companies, grocery shops, industrial goods

Source: Own elaboration based on *Oslo Manual, Guidelines for Collecting and Interpreting Innovation Data*, 3rd Edition, 2005, http://www.oecd.org/document/33/0,3746,en_2649_34451_35595607_1_1_1_1,00.html; Gras G., *Innovation or know-how in franchising?*, Eurocommerce SME Day – 21/10/2013 – Brussels.

Franchisees are likely to be more familiar with local market conditions than the franchisor. As Stanworth et al. (2002, p. 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 the standardised business formats which make no allowance for adaptation to local circumstances. This creates a constant tension in business format franchising. 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, p. 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).

Therefore, despite the dynamism of franchises, a chain must maintain a certain proportion of company stores to maintain a suitable level of implemented innovations. Chains encourage franchisees to innovate precisely by allowing them the autonomy to exercise initiative. For the most franchisees an innovation is an essential element in the day-to-day search for higher profits, not a separate activity. Innovation is a by-product of initiative, and initiative has a large payoff only when franchisees have the autonomy with which to exercise such initiative. Company managers have far less freedom than do franchisees, and this lack of freedom is partially responsible for their lack of initiative and innovativeness. Chains do not generally trust company managers to exercise initiative, because their incentives are so weak and other motivations could lead them to choose inefficient actions. Franchisees innovation initiative may lead to genuine innovations of chain-wide relevance. The empirical results indicate (Lewin, 1997, p. 26) that, to the extent that franchisees are innovative, this innovation is an indirect result of the initiative which they exercise in their search for higher profits.

However, in this process of market expansion franchisors have to balance the two strategic imperatives of format uniformity and format adaptation to local variations under 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).

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).

At the same time, concept creators (franchisors) have enough difficulties trying to manage within the boundaries of a typical business. So, the challenge of innovation networks takes them well beyond this. The challenges in franchise include possibilities to manage something they don't own or control, strongly build trust and shared risk and avoid free rider problem and information "spillovers" (Bessant and Tidd, 2011, p. 357). Considering those factors it is extremely important to implement new set of managerial skills among franchisors.

Moreover, it is important to notice that several researchers have focused on the links existing between innovation and the plural form, i.e. the combination of franchised stores and company-owned stores within the same chain (Bradach, 1997, 1998). They have asserted that the plural form enhances innovation within the chain. For instance, Bradach (1997, 1998) mentioned that, in a plural form chain, innovations must be tested first by the franchisor in his/her company-owned stores before proposing them to the franchisees.

Additionally, the franchisees can sometimes criticise the innovative products and/or services in order to improve them whereas the managers of the company-owned stores are not always able to do it because they are employed by the franchisors and not independent entrepreneurs (Bradach, 1997, 1998; Lewin-Solomons, 1999, Cliquet and Nguyen, 2004). Recently, Nguyen (2005) explored the influence of the plural form on the climate and process of innovation. The positive and significant influence was found confirming the first insights of Bradach (1997, 1998). To sum up, according to those previous authors, innovation will be favoured by the complementarity of franchised stores and company-owned stores within the same chain (Perrigot and Martinez-Ribes, 2008).

Nevertheless, it is noticed that some innovations can emerge from the franchisees as well. Sometimes, the franchisees can innovate by adapting the concept to the local conditions. De Albuquerque and Marccio (1996) underlined the involvement of some franchisees in the innovation process, but considered their roles well defined and without any overlap. In the same way, Sundbo et al. (2001), analysing innovations in service chains that are going internationalised, defined the frantrepreneur as "a franchisee who innovates by adapting a standard service concept to meet local conditions". They highlighted the roles of frantrepreneurs in the innovation process but concluded that their innovations were mostly in the form of minor and incremental changes.

Lessons for Poland

Due to the character of franchising relations it is hard to find revolutionary innovative solutions which are connected with franchising systems all over the world and in Poland. Generally those solutions consist of modernized products or introduction of new product or service, but often in Poland the innovation itself is implementation and use of franchising in companies to build new distribution channel. Often innovations in franchise relations are implemented for specific market but originally coming from other countries or from other non-franchising networks or from other branches of economy.

Results of 2007 - 2012 empirical research show that generally in franchising only few innovations have been implemented in the surveyed franchise chains[2]. This is the area which should be stimulated so franchises could strengthen their competitive position on the market. Gained results showed that in polish franchising systems innovations concerning new products and new marketing activities were dominant, and they covered also development of new distribution channels. It is important from franchisor point of view as franchising itself can be such an innovation for a company (network creator).

Implementing innovations franchising companies are driven by motives which allow them to make their product offer wider and better in quality.

[2] Based on empirical Research of Corporate Management Unit, Institute of Management, Collegium of Management and Finance, Warsaw School of Economics, Warsaw 2013.

Moreover franchisors put on new forms of sales when innovations are implemented what enables them to strengthen their competitive position. Franchising companies which implement innovations indicate that benefits of those implementations allow them to increase franchise brand awareness, market share and product quality, offered in franchises.

Among sources of innovations franchising companies list mainly customer needs, and set research hypothesis indicated contacts among/inside franchising network as genesis of innovation creation process. Contacts with network members were second in line source of innovation for respondents. It is worth to mention that the answer to a question concerning conductive indicators of innovation activities for many respondents was information exchange between franchisor and franchisees as factor which stimulates and realizes innovation activity.

Results of research show that franchisors list mainly as factors which foster innovation: marketing activities and employees competences. Franchisees on the other hand indicated: franchisor activities and exchange of information as main innovation activities factors. It is in line with essence of franchising and significant role of franchise system creator in establishing market position of the network. Moreover franchisors human resources are also valuable sources of innovation. Whereas for franchisees the most crucial is knowledge, know-how passed by franchisor, this particular factor is an advantage of franchise model over independent activity for franchisee.

In countries where franchising is common in their economy franchisees are the initiator for realization of innovation strategy in franchise system, in Poland it is not relevant for franchise companies. Abroad franchisees are the creators of many modern solutions as they have current contact with end consumer and can confront their experiences with franchise know-how for creation of new products and technology. Those solutions can be tested with franchisors approval and after positive test period they can be implemented into the entire franchise system.

Conclusion

It is important to underline that franchising is an on-going relationship which should be based on cooperation, mutual trust and understanding. The franchisors also have to increase the size of their chains in order to be profitable and reinforce their brand image and positioning in the territory, even if facing increasingly growing new expenses. In brief, they have to build a competitive advantage in order to survive. To achieve that they need to create and implement innovations in the franchise system.

Nonetheless, a new generation of franchises called network learning franchising approaches make this business model even more effective and efficient. In addition to the benefits embodied in the business format, this form implies participation of both parties in an integrated franchise system. Moreover, the network learning franchising entails the right and the obligation to stimulate innovation and implement the innovatory solutions among all people who are involved with the franchise chain (Ziółkowska, 2013).

As a conclusion, according to Lewin-Solomons (1999), innovation is a complex and collaborative process in which no one actor can claim full credit for the outcome. In the case of franchising chains, the franchisor can develop an idea, but it often depends heavily on the franchisees for feedback.

In fact, there are no sudden innovations or fundamental changes implying a transformation of the company, e.g. a new commercial concept such as the supermarket that appeared in 1957, or hard discount stores. The innovations found in the franchising context correspond more to what Liebmann et al. (2003) called gradual innovations or regular innovations, i.e. improvements of existing operations, in day-to-day business, e.g. cost reduction programmes, more efficient logistic processes, etc. (Perrigot and Martinez-Ribes, 2008).

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