

Franchising for multinational business expansion



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Franchising is considered a less risky investment decision than a wholly owned subsidiary. It provides entrepreneurs a low-risk opportunity to co-own a business with a proven format for success. In addition, franchising provides opportunities to capture economies of scale while empowering the entrepreneur. Franchise/license agreements typically involve contractual arrangements. These contracts represent relational exchanges; this means that benefits and burdens are shared in the relationship.

Some studies have looked at franchising from a non-theoretical perspective. Knight (1986) found that entrepreneurs were likely to franchise because of a known brand name and the ability to start a business more easily. In addition, franchising provides access to managerial help, a 'proven' business plan and name, and greater probability of survival. From the franchisor perspective, franchising was used to reduce risk. A firm could expand via franchising in order to test the potential of a new market; a franchisor could determine market potential without using company-owned assets, thereby reducing overall firm risk.

Problem Statement

To date, there have been few theoretical or exploratory studies about international franchise systems in the hospitality industry. By contrast, in the last two decades, manufacturing and retail franchise systems in foreign markets have been the subject of several empirical analyses. But systematic scholarly investigation has yet to be undertaken of the actual success and failure factors in Europe from a business perspective.

Not only will such an investigation contribute to the academic knowledge of franchise marketing, but it will also yield insights that will be of practical benefit to managers within the hospitality industry. With an understanding of the typical difficulties and challenges encountered by hospitality firms seeking to enter and expand an international franchisee system, managers will be better positioned to avoid some of the more common pitfalls. Through awareness of the distinctive characteristics of foreign as opposed to domestic markets, hospitality managers will be aware of the need to develop innovative and flexible market strategies that are responsive to the needs and wants of foreign markets.

Purpose of the study

The main purpose of the study is to examine and evaluate if franchising is a successful method for multinational companies in Europe with particular focus on the examination of the strategies of McDonald's.

Aims and Objectives

The main aim of this study will be to:

To explore the concept of franchising and review its theories.

To prove that franchising is the successful method of multinational business expansion.

To focus on the successfulness of the franchising system in hospitality industry.

Research Question

How does franchising helps in the expansion of multinational expansion of the firms?

What are the typical difficulties and challenges encountered by hospitality firms seeking to enter and expand in international franchisee system?

CHAPTER 2: LITERATURE REVIEW

In a franchise system, one firm (the franchisor) sells the right to a second firm (the franchisee) to market goods or services under the franchisor's brand name and use business practices developed by the franchisor. Put differently, it is the rental of an intangible proprietary asset and the operation of a decentralized production or distribution process. Typically, the franchisee acquires rights from the franchisor to conduct business in a geographically specified market.

Franchise Growing Trend

The concept of franchising has been around for many years, but over the last decade the numbers have grown as more people looking for businesses to set up a serious look at elements such as competition. If you are faced with the desire to create a business, but you enter a market dominated by corporate brand is likely that you should seriously consider the possibility of franchising or be very insightful, that your business strategy will work. However, the benefits of ' if you cannot beat them, join them ' attitude in the field of franchising is that today you will join as a developed infrastructure with a solid foundation for support. Several years ago there was a very flippant attitude of many corporate brands simply roll out as

many points of the franchise, as it is possible to further enhance their image, but it has led to many failed because business expansion outweigh the support element required to make the job a franchise .

The strategy of franchising

About 70% of McDonald's restaurants operate on the principle of franchising. This scheme allows without considerable investment to create a network of restaurants, but it also has a significant drawback – very hard to control the operation of the franchisors. For example, because of the owners of the franchise in China, the use of child labour, a blow was the reputation of the brand McDonald's. To minimize the above disadvantage company adheres to the following rule: to grant the license to franchise only proactive and experienced entrepreneurs with a good reputation, as well as specially to prepare them to actively promote the brand McDonald's on the ground.

Hotel business, being one of the types of economic activity, directly or indirectly creates jobs and is an important tool replenishes the treasury foreign exchange. The world is constantly learning new concepts Hospitality & retrofit. One of the positive trends of recent decades is the union of hotels in the chain and association. There are two main types of hotel chains: the integrated circuit, which are made of homogeneous units, and hotel consortium that unites independent hotels.

In Britain, the major hotel chains account for approximately 25% of the hospitality industry. The largest group of “ Forte” belongs to more than 350 hotels in the country, followed by “ Charlie Mount Tistl Otels” and “ Queen

Moat Hausis. In five major cities in the UK are concentrated 40% of all hotel rooms of the country.

Other European groups are also represented on the UK market. For example, the French group Accor ranks ninth in the league of top 50 hotel groups in the UK and has over 30 hotels. One of the factors that attract foreign investors in this country – wages is low compared with continental Europe.

In the European market is also well represented in major U. S. hotel industry leaders, such well-known hotel chains like Hilton Hotel Corp. “ Sheraton Corp.”, “ Marriott Corp. “, “ Ramada Int.” and “ Hyatt Otels”.

In Europe, France is the largest owner of hotel consortia. Twenty consortia of different sizes make up a quarter of all hotels in the country. The largest of them, “ Le Lodge de France provides 60% of the total number of proposals in the country and brings together nearly 70% of all hotels in Consortium member countries. In the UK, syndicated hotels provide 60% of the total supply of hotel rooms that is the fourth part of the market.

The aforementioned benefits let us know the potential that franchising has to offer. However, to understand the franchise phenomenon more closely, two key theories have been applied, agency theory and resource scarcity theory. Each theory provides a unique perspective of the franchise framework.

Agency Theory and Franchising

Agency theory examines the exchanges that take place between a principal (the franchisor) and an agent (the franchisee). Usually, principals delegate authority to the agent. A critical assumption is that the interests of the

principal and agent diverge; the goals of the franchisee may not be the same as the franchisor. This results in the likelihood that agents may misrepresent information and effort in order to achieve personal goals rather than franchisor goals. In order to avoid these goal misalignment problems, the principal has to expend resources to keep agent goals aligned with principal goals.

Franchising is a means to reduce agency problems. High upfront fees exist either because there is high brand name equity (such as McDonald's) or the franchisor does not have confidence in the value of the product or service. Upfront fees typically include land and building costs, equipment, and initial stock of items. Due to the high upfront payment fee made by franchisees, monitoring outlet managers is minimal because the franchisee has already made a huge investment in the outlet. Put simply, the franchisee should already have a high level of motivation to be successful and run the franchise unit properly if s/he is to recoup the high investment cost. If s/he is able to maintain high motivation, then s/he should be able to have a continuous profit stream.

When examining franchising from the agency perspective, there exist two types of agency problems, vertical agency and horizontal agency problems. Vertical agency problems occur when there is conflict between a franchisee and outlet managers. Franchisees provide full effort when operating franchise units because their incomes are linked directly to their effort. However, the unit (outlet) managers tend not to give full effort (shirk) because they do not have strong ownership incentives. As a result, outlet managers need to be monitored more closely, but monitoring is expensive.

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In order to reduce shirking by outlet managers, franchising may provide residual claims (profits after expenses) to the franchisee and manager.

Even though franchising may reduce monitoring costs, vertical agency problems may still occur. Franchisors are just as likely to seek opportunistic behaviour as much as franchisees. According to Storholm, franchisors may put franchise outlets too close together; close a franchise just to reopen it as a franchisor owned outlet; force franchisees to purchase inputs from the franchisor; embezzle advertising royalties; and write contracts that favour franchisors when disputes arise. Franchisees may release proprietary knowledge, fail to pay royalties, and not follow proper standards.

In order to align franchisors and franchisees vertically, Klein (1995) proposed the concept of quasi-rents. According to Klein, the franchise brand name creates pricing power that allows the franchisor to pay franchisees a payment that is greater than the opportunity costs of acting opportunistically. This payment is termed quasi-rent, which is an efficient means to reduce opportunism and thus aligns franchisees with franchisors. If the franchisor terminates the franchisee contract because the franchisee has not upheld quality standards or has released proprietary knowledge, then the franchisee loses the quasi-rent. However, if the franchisor puts franchise units too close together or embezzles advertising royalties, then the franchisee is still entitled to the quasi-rent. Hence, this quasi-rent helps prevent opportunist behaviour by franchisors and franchisees.

Horizontal agency problems occur when franchisees free-ride on other outlets. Franchise outlets operate under the same brand name, allowing

customers to transfer their same perceptions across all outlets, causing spill over effects to other franchisees. While some franchisees invest heavily to uphold standards, others may not be so willing, leading to under-investment. Moreover, customer mobility enhances horizontal agency problems. Imagine that a franchise is in a location that mainly serves one time customers, such as a fast food chain located on a freeway. This franchise unit may be less willing to uphold quality standards because the likelihood of a repeat customer is low. Again, the franchisor could expend additional costs to monitor franchisees, but this undermines one of the key advantages of franchising, reduced monitoring costs. To avoid additional costs, when horizontal agency problems may occur, the franchisor may own the outlet itself. Hence, franchisors have to be concerned with monitoring costs (vertical agency) and customer mobility (horizontal agency) when establishing franchise units.

CHAPTER 3: METHODOLOGY

Research Method

The research methodology is the set of processes used to collect and analyze data. This section presents details about the proposed methodology and elaborates the chosen research philosophy, approach and strategy that the researcher intends to use and the reasons for their selection.

As the main purpose of this study is to examine the franchising as successful method for multi-national business expansion, the researcher intends to use McDonalds as an example and the case study. For this purpose, the researcher will explore the success or failure factors and the business

strategy of hospitality industry specially focusing on the McDonald's franchising strategy.

The second question will be answered through the thorough discussion of the literature. Various researches would be analyzed and then conclusion would be made accordingly. For example, in grounded theory the focus of the study is largely determined by the data generated and the review of literature is conducted when the fieldwork is largely complete. It involves a series of coding and conceptualization techniques designed to harness a researcher's intuition and intellect.

Research Design

Saunders, Lewis, and Thornhill (2007) describe that research should be either basic or applied and any research should be based on these two principles. This study, which will examine the franchising practices and strategies of the hospitality industry using McDonald's as a case study, intends to be a basic research in order to inform the reader the relationship between the success and the franchising strategies of famous food service firms. This research design is expected to provide a better understanding of the problem of franchising in European countries and a basis for further research on the subject.

The researcher will use an exploratory design to analyze and evaluate the factors of success and failure of the franchising in European countries. For this purpose, a well structured self-report survey research method will be used to collect data. A questionnaire to collect data from the participants will

be designed to assess the opinions of the participants of this study about the franchising practice of McDonald's.

According to Saunders, Lewis and Thornhill (2007) there are three main views for a research philosophy; a) epistemology; 2) ontology; and 3) axiology. These can further be elaborated as a distinctive way of thinking of the research process, which are interpretivism, realism, and positivism. The researcher will use the positivism philosophy, which falls under epistemology. Through this research philosophy, this research will conduct by using the basic concepts of the different success factor of franchising and their impact on hospitality industry. The researcher selected this philosophy because the resources used in the process of data collection are external, and there is no influence to alter the data that has been collected. The Statistical Package for Social Sciences (SPSS) will be used for the quantitative data analysis that contributes to a better understanding and identification of the variables affecting multinational business.

Instrumentation

The instrument that the researcher will use in this study will be the well-structured, self-report questionnaire based on a 5-point Likert scale that will offers closed-ended (multiple choice) questions. Prior consent will be sought from the participants of this study.