

Transaction cost
theory on the
franchise
corporations
economics essay



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The purpose of this paper is to discuss the application of transaction cost theory on the franchise corporations. Over the past 40 years, transaction cost economics (TCE) has grown in importance as a central perspective germane to various fields of economic and business research (Dahlstrom, 2010). In 1937, Ronald Coase, who was a winner of Noble prize, introduced the theory of the transaction cost in his book " The Nature of the Firm". Based on his transaction cost theory, the franchise is the process of the trading in public market transferring into the intra firm trading. Thereby, the company has reduced its transaction cost to the minimum level. The benefits embodied in the savings on transaction costs. In other word, the transaction reduces the internalization of transaction costs. Comparing to the single company mode, which has many independent stores, chain stores unified the purchase that reduces the information costs for searching the trading partners. It was observed that information exchange among supply chain partners lead to improved supply franchises in terms of quality and efficiency (Wong, 2010). In addition, the headquarters unified management the internal transfer cost in order to coordinate and eliminate of the information costs for price comparisons.

Furthermore, the problems and countermeasures of the franchises in China will also be analyzed in this paper. The problems of franchise in China are lacking in quantity and size, sole running type, backward in management and reckless expansion. All the problems need to be targeted and solved by correct methods.

Transaction cost and the franchise

Transaction is constituted by people's time, energy, configuration and cost. Transaction costs generally refers to all costs besides the direct production costs of companies in the business process. In other word, it is cost that must be faced in the market transaction inside or outside the enterprises. The main contents of Ronald Coase include the following contents.

Firstly, there is an opportunity cost. Enterprises must timely detect the potential consumer demand of consumers and guide consumers to respond in a timely manner. During this period, companies need to spend some costs in order to find others' demand.

Secondly, there is a contract cost. Business contracts, negotiations and documentation must be investigated before the development. To spend a certain cost, the negotiations will take time, money and manpower, which is the cost of the contract.

Thirdly, there is a monitoring cost. After the enterprise is required to purchase the goods, it is necessary to inspect them, which will take a certain amount of cost (David & Han, 2004). That is to oversee the execution of the contract cost.

Then, there is a contract performance cost. When the product quality is certain, the enterprise have to go to the bank to pay for others. It also takes some time and cost which can be seen as the delivery cost of the contract. If contract disputes arise during the implementation process, there will be some costs for dealing with the disputes. That is also related to the transaction costs.

Therefore, the costs will raise when the market is running and transaction. Transaction costs is significant for business and societies, so most companies are seeking ways to reduce transaction costs (Wong, 2010). The franchise is one of the best business modes to reduce the transaction costs efficiently.

Franchise is a modern business management methods and organizational form. It refers to the distribution industry in a number of shops with the industry to jointly purchase, grant franchises, etc. into the chain. In order to achieve standardization of services, business professional, standardized management, sharing of scale and reduce market transaction costs (Lee & Clark, 1996). The arrangement of the chain system significant saves in transaction costs. Thereby, it increases economic efficiency and stimulates economic growth. The benefits of franchise are:

Franchise can reduce the procurement cost. Stores purchase large quantities, hence the price is low, purchase volume and price is inversely proportional (Spinelli & Birley, 1999). Stores purchase large quantities from manufacturers to obtain advertising discounts, quality products, deferred payment, timely delivery and other benefits. In addition, the chain from the headquarters staff for the purchase, staff and time required is much less, thus saves the procurement staff costs.

Franchise can save transportation and storage costs. Stores, which purchase large quantities, usually can be given preferential treatment or even free shipping. With centralized distribution of goods methods, the transportation costs are low because the cost of shipping large quantities of a small batch

number is far below the cost of shipping. More importantly, the store has no warehouse, because the goods are stored in the distribution center for safekeeping. Therefore, stores can reduce the management, storage space and reduce product loss. Chain stores not only save storage costs, but also ensure quality.

Franchise could save the cost of advertising and decoration. With the increasing expansion of advertising expenses in recently days, advertising has become an important commercial promotion method. The chain system has a unified corporate identity system such as the shop forms are similar, and widely distributed. So it is good effect advertising for itself (Spinelli & Birley, 1999). Also only one advertisement can let all s (Alon & Welsh, 2001)tores benefit, thus total sales of advertising costs can be reduced. In addition, a unified design tone chain can save design fees, the bulk purchase, decorating materials and capital equipment. It also cam obtain price discounts and other benefits for reducing the material costs.

Franchise can lower the management cost. It has a clear division of labor within the chain system, also it commonly used by advanced science and management equipment, tools and methods. Simplification of the operation and management, civilization^¼Especialization and standardization, making the chain of management science and effective (Lee & Clark, 1996). Efficient management reduces mistakes due to mismanagement and the loss, also can prevent the management of loopholes. These will help manage the cost savings.

In addition, the franchise format between members of the enterprise can effectively inhibit the opportunistic behavior. Chain of the internal control is diversity and flexibility that can effectively reduce the cost of trading activities. Also thef's structural can improve the efficiency of information transmission and reduce the information costs (David & Han, 2004).

The emergence of chain is the result of commercial retail and institutional change. Chain compared to any form of institutional arrangements in the past has advanced points, because it greatly saves the transaction costs. This is the cause of franchise, also the development dynamic of the franchise (Lee & Clark, 1996). Commercial chain institutional operation is currently one of the best choices.

The problems and countermeasures of the franchise in China

With the deepening of reform of circulation and the accelerating pace of opening up in recent years, chain stores in China have seen rapid development. However, compared to the foreign chain enterprises our chain enterprises still have many problems.

The chain stores are lacking in quantity and the size is too small. The data indicate that the national average each chain has stores in only 14, while developed countries generally have hundreds of chain stores (Alon & Welsh, 2001). Franchise is able to provide customers with lower prices of goods, because after reaching a certain size scale chains system can reduce costs through bulk purchase procurement and purchase of goods significantly.

Thus the chain is to improve the vitality of the degree of organization and enterprise scale, reduce costs and expand market share.

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The franchise type is sole. Chain can be divided into three types, which are the regular chain, franchise chain and free chain. In the developed countries, each of the three types of franchise has relatively successful examples.

Moreover, most franchises are regular chain in China. How to improve the situation of franchise in China is a question for all the chain companies. The best way to solve this is to use brand strategy in order to improve the competition ability. Chain retail companies should pay more attention to the consumers, understand the unique advantages of consumer demand and actively develop its own brand product design in order to reduce costs and to improve the ability to compete against retailers.

The chain companies have low standardization and backward in management. In the embodiment of modern means of chain companies, the majority of domestic enterprises are still in a relatively primitive (Alon & Welsh, 2001). The state, transport, communications, financial settlement and other means are very original. So the chain companies must understand that improves the internal management system is the only way to make long-lasting business. Improve the management system for long-term stable development of chain enterprises is the preconditions of promoting the healthy and rapid development of franchise.

Conclusion

Transaction cost theory claims that the franchise through centralized, unified and professional management can minimize the costs. The facts proved that successful franchises could reduce the procurement cost, save transportation and storage costs, advertising and decoration costs and

management cost. Franchise will become the trend of all operation types. However, with the economical globalization, the intensification of market competition and development of information technology, franchise enterprises will face many problems and opportunities. To further enhance the level of chain will help reduce business transaction costs.