



## **Chapter VII**

# **Franchising and Information Technology: A Framework**

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## **INTRODUCTION**

According to Justis and Judd (1998), franchising is defined as “a business opportunity by which the owner (producer or distributor) of a service or a trademarked product grants exclusive rights to an individual for the local distribution and/or sale of the service or product, and in return receives a payment or royalty and conformance to quality standards. The individual or business granting the business rights is called the *franchisor*, and the individual or business granted the right to operate in accordance with the chosen method to produce or sell the product or service is called the *franchisee*.” Although the business of the franchisor is usually larger than the “satellite small businesses” of the franchisees, most franchisors manage mostly small and medium-size enterprises (Stanworth, Price, and Purdy, 2001). The U.S. Small Business Administration (SBA) recognizes this fact and sponsors various seminars in franchising, for example, business plan and raising capital, through regional Small Business Development Centers (Thomas and Seid, 2000). In addition, SBA sets up programs specifically designed for franchises (for example, Franchise Registry Web site: [www.franchiseregistry.com](http://www.franchiseregistry.com)) to streamline the review process for SBA loan applications (Sherman, 1999) and provide

special incentives for franchisees to open locations in economically depressed areas (Thomas and Seid, 2000).

Franchising has been accepted as a growth strategy for small businesses (Barber, Mand so forthalfe, and Porteous, 1989; ACOST, 1990; Justis, Catrogiovanni, and Chan, 1994). Two main schools of thoughts support this growth strategy: Resource Scarcity and Agency Theory. The Resource Scarcity school argues that the primary barrier for small business to grow is the lack of working capital, and this barrier can be overcome through franchising as franchisees bring in some capital for growth (Norton, 1988; Hall, 1989; Lafontaine and Kaufmann, 1994). The Agency Theory school argues that the agency costs, such as the costs of monitoring managers, can be reduced through franchising, since the incentives for the agent (franchisee) and principal (franchisor) are very closely aligned through the contract (Brickley, Dark, and Weisbach, 1991; Lafontaine 1992). Franchising is also believed to be an important forum to transfer technology and import entrepreneurial activity into developing economies (Stanworth, Price, and Purdy, 2001). For example, emerging markets such as Internet business (Jupiter Report, 2001) are reported recently to be among the fastest growing markets through international franchising (Paswan, Young, and Kantamneni, 2001; Welsh and Alon, 2001). Franchising is not only a way for small businesses to succeed but also a model by which small businesses may learn the structure needed to become successful.

The use of franchising as a small business growth strategy has its share of problems (Kirby, Watson, and Waites, 2001). For example, in the early stages of franchise development, “the strains normally associated with small business growth are, in fact, likely to be magnified and concentrated, rather than reduced” (Stanworth, 1995, p.60); “expenditure will almost certainly exceed income” (Ayling, 1987, p.114); and it could take three to five years for a business to break even (Mendelsohn, 1992). Understanding and solving the problems are of the greatest interest to the franchise community. In their study on U.S. franchisor entry and survival, Lafontaine and Sun (2001) identify the following four important factors on franchisor survival: (1) business experience, that is, the number of years of experience of a firm before it becomes involved in franchising; (2) corporate units, that is, the number of company-owned outlets in the chain when it begins franchising; (3) franchisee units, that is, the number of franchised units it established in its first year; and (4) capital, that is, the amount of capital required to open an outlet. They also suggest: “mostly that firms significantly increase their chances of being successful in franchising if they face good post-entry macroeconomic conditions. Thus firms may want to use forecasts of GDP growth from well-established sources to adjust the timing of their entry and maximize their likelihood of success.” Other factors on franchisor

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