

Articles

Hey, Emerging Franchisor! How Does Franchising Get Its Sexy Back?

Christos Kelepouris¹

¹ Titus Center for Franchising, Palm Beach Atlantic University

Keywords: Franchising, Emerging markets, Franchisor, Franchisee, Small business

<https://doi.org/10.53703/001c.73294>

Small Business Institute Journal

Vol. 19, Issue 1, 2023

In this article, the author provides a unique perspective on the future of franchising and the role to be played by emerging markets. For many years, the franchise business model has been applied because it is seen as a “Sexy” and proven method for accelerating the growth and profitability of small businesses. Is it possible that accelerated growth and profitability have been outweighed by franchise market saturation? If so, how do you get franchising’s “Sexy” back? Franchising in emerging markets is the answer!

What is Franchising?

The definition of franchising has evolved and continues to do so (Kelepouris et al., 2017). Various disciplines characterize franchising in different ways: From a legal perspective, franchising is a contractual relationship among natural or artificial persons. It is a type of license that may also capture elements of other legal relationships, including agency, joint venture, distributorship, investment, employment, and customer relations (Spencer, 2013). From an entrepreneurship perspective, franchising is a prominent part of the economy used to assemble resources to rapidly create large chains of supply (Michael, 2003). Finally, from a business perspective, it is understood as an organization form, a distribution channel, a marketing channel, or a means to exploit intellectual property (IP), and a type of monopolistic conduct (Castrogiovanni & Justis, 1998; Schul et al., 1983; Stanworth & Curran, 1999).

Regardless of which discipline is providing the definition, franchisors receive some sort of payment, typically in the form of royalties, from the franchisees’ sales, and franchisees receive knowledge about proven business practices and possibly rapid market penetration, along with residual profits (Kelepouris et al., 2017). The essence of franchising is to capitalize on both the economies of scale associated with large systems and the benefits derived from small, localized operations (Kaufmann & Eroglu, 1998). In addition to leveraging knowledge and promoting efficiencies while providing access to the experience of the franchisor, training, purchasing power, advertising, research and development, and business synergy (Kelepouris et al., 2017). The end goal of the franchise business model is to accelerate growth and increase profitability. This has led to the proliferation of new and emerging franchise systems. There is no agreed-upon definition for an emerging franchise brand. Some define it by years, for example, less than five years old, or, more commonly, by units, less than 100 units (EmmerScale, 2022).

Franchising has become so popular that in the U.S. alone, it accounts for an estimated \$800 billion in gross

sales while representing forty-percent of retail trade (Swartz, 2001). Franchising has clearly been highly successful, but at the same time reached saturation in the US, Canada, and parts of Western Europe (Welsh et al., 2006). In a few short years, these statements will be two decades old. This means franchising in the US, Canada, and parts of Western Europe has become even more saturated, meaning there is minimal room for emerging franchisors to capture market share.

As stated earlier, the franchise business model is applied because it has been a proven method to accelerate growth and increase profitability, and this is “Sexy.” Is it possible that accelerated growth and profitability have been outweighed by franchise market saturation? If so, how do you get franchising’s “Sexy” back? Franchising in emerging markets is the answer!

What is an Emerging Market?

Emerging markets are characterized by new industrialization, low income, rapid growth, an emerging middle class, weak institutions, and high uncertainty (Hitt et al., 2000; Hoskisson et al., 2000). This makes them very different from developed economies due to the wealth of opportunities in trade, technology transfers, and foreign direct investment (Khanna & Rivkin, 2001). They are an increasingly critical force shaping the world economy, which has become increasingly saturated (Isobe et al., 2000). This is why many multinational corporations (MNCs) have turned to emerging economies such as India, Indonesia, Brazil, China, and Mexico, among others, as key locations for future growth.

Other Considerations about Emerging Markets

The rules of the game are ambiguous in emerging markets, where economic and social instability creates substantial uncertainty with respect to the rules of exchange (Hitt et al., 2000). Like most resources that create competitive advantage, resources for competitive advantage in emerg-

ing economies are, on the whole, intangible (Hoskisson et al., 2000). First-mover advantages like new product markets, reputation effects, and preemptive domination of distribution and communication channels are difficult to establish without good relationships with the home government. In emerging economies, local competitors may have developed capabilities for relationship-based management in their environment that substitute for the lack of institutional infrastructure (Hoskisson et al., 2000). In these circumstances, resource sharing between firms becomes more critical.

It should be clear that emerging markets are particularly fraught with risk and uncertainty (Kelepouris et al., 2017). The theoretical challenge has been that learning from first-hand experience may be impossible when the firm seeks to replicate its international strategy from developed countries in emerging markets. Prior foreign investment may provide little guidance. Although emerging economies have grown at a stronger pace than most developed countries, many of the businesses in emerging markets are young (Hitt et al., 2000).

How Does an Emerging Franchisor Enter an Emerging Market?

Overall, research involving franchising in emerging markets is still not as developed as one would expect and revolves mainly around international franchising by English-speaking authors from developed countries. Of the top twenty most relevant articles about franchising in emerging markets, the most influential study is from 2006, and fifteen of the twenty articles are over a decade old (Bretas & Alon, 2021).

Based on the existing literature, one thing is certain, business format franchising using the master franchise model is the most commonly used method of international expansion (Jell-Ojabor et al., 2022). It is still important to understand the primary ways a franchisor can expand to any international market:

1. Direct Investment - This can take numerous forms. Typically, it is where the franchisor opens and operates a company-owned store(s), or it may come in the form of a partnership or joint venture.
2. Indirect investment - This historically comes in two forms “traditional franchising” and “business format franchising” (Blair & Lafontaine, 2005).

Indirect investment, is the preferred method for global expansion because of the lower cost and reduced risk, which is extremely important in relation to emerging markets.

The first form of indirect investment is “traditional franchising,” also known as product format or trade name franchising. This is franchising in its simplest form and offers the least commitment between parties. Here, exclusive rights are granted, otherwise known as a license to sell or distribute from the franchisor. The franchisor’s product is sold to the franchisee, and the franchisor’s profit comes from the markup earned by dealers (Lafontaine & Blair, 2003). The best examples of these types of franchises are automobile dealers, gas stations, and soft drink bottlers.

The second form of indirect investment is business format franchising which is the most common. In this form of franchising, the franchisee not only uses the product, service, and trademark but also the complete method to conduct business, including appropriate marketing plans and operating manuals (International Franchise Association, 2013). Under this form of franchising, franchisees typically pay initial fees at the beginning, along with running royalties which are traditionally a fixed percentage of sales revenue. Other fees, such as advertising fees may apply. Examples of business format franchising are predominantly present in the fast-food, hospitality, and retail industries.

Business format franchising has a popular subcategory used for global expansion known as master franchising. In a master franchise agreement, the master franchisee is granted exclusive rights over a specific territory where they can develop sub-franchisees in a specific territory or throughout the country. This is the most common form used by international firms entering emerging markets (Welsh et al., 2006). This is because the master franchising model offers numerous benefits, such as knowledge of the local market, access to resources, faster adaptation, and faster development of selling prospective franchisees (Nair, 2001). In addition, the master franchisor becomes solely responsible for financial, strategic, and operational decision-making at the local franchise level, while the franchisor is typically responsible for global brand development (Jell-Ojabor et al., 2022). Many times, a direct entry approach is used to identify and develop local talent with the necessary tacit knowledge to transition them to a master franchise agreement (Kelepouris et al., 2017).

Not for The Risk Averse

The unique challenges of emerging markets, such as unusually rapid growth, political turmoil, institutional voids, and a lack of developed markets, create significant barriers to entry (Tuschke et al., 2014). In essence, a healthy dose of daring confidence is required to overcome the challenges emerging markets pose, which may include: mistrust in the country’s legal system, which deems formalities as contracts useless, suggesting a lack of property rights and unstable institutional environments (Mesquita & Lazzarini, 2008).

Regardless of the entry method, franchisors must form local alliances to build their resources. Networking is performed not only to respond to threats but also to seize opportunities (Luo, 2003). During an economic transition in an emerging market, interdependence becomes stronger, thus creating a greater need for networking. Resource dependence increases because firms can no longer rely on governments for dispatching needed resources. In this environment, firms benefit from sharing operational resources such as distribution channels and organizational resources such as information, experience, and connections (Luo, 2003).

This network-based sharing helps reduce the hazardous effect of market volatility on firm growth during economic transformation (Luo, 2003). Small and medium enterprises may work together to integrate complementary assets. Ac-

tivities of firms can be operated in a pooled manner, such as through their supply chain or in a reciprocal fashion, where each is dependent on the other's output (Mesquita & Lazzarini, 2008).

One common feature permeating emerging markets is the existence of institutional voids resulting from a lack of market-supporting institutions (Luo, 2003). In emerging economic regions, foreign and local partners have different interests and expectations for alliances (Isobe et al., 2000). In an environment where institutional constraints, such as legal frameworks and industrial and intellectual property rights systems, are underdeveloped or undeveloped or under-enforced, informal institutional constraints, such as those embodied in managerial networking, may play a more important role in facilitating economic exchanges (Luo, 2003). To leverage this network-based sharing, a striking feature of many emerging economies is the prominent role played by business groups (Khanna & Rivkin, 2001).

These business groups go by different names in different countries (e.g., groups in Latin America, business houses in India, and chaebol in South Korea) and share some broad similarities. Though member firms remain legally independent, a maze of economic and social ties typically unites each group. The ties enable member firms to coordinate their actions and leverage their market. Many groups span a diverse set of industries, and most are associated with a single extended family. Such groups are ubiquitous in emerging economies. They often control a substantial fraction of a country's productive assets and account for the largest and most visible of the country's firms (London & Hart, 2004).

The benefits of group membership include the ability to consummate favorable transactions that non-group firms cannot. For a franchisor or franchisee, this can provide access to capital, labor, and suppliers at a lower cost. They can also exchange goods and services internally without the hazards of arm's length exchange. Furthermore, they have superior access to the political power structure and hence draw from a richer pool of opportunities (Khanna & Rivkin, 2001).

Tips for Emerging Market Entry

Researchers have identified the benefits of first-mover advantage and found that early entry is associated with greater success in emerging markets. Others have documented the potential disadvantages of first-movers and highlighted that latecomers are able to adopt successful strategies merely by observing and learning from first-movers mistakes (Roberts et al., 2022). In essence, it is never the perfect time to enter an emerging market. Emerging franchisors must be open-minded and overcome mental roadblocks. If there is an unmet demand for a franchisor's product or service in an emerging market, then continued due diligence is warranted. Take, for example, Happy Joe's Pizza & Ice Cream, an emerging midwestern pizza franchise that most recently opened a location in Cairo, Egypt, in 2022. Or, Tucano Coffee, an emerging Franchisor from Moldova who now operates in eight emerging markets. Prior to them entering their emerging markets, both of

their product offerings, pizza, and coffee, were available, but there was an unmet demand.

Franchisors should expect differences in all shapes and forms. Many emerging economies do not have national franchise disclosure requirements akin to the Franchise Disclosure Document (FDD). For example, as of 2021, only two out of ten Balkan countries have franchise-specific legislation, while the rest are governed by general civil and commercial code law (Grünhagen et al., 2019).

It is important to remember that cultural differences play a major role in the success of franchise systems. For example, in China, site selection and store design were more important to customers than the products offered in the case of food and beverage. Because Chinese customers valued the ability to have a place of escape where they could lounge and use their electronic devices to connect to the internet for a while (Roberts et al., 2022). Therefore, the closer the cultural and economic distance between the host country and the home country may increase success by decreasing the chances of making insurmountable mistakes leading to failure.

Franchisors should be prepared to educate potential franchisees about franchising and how a particular system functions. Many times, large multinational franchise brands face resistance from the local population when attempting to enter their market for fear of negative impact on local businesses (Paswan & Prasad Kantamneni, 2004). The infancy and lack of brand recognition is a benefit for emerging franchisors as this local resistance may be a non-issue. Still, to avoid many common problems or concerns, franchisors must educate their local franchisee(s) that franchising benefits (1) small businesses, (2) creates employment opportunities, and (3) helps the local community (Paswan & Prasad Kantamneni, 2004). The franchisee(s) should then convey these benefits through their messaging to the community. This can take place in many different forms, for example; purchasing from local suppliers, employing local individuals, choosing a local charity to donate to, or creating your own local give-back initiative.

The best way to accomplish emerging market entry for your franchise is by utilizing business groups within that emerging market so you may leverage vicarious learning from network connections (Tuschke et al., 2014). These business groups are typically made up of local business owners and entrepreneurs. Similar groups in the US would be the local chamber of commerce, economic development, or industry associations. Seeking out these types of groups or traveling to the country and making connections is one of the best ways to minimize or avoid cultural and operational mistakes. These connections and time in the country will help you calibrate business assumptions and educate you in local distribution, including any beneficial localization of your product or service. Most importantly, it can be the first stepping stone in finding local partner(s) or franchisee(s).

Conclusion

It is evident that there is excellent potential for franchisors in emerging markets. The unique challenges of

emerging markets ensure the franchising landscape will not become saturated in the near future. This opens the possibility for accelerated growth and profits.

This itself is a blessing in disguise but, more importantly, a reminder that the best business strategies in emerging markets focus on leveraging the strengths of the existing market, not trying to overcome its weaknesses. In summary, to do this:

1. Keep an open mind
2. Embrace differences
3. Focus on culture
4. Be prepared to educate
5. Make business connections, and

Get ready to bring franchising's "Sexy" Back.

Submitted: October 01, 2022 MDT. Accepted: January 01, 2023 MDT. Published: April 01, 2023 MDT.



This is an open-access article distributed under the terms of the Creative Commons Attribution 4.0 International License (CCBY-NC-4.0). View this license's legal deed at <https://creativecommons.org/licenses/by-nc/4.0> and legal code at <https://creativecommons.org/licenses/by-nc/4.0/legalcode> for more information.

References

- Blair, R. D., & Lafontaine, F. (2005). *The Economics of Franchising*. Cambridge University Press. <https://doi.org/10.1017/cbo9780511753879>
- Bretas, V. P. G., & Alon, I. (2021). Franchising research on emerging markets: Bibliometric and content analyses. *Journal of Business Research*, 133, 51–65. <https://doi.org/10.1016/j.jbusres.2021.04.067>
- Castrogiovanni, G. J., & Justis, R. T. (1998). Franchising configurations and transitions. *Journal of Consumer Marketing*, 15(2), 170–190. <https://doi.org/10.1108/07363769810210377>
- EmmerScale. (2022). *What is an emerging franchise?* <https://www.emmerscale.com/what-is-an-emerging-franchise/>
- Grünhagen, M., Mumdzhev, N., Harča, B., Milenković-Kerković, T., & Dlačić, J. (2019). Franchising in the Balkans: History, status, and challenges. *Journal of Marketing Channels*, 26(1), 1–27. <https://doi.org/10.1080/1046669x.2019.1646188>
- Hitt, M. A., Dacin, M. T., Levitas, E., Arregle, J.-L., & Borza, A. (2000). Partner selection in emerging and developed market contexts: Resource-based and organizational learning perspectives. *Academy of Management Journal*, 43(3), 449–467. <https://doi.org/10.2307/1556404>
- Hoskisson, R. E., Eden, L., Lau, C. M., & Wright, M. (2000). Strategy in emerging economies. *Academy of Management Journal*, 43(3), 249–267. <https://doi.org/10.2307/1556394>
- International Franchise Association. (2013). *What is franchise?* <http://franchise.org/franchiseesecondary.aspx?id=52625>
- Isobe, T., Makino, S., & Montgomery, D. B. (2000). Resource commitment, entry timing, and market performance of foreign direct investments in emerging economies: The case of Japanese international joint ventures in China. *Academy of Management Journal*, 43(3), 468–484. <https://doi.org/10.2307/1556405>
- Jell-Ojabor, M., Alon, I., & Windsperger, J. (2022). The choice of master international franchising – A modified transaction cost model. *International Business Review*, 31(2), 101942. <https://doi.org/10.1016/j.ibusrev.2021.101942>
- Kaufmann, P. J., & Eroglu, S. (1998). Standardization and adaptation in business format franchising. *Journal of Business Venturing*, 14(1), 69–85. [https://doi.org/10.1016/s0883-9026\(97\)00097-9](https://doi.org/10.1016/s0883-9026(97)00097-9)
- Kelepouris, C., Schwartz, T., Cabarle, C., Govindasamy, S., & Smith, J. (2017). *Franchising In emerging markets: McDonald's expansion into Moldova: A case study*. Unpublished.
- Khanna, T., & Rivkin, J. W. (2001). Estimating the performance effects of business groups in emerging markets. *Strategic Management Journal*, 22(1), 45–74. [https://doi.org/10.1002/1097-0266\(200101\)22:1](https://doi.org/10.1002/1097-0266(200101)22:1)
- Lafontaine, F., & Blair, R. D. (2003). The evolution of franchising and franchise contracts: Evidence from the United States. *Entrepreneurial Business Law Journal*, 3(2), 381–517.
- London, T., & Hart, S. L. (2004). Reinventing strategies for emerging markets: Beyond the transnational model. *Journal of International Business Studies*, 35(5), 350–370. <https://doi.org/10.1057/palgrave.jibs.8400099>
- Luo, Y. (2003). Industrial dynamics and managerial networking in an emerging market: The case of China. *Strategic Management Journal*, 24(13), 1315–1327. <https://doi.org/10.1002/smj.363>
- Mesquita, L. F., & Lazzarini, S. G. (2008). Horizontal and vertical relationships in developing economies: Implications for SMEs' access to global markets. *Academy of Management Journal*, 51(2), 359–380. <https://doi.org/10.5465/amj.2008.31767280>
- Michael, S. C. (2003). First mover advantage through franchising. *Journal of Business Venturing*, 18(1), 61–80. [https://doi.org/10.1016/s0883-9026\(01\)00085-4](https://doi.org/10.1016/s0883-9026(01)00085-4)
- Nair, S. R. (2001). Franchising opportunities in China from the perspective of a franchisee. In *International Franchising in Emerging Markets: China, India, and Other Asian Countries* (pp. 109–121).
- Paswan, A. K., & Prasad Kantamneni, S. (2004). Public opinion and franchising in an emerging market. *Asia Pacific Journal of Marketing and Logistics*, 16(2), 46–61. <https://doi.org/10.1108/13555850410765177>
- Schul, P. L., Pride, W. M., & Little, T. L. (1983). The Impact of Channel Leadership Behavior on Intrachannel Conflict. *Journal of Marketing*, 47(3), 21–34. <https://doi.org/10.1177/002224298304700304>
- Spencer, E. C. (2013). An exploration of the legal meaning of franchising. *Journal of Marketing Channels*, 20(1–2), 25–51. <https://doi.org/10.1080/1046669x.2013.747858>
- Stanworth, J., & Curran, J. (1999). Colas, burgers, shakes, and shirkers: Towards a sociological model of franchising in the market economy. *Journal of Business Venturing*, 14(4), 323–344. [https://doi.org/10.1016/s0883-9026\(98\)00019-6](https://doi.org/10.1016/s0883-9026(98)00019-6)
- Swartz, L. N. (2001). Franchising successfully circles the globe. In *International Franchising in Emerging Markets*.
- Tuschke, A., Sanders, W. G., & Hernandez, E. (2014). Whose experience matters in the boardroom? The effects of experiential and vicarious learning on emerging market entry. *Strategic Management Journal*, 35(3), 298–418. <https://doi.org/10.1002/smj.2100>
- Welsh, D. H. B., Alon, I., & Falbe, C. M. (2006). An examination of international retail franchising in emerging markets. *Journal of Small Business Management*, 44(1), 130–149. <https://doi.org/10.1111/j.1540-627x.2006.00158.x>