A Theoretical Explanation of the Cost Advantages of Multi-unit Franchising

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Abstract

We advance franchising research by explaining the important role, so far overlooked, of different franchising forms in developing low cost competitive advantage. We analyze the most meaningful cost drivers for franchising systems: economies of scale, reduced transaction costs, economies of learning, reduced monitoring costs, standardization, and relative bargaining power. Our analysis suggests that asymmetrical cost effects are likely for franchisors and franchisees. For franchisors, relative to single-unit franchising (SUF), multi-unit franchising (MUF) should yield lower costs from scale economies and monitoring, higher costs from bargaining power, and similar costs from learning economies and standardization. For franchisees, lower costs for MUF are indicated from scale economies and standardization, but not for monitoring. Within MUF, comparisons between area development franchising (ADF) and incremental franchising (IF) suggest that ADF yields lower costs from scale economies and learning economies for the entire system, but monitoring and standardization only reduce costs for their franchisees. Implications for practice and research are discussed.