Multi-unit Franchising

Organizational Capability and Transaction Cost Explanations

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ABSTRACT

This study presents an organizational capability (OC) and transaction cost (TC) explanation for the franchisors’ choice between single-unit and multi-unit franchising. The OC-perspective regards the firm as a bundle of resources which are transformed into organizational capabilities through interactive firm-specific processes, in order to create competitive advantage. According to the OC-view, multi-unit franchising increases the franchise firm’s capabilities (such as knowledge transfer, monitoring, and innovation capabilities) and hence its competitive advantage (as rent-generating potential) when compared to a single-unit franchising system. On the other hand, the TC-perspective regards the firm as an incentive and adaptation mechanism. It is primarily oriented towards the selection of an ownership strategy which minimizes transaction costs. According to the TC-view, multi-unit franchising reduces the franchisor’s opportunism risk due to the stronger bonding effect of transaction-specific investments when compared to single-unit franchising. Multi-unit franchising also increases the franchisor’s control over the network, as he/she has to manage a smaller number of contractual relationships, resulting in reduced behavioral uncertainty through lower opportunism risk. On the other hand, high environmental uncertainty reduces franchisor’s propensity to use multi-unit franchising, resulting from the lower local responsiveness of the multi-unit franchisees when compared to single-unit franchisees. The results from the German franchise sector support the OC and TC hypotheses. Overall, our study complements the agency-theoretical perspective by developing and testing a combined transaction cost and organizational capability model to explain the franchisor’s use of multi-unit franchising.

Key words: Multi-unit franchising; organizational capabilities view, transaction cost theory, empirical analysis