Leeds University
Business School

UNIVERSITY OF LEEDS

BEST IN CLASS INTERNATIONAL FRANCHISING

Report for the UK Retail Sector

Matthew Robson, Kathryn Watson, Vita Kadile and L. Jeremy Clegg

December 2015

World Ranked – Triple Accredited – Award Winning

CONTENTS

EXECUTIVE SUMMARY

Retailing is such a fast-moving industry it is difficult to keep on top of changes in domestic markets, let alone those in geographically and culturally distant foreign markets. Although it is tempting for a UK-based retailer to remain domestic and focus on strengthening their competitive position in the UK before going overseas, the most successful retailers continuously explore what it takes to operate effectively across national borders. UK retailers need to “think bigger” if they are to escape the economic slowdown of Western Europe.

There is now a renewed push for internationalisation by UK firms and they are setting adventurous growth targets. Retailing is fast becoming a global industry and it is vital for “UK plc” that our leading retailers are successful in emerging markets. Against this backdrop, we conducted a study of one type of foreign market entry mode, namely franchising. We propose that franchising is to retailing what exporting is to manufacturing. It is a low-risk, low-involvement way for retailers to enter risky foreign markets, but which nevertheless must be professionally executed.

In order to shed light on how UK retailers can make franchising work in emerging markets, we focus on the advanced franchising model used by one particular retailer. This model has been developed over decades of steady expansion of its franchising operations overseas. As well as examining their franchising operations, the study gathered a range of other information on international franchising in order to develop a complete picture of good practices.

It is unlikely that a firm with a fast-moving, complex product assortment (e.g., general merchandise) will be able to follow the franchising model of dealing with many small franchisees across many foreign markets (i.e., the McDonald’s model). Indeed, the focal retailer uses an area development franchising approach, targeting franchisees that have capabilities sufficient to develop and manage a franchisor-branded store network in their country or region. While not equals, given the franchisor’s ownership of the brand, such relationships operate as partnerships. Franchisees are empowered to exert influence and use their local know-how to help meet the precise needs of foreign customers.

Unlike in traditional franchising partnerships, where the franchisor is in control and intensively monitors across its network of franchisees, we observe that cross-border franchising may be optimally developed through openly communicating with and trusting a capable partner. The differences between emerging markets and the UK can be so extreme that it is difficult for the franchisor to control operations there, irrespective of their resource base and experience. In effect, the franchisor is reliant on the franchisee to make and implement decisions in the local marketplace and absorb risks. The overseas franchisees can effectively play a role in building the brand with the franchisor through a form of alliance.

Knowledge exchange is crucial not only in the running of the franchise partnership but also for the franchisor’s learning about local market conditions and growth opportunities. When operating in emerging markets the franchisor needs to “learn from their experiences all the time”.

UK retail brands resonate strongly amongst aspirational, emerging market customers. Yet, retailers can be slow to go overseas if they perceive differences in, and lack familiarity with, foreign markets. This is where franchising comes in. Far from being a basic business model, *best-in-class franchising* can be made to play a central role in overseas retailing due to its ability to mitigate threats and seek out growth opportunities. Furthermore, UK retailers can derive flexibility advantages from using franchising in emerging markets as the basis upon which to expand into other, higher-profit equity-based modes (e.g., joint ventures) if and when local circumstances dictate this.

PREFACE

In 2013 the Economic & Social Research Council (ESRC) launched the Retail Sector Initiative, to oversee collaborative projects between university researchers and UK retailers. Professor Matthew Robson and Professor Jeremy Clegg at the Leeds University Business School were successful in winning a Knowledge Exchange grant under this initiative and this enabled them to conduct an in-depth study of international franchising in developing markets in collaboration with a major UK retailer. The project team also included Dr Vita Kadile, Research Fellow, and Dr Kathryn Watson, Research Impact Manager for the Business School.

This report summarises the findings from qualitative interviews conducted with retail franchisee regional and store managers in the Middle East and Cyprus and head office (franchisor) staff in the UK; together with insights from both the academic and business literature on international franchising. A further interview was held with an international franchise lawyer and the findings from this are reported. All interviews were conducted anonymously. Topics covered were identified in the literature and through discussions with the project partner and relate to market knowledge and opportunities, franchise relationships and partnership development and the management of franchise operations. This report addresses these topics specifically with regard to international retail expansion in emerging markets.

The authors wish to thank the ESRC for their support of the project, and Dr Kim Cassidy, Coordinator of the Retail Sector Initiative, and Mr Nelson Blackley, Research Assistant to the Retail Sector Initiative.

The structure of this report is as follows:

SECTION 1: Introduces international franchising, taking key points from the literature.

SECTION 2: Provides insights into successful franchising, based on an interview with an international franchising lawyer.

SECTION 3: Summarises the main points from our qualitative research in the Middle East and Cyprus together with a small observation study of retail environments in the emerging markets visited.

SECTION 4: Gives an overview of the internationalisation strategies of a number of key retailers, partly based on research conducted by Mr Nelson Blackley.

SECTION 5: Outlines key points to take forward for different types of retailer.

APPENDIX A: Explains key components of franchising relationships.

APPENDIX B: Explains the main legal forms of franchise.

SECTION 1: International Franchising—Key Points from the Literature

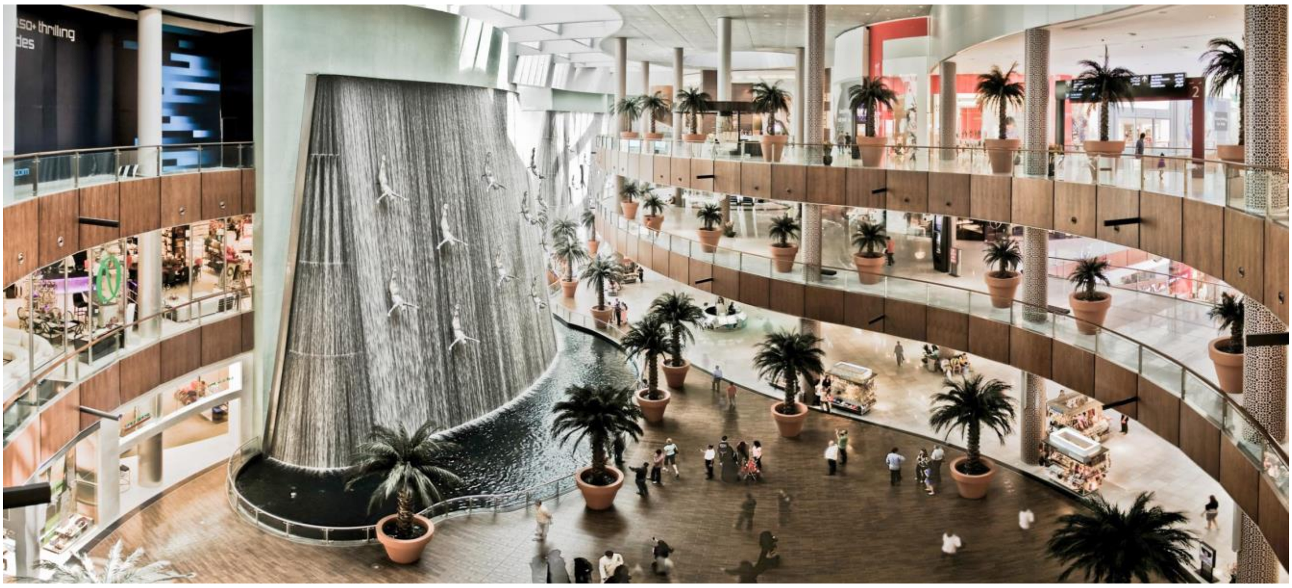
There is quite a sizeable body of literature on franchising consisting of journal articles mainly written by Western European, American and Australian academics. But much of this work relates to domestic franchising and single unit operators. Here we provide a short summary of the key points arising in the work of other researchers with a focus on international and multi-unit franchising.

1.1 Primacy of the Brand

Franchising is essentially an investment-based relationship, where both parties—the franchisor and the franchisee—invest financial resources and strategic assets. The franchisee buys the right to operate the franchise, within the franchisor's overall franchise system. Two types of franchisor-owned strategic assets are highlighted in prior research (Combs et al., 2004): *brand reputation or equity* and *operational knowledge* (Sorenson and Sørensen, 2001). Brand reputation refers to how well respected and widely known the company is compared with competitors (Gillis et al., 2014). The brand's reputation depends on the franchisor's ability to consistently deliver standardised products and services, which is facilitated by a franchisee in the case of franchising. The other key strategic asset of the franchisor is the set of operating routines. Many franchisors depend on operating routines that must be precisely carried out by franchisees to deliver superior quality and service. Thus, franchise system standardisation and consistent monitoring to this end, can be a useful approach to leverage operating routines for competitive advantage (Knott, 2003).

From the franchisor's side, brand architecture is used to describe the role of the brand and the nature of relationships between a firm's brands (Devlin and McKechnie, 2008). Retailers should carefully plan and implement a brand architecture strategy to maximise on sales and brand equity (Ailawadi and Keller, 2004), especially when franchising to international markets (e.g., using multiple brands to lower risk). Moreover, franchisees that are retailers in their own right may also be trading on the basis of multiple brands and its own brand architecture could drive its approach to a given franchisor brand.

It is most important that franchisees exhibit *brand citizenship behaviour*, which refers to their employees' extra-role behaviour aimed at enhancing brand identity (Burmann and Zeplin, 2005). An important aspect to consider here is flexibility or adaptability of a franchisor towards any suggestions for improvement from motivated franchisees. For instance, cultural sensitivity demonstrates the extent to which a franchisor sensitises and adapts its business practices to the nuances of the franchisee's local market, in order to develop and maintain relationship quality (Altinay and Brookes, 2012). However, not many franchisors are willing to do so, which in turn complicates the relationship for the franchisee, as this could decrease their sales and profits.



1.2 Franchising Structures

Structures used to manage franchising arrangements are many and various. They include ownership structure (e.g., single or multi-unit franchising, proportion of units in the system owned by franchisees), business format (e.g., provision of support, extent of control), contract design (e.g., level of initial and ongoing payments, territorial exclusivity), and size and age (e.g., size and age of franchisee) (see for discussion, Nijmeijer et al., 2013).

Irrespective of the contract, it is often the case in franchising that the incentives of both parties are not totally aligned, because they compete for the appropriation of the value added in the partnership (Kidwell et al., 2007; Solis-Rodriguez and Gonzalez-Diaz, 2012). It may be the case that multi-unit forms of franchising (i.e., a franchisee is responsible for two or more stores) are more managerially effective because innovation, uniformity and economic efficiency are more achievable in such a model. Essentially, the franchisees contribute to innovation, because they have a greater incentive to perform well as independent entrepreneurs in leveraging innovations across retail sites (Nijmeijer et al., 2013). The multi-unit model within a franchising context is aimed at meeting four managerial challenges related to (1) spatial expansion; (2) brand protection; (3) reaction against competition; and (4) service and/or product concept evolution (Dant et al., 2008).

A new area of the franchising literature concerns how the model can accommodate e-commerce. Since franchise agreements usually call for the franchisee to have exclusive geographical territory, a franchisor's transactional website may well cause an encroachment issue. Solutions might involve letting the franchisee manage its own transactional website or developing a click and collect or web to store model from the franchisor's website; taking effect within the franchising agreement or introducing a joint venture model specifically relating to the e-commerce business (Perrigot et al., 2013).

Whilst there is a tradition in the franchising literature of examining formal contractual elements, contracts are not always the most effective and efficient route to maximising a franchisee's compliance in uncertain institutional environments (e.g., emerging markets). Relationships complement contractual agreements by any plugging gaps that emerge due to changes in the retailing environment and/or the circumstances of the partners. [For an explanation of key attributes of franchising relationships see Appendix A.]

SECTION 2: International Franchising—Legal Perspectives on Best in Class

2.1 A Recipe for Successful Franchising

Franchising needs to be a "win-win" situation for both parties so that both make money. If the franchisee does not make good money they are not going to open more units; if they don't make any money at all they will stop franchising. Therefore, there has to be sufficient margin within the proposition for the two parties to share. If this is not the case, then it is not possible to do it successfully. If the deal is "too rich" on one side, for e.g., for the franchisor, then the relationship will not work. If the franchisor takes too much money from the arrangement, the franchisee will focus their attention elsewhere.

There is a lot of retail interest in emerging markets, in particular, the Middle East. There is no VAT so that means you have a further 20% margin to work with. Also, prices can be a little higher and people may be prepared to pay a little more. But if you are too greedy and charge too high a margin over other markets then it will not work. Many people living in the region do travel to other places and if they see significant price differentials it will not do the brand any good.

Franchising does not just have to be about (luxury) products. It can be based on having particular knowledge, for e.g., a system or method of sourcing products efficiently or knowledge about how to merchandise a particular category of products in a certain way that will maximise purchases. The franchise is possible because the local market does not have this knowledge. The franchisor should be innovating all the time and thinking about how they can keep the business model fresh and cutting-edge.

2.2 Multi-Unit Franchising Vs. Joint Ventures

People often confuse *master franchising* and *area development franchising*. Master franchising is where one person (or company) is given the rights for a region and sub-franchises to others who run one or more of the operations. Area development franchising is where the franchisor has an agreement with the franchisee for a particular geographical area (which could be a country), where they will then have the exclusive right to open a number of operations (e.g. retail stores) within that area. A problem with master franchising is that because you have an extra layer within the franchise structure, it can become very difficult to manage due to the remoteness between the franchisor and store operators. So you have less direct control and there is another partner requiring a share of the margin. Also the smaller operators could struggle to get leases in the right locations, especially in the Middle East. [For a more detailed explanation of the different types of franchising and their key features/benefits see Appendix B.]

Certain countries, e.g. Russia, China and India, are classic *joint venture* markets because there are restrictions on foreign direct investment. Joint ventures are a lot more complex than franchising. The company needs to invest money and may have to be prepared to put in more money if it is more expensive than planned and they need to have the right people at the right level available to serve on the board of directors. The documentation is tenfold that required for a franchise operation, it is considerably riskier and they are very hard to manage as well. As a form of co-operation, a franchise arrangement can give you 80% of what a joint venture can give you without the added risk and complications [this was the personal opinion of the international franchise lawyer interviewed as part of this study].

2.3 The Franchise Model

The financial structure of franchise agreements can be based on the franchisor supplying stock to the franchisee at a margin or you can have a system based on royalties or a mix of both. There is also a service fee element that can be charged for certain support services. It is important to distinguish between the royalty fee and the service fee because legally they are different and the tax implications are different. The service fee should be for something that the franchisee needs and it should have value—it could relate to superior know-how or technology. These services can be either optional or mandatory; it is not permitted to force your franchisee to buy absolutely everything from you, but it has to be tied to uniform appearance and quality standards.

2.4 The USA Model Vs. UK/European Model

In the USA, franchising is very much driven by regulation where you have very technical franchise laws and requirements for disclosure documents. In Europe, it is far more a form of commercial contracting where the skill set required for franchise lawyers is in understanding the franchise as a business and then advising on what that means you need to have in the legal documents. In the European context, the process is driven by the commercial roles of the two parties. In the USA, you have to register as a franchisor and file the disclosure documents every year otherwise it is illegal. They are also more exposed to lawsuits from unhappy franchisees.

By comparison, the UK system is pure freedom of contract. You need to have a legal document that addresses the right commercial issues. A good franchise agreement is neither too short nor too long. There needs to be a good balance between what you put in the agreement and in the manual. The main legal tenets belong in the agreement and the details about specific requirements belong in the manual, with cross-references. You can also have a main manual which covers how you operate the stores in the UK and you can have territory versions of the manual which allow for adjustments, for e.g., cultural or religious differences. But you would still want to have control over that so that the franchisee does not deviate too far from the overall brand image. A good manual should be used a lot because it contains practical things that help the franchisees on a day-to-day basis—it is not just “do’s and don’ts”, but rather an operational book that helps them.

2.5 Franchise Failure

The main reason why franchise contracts break down is non-payment. Sometimes a franchisor will delay acting in situations of non-payment because it can be difficult finding a good franchisee, but then when the franchisee runs into financial difficulties this usually ends up in termination and loss of money. A good test is whether a franchisee negotiates on a contract. If they just sign it without any resistance or queries they probably do not intend to honour it.

There can be issues around the business plan being wrong. For e.g., a franchisee might commit to opening 20 stores over five years, but then in reality only open three. The franchisor could think the market has more potential and the franchisee is not exploiting it. This is often because they have been overly confident at the start, or it can just be a lazy franchisee.

The franchise agreement will normally refer to the business plan. The franchisor should insist that they see it and work through it with the franchisee. The franchisor needs to think about document management as well because these things tend to be lengthy. There is no need to have the business plan attached to the agreement.

Most franchisors have some key performance indicators and there would normally be some in the franchise agreement, the most basic one being how many stores will be opened over a period of time. It may also refer to the locations and order of expansion; for e.g., the capital city before other, secondary cities. There may also be minimum turnover or minimum purchasing requirements. Some franchisors are currently seeking to include “Net Promoter Scores” (i.e., customer loyalty metrics).

Other problems can arise around local sourcing regulations for specific countries which can make the operation difficult or more expensive. Franchisors need to think about the operational restrictions before entering a particular country. There is also the level of intellectual property protection to consider.

2.6 Good Practice

It is important to remember that the franchisee is not an employee and you have to let them make their entrepreneurial contribution to the partnership. Another challenge is to have a good franchise team within the company that understands the type of entrepreneur (or retailer) who will buy a franchise. They are buying a ready-made business model but they have to invest cash in it and they still have some entrepreneurial risk.

Examples of good franchising are: (1) building from a strong base in the home market and then broadening out into more challenging markets and learning from the experience all the time, (2) developing a simple business model, as simplicity can be another factor in success, and (3) having high quality management teams in charge of the franchise business.

2.7 The European Franchise Market

In the EU, the biggest franchise markets are the UK, Germany and France followed by Italy and Spain. In Germany there is a big association (http://www.franchiseverband.com/index.php?id=43) with thousands of different franchise systems on the market. In France too, it is a significant part of the market (http://www.franchise-fff.com/). In Europe, franchising is 2% of the economy whereas it is 10% in the USA. Both Germany and France are taking franchising into emerging markets but not to the same extent as the UK (see for e.g., British Franchise Association: https://www.thebfa.org/).

2.8 Sector Differences

There are differences depending on industry sector; retailing is relatively straightforward. The higher the service element of the business, the greater the risk that the quality of the service will fail. In retailing, the merchandising (arrangement of the stock) in the store can be important and whether the visual elements draw you in. In these circumstances, the franchisor should not under-estimate the amount of ongoing support that is required for the franchisee.

SECTION 3: Middle East and Cyprus Study—Key Findings

3.1 Opportunity for International Growth

3.1.1 Marketing Strategy: Standardisation Vs. Localisation

The issue of whether international marketers should have one integrated or standardised international (or global) marketing strategy or whether they should embrace local responsiveness of the strategy to meet different market needs has been around for many years. The pros and cons of each approach are well documented. All the same, the key to success would involve finding the right balance between standardisation and localisation (Katsikeas et al., 2006; Subramaniam and Hewett, 2004; Ryans Jr et al., 2003). Balance can be achieved by allowing some flexibility through treating the different features of the strategy as a hierarchy. In this approach, strategy at the highest level (which relates to the “idea concept”) is fixed as it embodies the guiding principles on which the business is based. However, for strategy at the bottom of the hierarchy (specific product offering, pricing etc.) variations are allowed in response to local learning (Jonsson and Foss, 2011).

From our own study of franchising operations in emerging markets, we would put forward the following key findings that are consistent with the idea of balancing consistency and flexibility:

- **Standardise fundamental elements and features of the brand across country markets to build a strong international brand.** In order to facilitate brand recognition and awareness globally, it is essential to maintain core elements of the brand at a consistent level across all international locations. Such consistency is especially important when the brand is not yet well-known in certain countries. Brand attributes, such as the name, logo and colour schemes, along with values and reputation create an overall brand experience for the consumer. These attributes need to generate core benefits of the brand and its uniqueness. The product’s or store’s brand attributes are usually subject to great scrutiny by emerging market consumers, as these consumers can be highly aspirational.
- **Identify and respond to factors creating different customer needs and preferences in country markets to develop customer loyalty.** Customers overseas are more drawn to the brand if there is a demonstrable effort to be attuned to their local needs and preferences. Whilst many of these needs reflect cultural norms and religion, there are other underlying differences as well (e.g., demographic profiles, climate differences) that can have a very significant impact. Franchisors are faced with the challenge of maintaining uniformity across the franchise system to protect the brand, whilst franchisees need to enhance local responsiveness to meet the demands of different markets they operate in. As such, a discretionary modification of tangible and intangible product, price and promotion attributes—to make the offer culturally and economically suitable to overseas customers—could increase customer acquisition, their loyalty and, ultimately, brand performance.
- **Consider whether customers are treated equally across country markets.** Many customers in emerging markets are highly mobile and travel extensively within the region (e.g., the Middle East) and to other countries such as the UK, France and further afield. It is important that a customer in Cairo, for instance, has as good an experience of the brand as the customer in say Limassol. Where there are significant variations in the retail offer (e.g., price, product availability, in-store service) these will be noticed and commented upon. Variations affect customer perceptions of the brand. Still, achieving consistency has to be within the context of the available franchisee retail floor space, which will not be the same across markets. Retailers should also consider whether franchisees are giving customers a sufficiently consistent experience within their country/regional territories.
- **Create a corporate culture that is flexible and open to new ideas and innovations.** Global retailing involves a constant flow of new opportunities for sales growth and development of the brand. Specifically, the retailing landscapes of emerging markets are fast becoming customer-facing, for e.g., due to shopping mall development. Failure to allow some local adaptation by guarding a rigid global strategy will mean that growth

opportunities are lost as competitors get to those opportunities first. The expertise of international marketing staff lies not in the assumption that they know best, but in listening and recognising good ideas and opportunities wherever they arise.

3.1.2 Market Knowledge and Organisational Learning

Internationalisation is often characterised as a process of learning, with incremental resource commitments made over a period of time, driven by increasing experiential knowledge. Organisational learning and knowledge sharing is also important for firms that are already highly internationalised. Just as a multi-national corporation must concern itself with knowledge transfers from and between its subsidiaries, franchisors should do so with respect to their franchisee network. The key questions for international retailers to address are:

- How much attention are we paying to local market information?
- How can we effectively assimilate a vast amount of local knowledge into our strategies and operational functions?
- How can we embed the international (or global) perspective into their core business?

These questions are more complex and involved in situations where the retail offer is diverse (e.g., multiple product categories) and the retailer's history has been focused on the home market or a limited number of international markets. Organisational learning in this context needs to be viewed against a backdrop of increasing "open sourcing of data and technology", "open sharing of knowledge" and "open innovation partnering" in business, government and public sector institutions. The generation of vast quantities of data and advances in technological capabilities (e.g., data storage and analysis) mean that the retailing world has changed significantly and that restricted ownership of information and knowledge is not really a viable business proposition.

Based on our research, we put forward the following key findings:

- **Open sharing of knowledge and ideas across franchise partnerships maximises market opportunities.** A superior form of franchising is one where communication between the franchise partners (franchisor and franchisee) is pivotal in facilitating knowledge sharing and learning from best practices. The franchisor therefore needs to consider whether providing a tailored communication channel for its partners globally could be a useful tool in the maximisation of international growth.

- **Encourage franchisee communities of practice so that greater opportunities for sales growth and brand development are identified**. Often innovative ideas and potential opportunities are "lost" in top-down planning systems due to a high level of formality in decision making. Vertical knowledge exchange between the franchisor and franchisee is necessary but not sufficient. In international franchising, there may well be greater commonality between two franchisees' markets than between their markets and the home market. Horizontal knowledge exchanges between the franchisees may be contrary to organisational or cultural norms and even if the technology exists to facilitate these exchanges, its effective utilisation will depend on the social and managerial infrastructure within the franchise system.

- **Internationalise by learning to show awareness that history does not exist in new markets.** In the home market, how customers and employees understand a well-established retail brand will have a considerable amount of history. Overseas, however, a retailer can effectively "wipe the slate clean" and use this to identify new growth opportunities. For e.g., it might be assumed from the home market that a certain type of customer (e.g., a particular demographic) buys a certain brand. This assumption does not exist in the international market where the brand has no existing image or history associated with it. The retailer therefore needs to be very careful about what messages they convey about the particular brand from the start—what perceptions do they want to pass on to the new market? There is an opportunity to do something different and perhaps revitalise and reinvigorate a brand that has been going for some time.

- **Understand that fundamental differences in retailing and how people shop in different markets around the world can generate new opportunities.** It is quite easy to be cognisant of the main cultural and demographic differences in international markets. What can be rather more subtle and less obvious are fundamental differences in the nature of retailing and the way we shop. For instance, although it is much lamented, the UK does have a high street still and we are not as entrenched in the concept of mall shopping. We examined some retail data which showed that the daily peak selling period within a mall was after 9.00 pm. This difference has significant marketing implications, for e.g., you might want to convey marketing messages to people dining in mall restaurants in the early evening to direct them to your store. A related consideration is the extent to which marketing campaigns and assets developed by the franchisor address the task of how to drive customers from the mall into the store.

3.2 Franchise Partnership Relations

3.2.1 Communication and Trust with Franchisees

Whilst much international business communication may be characterised as “internal” such as within a company between its head office and subsidiaries or “external”, for e.g., between trading partners; franchising and other forms of strategic partnerships are a special case. Communication within a franchise cannot be regarded as in either wholly internal or wholly external, it sits somewhere in the middle. It is self-evident that a franchise system needs to have regular, timely, efficient and responsive communication through a variety of media (verbal as well as written). This needs to be reciprocated by both sides of the partnership. The key findings that our research can add to the particular topic of franchise communication are:

- **Distinguish between communication which is operational in nature and communication which is strategic.** Depending on the status of the franchisee and its capabilities, communications may include more strategic or operational considerations and vary in their length and frequency. Irrespective, time needs to be set aside for strategic discussions between the franchisor and franchisee. This should involve a variety of people who have something useful to contribute and not be restricted to those at the top of each franchise partner firm. The tendency to focus on immediate and pressing issues—for e.g., supply of stock and materials, new store openings, etc.—means that important shared strategies may not receive sufficient attention and opportunities may be missed.
- **Trust between the franchise partners is essential for effective communication leading to appropriate decision making that will enable the company/brand to grow.** Whilst contractual agreements and manuals will no doubt set out very specific responsibilities for respective partners, there needs to be a strong culture of trust and willingness to explore new ideas and opportunities and resolve problems without feeling that one side is encroaching on matters outside their remit. To develop a high-trust approach, communication channels should combine formal (e.g., weekly update calls, formal visits) and informal (e.g., email exchanges) elements, and be responsive to the communication styles of the franchisees (e.g., conference calls do not always work).
- **Communicate important messages that need to be understood or acted upon by a variety of people directly.** It is important not to be reliant on an individual or small group passing on information from a conversation or a meeting. Both the franchisor and franchisee need to have a clear strategy on how information travels throughout the overseas store network. Sharing of information and knowledge will be more effective if it is inclusive of people it directly relates to rather than them receiving it “passed on”. Store managers should have the opportunity (e.g., by intranet) to engage in direct communication with the franchisor and their contribution to knowledge sharing should be valued.
- **Communicate in a way that ensures that all franchisees feel equally valued and important, even if they are a comparatively small operation.** Smaller franchisees still

have a stake in the brand and their customers need to feel that they are as important and respected as others. Formal communications that show the relative status amongst franchisees, for e.g., in terms of their sales, can demotivate smaller partners; encouraging the thinking that this is the reason the relationship is not emphasised by the franchisor.

3.2.2 Support for Franchisees

The franchisor's support is a key part of the franchise deal and even well-established and large franchisees need ongoing and continued support. Support demonstrates the level of commitment that the franchisor has in developing the brand internationally and without this it is unlikely the brand will achieve its full potential. Key findings include:

- **Treat training support as a core component of maintaining an appropriate level of brand knowledge throughout the franchisee operations.** All organisations will have a level of staff turnover and new staff need to understand the brand and the standards of service required by the franchisor. Equally important is for existing staff to maintain their professional development. Brand-specific training is not only important for larger franchisees that trade under multiple (owned and/or franchisor) brand names, but also would resonate strongly amongst smaller franchisees that may have less well trained staff generally. The motivational effects of training opportunities provided by UK retailers should not be underestimated.
- **Build mutual trust and respect with franchisees so that problems can be easily sorted out.** This might also require a degree of flexibility and responsiveness and recognition that something that might be a small issue for the brand globally could be a significant inconvenience for the franchisee.

3.3 Supply Chain Management

According to Chaturvedi and colleagues (undated McKinsey & Co online article), many of today's retail supply chains are simply not set up to handle the demand for speed and convenience required by multichannel consumers in a cost effective way. They contend that most retailers' networks do not include enough distribution centres, legacy systems lead to poor cross-channel co-ordination causing higher out-of-stocks, and the proliferation of product assortment (stock keeping units—SKUs) is creating capacity and cost challenges. Our research findings are to some extent consistent with this picture; the key findings were:

- **Legacy IT systems led to problems of visibility of the stock in the system, accuracy of data and some instances of incompatibility with the systems of the franchisees.** To address these inherent problems major investments were being made in a new system and franchisees were being encouraged to use a single supplier of IT infrastructure in order to achieve connectivity (i.e., a "handshake" between the respective organisations' IT systems).
- **Lead times from the product order being placed by the franchisee to it actually being delivered and on the shop floor are critical.** Consumer demand for specific types of products varies vastly from one region to another, dependent upon many factors (culture, climate generally, and actual weather experienced, specific holidays and festivals, etc.). Having the appropriate stock in store at the right time requires a superior supply system.

  When product arrives in a specific destination it should be in a format where it can speedily be transferred to the shop floor. Problems with matching up SKUs that are supposed to be together, size ranges or other labour intensive work such as relabelling for price, product description and legal requirements, can lead to delays in product being put on sale. Ideally, this type of preparation/adaptation of the product for the market should be done before it arrives in the regional distribution centre. But this would require an immense amount of coordination in the design a system to meet these needs.

SECTION 4: Best in Class Retailers—Overview of the Internationalisation of Key Retailers.

Franchising remains one of the most common ways of entering a new market, as well as a relatively low-cost option to test for product demand in unfamiliar territories. Many UK-based retailers, particularly within the fashion industry, are turning to franchising when expanding internationally. Karen Millen, Mamas & Papas, Mothercare, M&S, Ted Baker, and Topshop, to name just a few, are amongst some of the most successful international retailers and all have franchised stores abroad in various locations. Notably, this approach is particularly common and suitable for the Middle East region, as it helps to address ownership structure entry barriers.

Many UK businesses have found success overseas thanks to the international love of British brands. Alongside BRIC countries, East Asia and the Middle East, some of the more recently discovered “hot” locations are in Africa and other parts of South America. In Africa, for instance, British retailers have exploited various markets: in Morocco one can find New Look and Next; in Nigeria and Ghana, there is TM Lewin; in South Africa, Topshop and Mamas & Papas operate. Indeed, South Africa remains the most popular African market for international retail expansion, followed by Ghana and Kenya, according to a survey by Barclays in 2014.

As for the South American market, the demand for European-style fashion clothing and British brands is very strong. While this opportunity was recognised by some British retailers such as Next, others have yet to discover this market’s potential. Mothercare have tapped this emerging opportunity with a surprising number of stores in Central and South America. It may have only ventured into the region in 2011, but it has since expanded to over 50 stores across eight countries including Colombia, Panama, Chile and Peru. Their success is facilitated by the fact that British heritage strongly resonates in the region, and by their high quality, well-priced products.

With regard to future “hot spots”, South America is showing potential beyond Brazil: Chile, Colombia and Mexico are tipped to be part of the next wave of opportunity with regard to retail. In Asia the next phase of growth might be in south eastern countries like Vietnam and Indonesia, as well as Mongolia. These represent particularly strong opportunities in fashion retail.

In addition to the franchising entry mode, some retailers like French Connection have opted for an in-store presence in other retailers’ shops overseas, via concessions or wholesale. Primark’s expansion to overseas markets has been facilitated by the opening of more distribution centres in Spain and Germany, opening opportunities to enter other countries in the region. Waitrose, the John Lewis-owned grocer, sells its products in Hong Kong with the help of a local grocer ParknShop, carrying over 500 Waitrose wines and over 1000 Waitrose lines.

The challenges of many retailers nowadays are related to moving into the next stage of omnichannel retailing, and of investing in core IT systems whilst balancing this with innovation and customer-facing technologies. Burberry, M&S and Clarks are actively integrating flagship stores, conventional wholesale outlets and digital marketing and sales into their international multichannel strategy. Retailers continue experiencing considerable increases in the total number of overseas consumers browsing for UK brands on their smartphones and tablets, whilst still visiting physical stores. Some have paid particular attention to changing their store designs for the consumer, so that they have a better in-store customer experience in terms of the generation of e-word of mouth. Take Burberry, who in the last year transformed their Regent Street flagship into an extension of the runway and a concert venue.

As retailers redefine the function of bricks and mortar, focusing on “revamping” offline experience from places of transactions into experiential theatres to showcase products and engage consumers, digital technology continues to facilitate everything from checking stock to locating products, to completing online purchases, using mobiles and wearables even whilst in store.

Consequently, the adoption of “bricks and clicks” strategy, when entering foreign markets, is seen as appropriate approach for internationalisation. Increasingly retailers maximise their international returns by launching customised foreign-language sites. For instance, Debenhams launched a German-language website, its first in a foreign language and plans to expand its online reach by extending their international delivery services from into more than 60 countries in the near future. Similarly, footwear retailer Clarks has launched localised e-commerce sites for France, Germany, the Netherlands, Spain and the US. Mothercare has also upgraded its web platform in some countries to achieve flexibility with foreign currency and language even ahead of an international roll-out online.

The importance of robust logistics and IT remains an important aspect in any retailer’s strategy--especially at the international level—as these areas are essential for meeting the diverse needs of the modern, educated and demanding consumer. Furthermore, retailers experience severe challenges in following market innovations and reacting to competitor moves. Whilst retailers are facing undoubtedly complex decisions in their international expansion process, new franchising concepts and visual merchandising innovations provide original ways of generating international presence. Some of the latest examples include airport franchises, pop-up franchise boutiques and locally-tailored store layouts, which could sometimes mean cutting back on product density and replacing it with attractions that capture consumer imagination.

SECTION 5: Key Points to Take Forward for Best in Class Franchising

5.1 Managerial Implications and Top Tips for Larger Retailers

Larger retailers could derive benefit from the following directions for best in class international franchising that emerged from our study:

- Do not just expand incrementally to neighbouring, developed markets—think bigger and longer-term by considering emerging markets and how their customers positively perceive UK branded products.
- Seek area development franchisees in emerging markets with aspirations to expand that match your own, but also the resources to do so—building links to fewer, larger franchisees is more efficient and effective.
- Do not rely too much on contractual provisions, as the relationship route to overseeing a foreign partner's work offers greater flexibility to changing institutional environments and commercial issues.
- Go for a win–win arrangement, as if the franchisee is not making good money it cannot open more units and expand the branded store network (i.e., you lose too).
- Forge the relationship by showing humility and valuing the knowledge contributions of the franchisee—a willingness to listen to their ideas for localisation and brand innovations that link to new opportunities and possibilities.
- Seek balance between standardisation and localisation by treating the different features of the strategy as a hierarchy (e.g., more tactical aspects like price could be localised), but make certain to ensure customers are treated equally across markets.
- Work closely with franchisee partners in order to assimilate local knowledge—use this to drive change in your business if needed. Many UK retailers focus on the domestic market and lack processes prioritising internationalisation.
- Use the full range of communication forms and types (strategic and operational, formal and informal, horizontal and vertical, one-way and reciprocal) so that everyone in the franchise system is pulling in the same direction and trust can percolate.
- Do not underestimate the importance of franchisor-sponsored training and extra support—e.g., beyond the terms of the agreement—in motivating (smaller) franchisees.
- Anticipate that global supply chains will be one of the most difficult things to optimise in international retail franchising where lead times are pivotal—invest in IT and supply processes that reduce franchisee perceived issues (e.g., even things you consider minor).
- Think through the full implications of using franchising and other modes on foreign market entry, simultaneously—such as potential solutions for e-commerce encroachment issues.

5.2 Managerial Implications and Top Tips for Smaller Retailers

It is important that the above guidance is considered by smaller retailers too. Franchise expansion can still be rapid amongst smaller firms and they also need relationships to stimulate their learning about foreign markets. Irrespective of the fact that franchising is a low-risk foreign market entry mode (i.e., equivalent to exporting for a small manufacturer), smaller firms would be well advised to remove additional risks by doing the following:

- Build from a stable position in the UK market (e.g., brand reputation) and from a simple, understandable business model that lends itself to franchising overseas.
- Select emerging markets that do not face very strong head-winds (e.g., economic issues, political problems) as it is more difficult for smaller retailers to forego short-term financial gains.
- Rather than seeking franchisees on the basis of aspirations to expand, make sure to select those that have a good set of resources (e.g., market knowledge) and can absorb local risks.
- Draw on the expertise of a variety of support agencies and international marketing/retailing experts but look at value for money and returns if considering engaging professional consultants. Having a good team/network of external contacts to facilitate the process could be very useful and help broker good international relationships.
- Give a great deal of strategic consideration as to what it is that you can bring to the international market. Your company’s strength might be in some particular capability and not simply about the retail product offer.
- If your international operations really take off, how easy or difficult is it going to be to expand your supply chain and logistics to meet this growth in demand? Look seriously at how well an international franchise partner would support you through the process of incremental growth.

REFERENCES

Ailawadi, K. L. and Keller, K. L. 2004. Understanding retail branding: conceptual insights and research priorities. *Journal of Retailing*, **80**(4), pp. 331 - 342.

Altinay, L. and Brookes, M. 2012. Factors influencing relationship development in franchise partnerships. *Journal of Services Marketing*, **26**(4), pp. 278 - 292.

Bradach, J. L. 1997. Using the plural form in the management of restaurant chains. *Administrative Science Quarterly*, **42**(2), pp. 276 - 303.

Burmann, C. and Zeplin, S. 2005. Building brand commitment: A behavioural approach to internal brand management. *The Journal of Brand Management*, **12**(4), pp. 279 - 300.

Chaturvedi, N., Martich, M., Ruwadi, B. and Ulker, N. undated. The future of retail supply chains, McKinsey article, accessed 07.08.15 http://www.mckinsey.com/client_service/retail/latest_thinking

Chiou, J. S., Hsieh, C. H. and Yang, C. H. 2004. The effect of franchisors' communication, service assistance, and competitive advantage on franchisees' intentions to remain in the franchise system. *Journal of Small Business Management*, **42**(1), pp. 19 - 36.

Combs, J. G., Michael, S. C. and Castrogiovanni, G. J. 2004. Franchising: A review and avenues to greater theoretical diversity. *Journal of Management*, **30**(6), pp. 907-931.

Dant, R. P., Perrigot, R. and Cliquet, G. 2008. A cross-cultural comparison of the plural forms in franchise networks: United States, France, and Brazil. *Journal of Small Business Management*, **46**(2), pp. 286 - 311.

Dant, R. P., Weaven, S. K., Baker, B. L. and Jeon, H. J. 2013. An introspective examination of single-unit versus multi-unit franchisees. *Journal of the Academy of Marketing Science*, DOI 10.1007/s11747-011-0265-2.

Darr, E. D., Argote, L. and Epple, D. 1995. The acquisition, transfer, and depreciation of knowledge in service organizations: Productivity in franchises. *Management Science*, **41**(11), pp. 1750 - 1762.

Davies, M. A., Lassar, W., Manolis, C., Prince, M. and Winsor, R. D. 2011. A model of trust and compliance in franchise relationships. *Journal of Business Venturing*, **26**(3), pp. 321 - 340.

Devlin, J. F. and McKechnie, S. 2008. Consumer perceptions of brand architecture in financial services. *European Journal of Marketing*, **42**(5/6), pp. 654 - 666.

Doherty, A. M. and Alexander, N. 2006. Power and control in international retail franchising. *European Journal of Marketing*, **40**(11/12), pp. 1292 - 1316.

Dubost, N., Veronique, G., Kalika, M. and Gauzente, C. 2008. How franchisor and franchisee relationships affect franchisees' satisfaction? The importance of fairness, communication and trust as ethical bases of relationship marketing. *International Journal of Entrepreneurship and Small Business*, **6**(1), pp. 155 –172.

Dyer, J. H. and Singh, H. 1998. The relational view: cooperative strategy and sources of interorganizational competitive advantage. *Academy of Management Review*, **23**(4), pp. 660 - 679.

Gassenheimer, J. B., Baucus, D. B. and Baucus, M. S. 1996. Cooperative arrangements among entrepreneurs: an analysis of opportunism and communication in franchise structures. *Journal of Business Research*, **36**(1), pp. 67 - 79.

Gillis, W. E., Combs, J. G. and Ketchen, D. J. 2014. Using resource-based theory to help explain plural form franchising. *Entrepreneurship Theory and Practice*, **38**(3), pp. 449 - 472.

Kane, J. R. 2001. Communication: the road to solid franchisee relations. *Franchising World*, **33**(1), pp. 28 - 31.

Katsikeas, C. S., Samiee, S. and Theodosiou, M. 2006. Strategy fit and performance consequences of international marketing standardization. *Strategic Management Journal*, **27**(9), pp. 867-890.

Kidwell, R. E., Nygaard, A. and Silkoset, R. 2007. Antecedents and effects of free riding in the franchisor–franchisee relationship. *Journal of Business Venturing*, **22**(4), pp. 522 - 544.

Knott, A. M. 2003. The organizational routines factor market paradox. *Strategic Management Journal*, **24**(10), pp. 929 - 943.

Mayer, R. C., Davis, J. H. and Schoorman, F. D. 1995. An integrative model of organizational trust. *Academy of Management Review*, **20**(3), pp. 709 - 734.

Meek, W. R., Davis-Sramek, B., Baucus, M. S. and Germain, R. N. 2011. Commitment in franchising: the role of collaborative communication and a franchisee's propensity to leave. *Entrepreneurship Theory and Practice*, **35**(3), pp. 559 - 581.

Nijmeijer, K. J., Fabbricotti, I. N. and Huijsman, R. 2013. Making franchising work: A framework based on a systematic review. *International Journal of Management Reviews,* **16**(1), pp. 62 - 83.

Perrigot, R., Basset, G., Briand, D. and Cliquet, G. 2013 Uniformity in franchising: A case study of a French franchise network with several franchisees having their own website, *Journal of Marketing Channels*, **20**(1-2), pp. 99 - 119.

Ryans Jr, J. K., Griffith, D. A. and Steven White, D. 2003. Standardization/adaptation of international marketing strategy: Necessary conditions for the advancement of knowledge. *International Marketing Review*, **20**(6), pp. 588 - 603.

Solis-Rodriguez, V. and Gonzalez-Diaz, M. 2012. How to design franchise contracts: The role of contractual hazards and experience. *Journal of Small Business Management*, **50**(4), pp. 652 - 677.

Sorenson, O. and Sørensen, J. B. 2001. Finding the right mix: Franchising, organizational learning, and chain performance. *Strategic Management Journal*, **22**(6-7), pp. 713 - 724.

Subramaniam, M. and Hewett, K. 2004. Balancing standardization and adaptation for product performance in international markets: Testing the influence of headquarters-subsidiary contact and cooperation. *Management International Review*, **44**(2), pp. 171 - 194.

APPENDIX A: Franchising Relationships

Relationships as a route to overseeing the franchisee's work offer greater flexibility to changing commercial issues than is possible through pure reliance on contracts. They also allow franchisors to take advantage of unique strategic assets that franchisees can bring to the table, such as entrepreneurial innovation and local market expertise (Darr et al., 1995; Sorenson and Sørensen, 2001).

Nonetheless, relatively little work has examined the dynamics that impact the nature of the franchisor–franchisee relationship (Meek et al., 2011). Relational factors that can affect franchise performance form a complex web of explanatory concepts. Still, two relational assets that appear important in the franchising literature are franchisor–franchisee trust (Bradach, 1997; Gassenheimer et al., 1996) and knowledge-sharing routines (Sorenson and Sørensen, 2001).

Trust is defined as a "willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party" (Mayer, Davis, and Schoorman 1995: p. 712). In a franchise system characterised by mutual interdependence but somewhat asymmetrical control—usually the franchisor is more powerful as it owns the brand—success can build from the presence of trust between the franchisor and franchisee. In practical terms, the franchisor relies upon the franchisee to perform at expected levels and within specified guidelines, in order to deliver the brand values appropriately, whilst the franchisee relies upon the franchisor for both promotional (brand equity and activities maintaining this) and managerial support (training and process design). As well as driving business performance (Davies et al., 2011), trust affects the franchisee's satisfaction and intention to remain in the relationship (Chiou et al., 2004; Dubost et al., 2008).

Knowledge-sharing routines are regular patterns of interfirm communication and cooperation that permit the transfer, recombination, reallocation or even creation of specialised assets (Dyer and Singh, 1998). In franchising, knowledge-sharing routines can create an effective support system, which is crucial to the development of a successful international franchise business—information sharing helps to overcome perceptions of geographic and cultural distance between the partners. Knowledge sharing also serves as a means of controlling the retail brand offer. Various support activities form a set of administrative control factors, which in turn facilitate the relational outcomes of the franchise. Key support activities include the franchise manual, development plan, store opening advice, ongoing visits from franchisors to franchisees and vice versa, the product/merchandise range review and adaptations, as well as training of franchisee staff (Doherty and Alexander, 2006).

Franchisors need to be very active in communicating with international franchisees in order to keep channels of communication open and achieve mutual understanding (Kane, 2001). As a result, communication is not only a useful control mechanism, but also an important tool for franchisors to maintain successful relationships with franchisees. Communication that is characterised by high frequency of interaction, mutual involvement, reliance on set procedures and emphasis on common goals is key to a healthy franchise relationship (Chiou et al., 2004). All the same, the franchising literature is silent as to how communications may respond to geographic and cultural distance between the partners.

APPENDIX B: Legal Forms of Franchise

Direct Franchising

A common type of franchising, often used domestically, is *Direct Franchising.* In this arrangement the franchisor contracts individually with single-unit franchisees in the target market. Single-unit franchisees tend to be small independent owners who receive training and support as well as a large degree of control from the franchisor. According to the International Franchising Association, direct franchising is no longer considered the ideal way to expand internationally.

Multi-Unit Franchising

Strictly speaking multi-unit franchising often occurs incrementally, when a single-unit franchisee seeks to add additional units to expand its business (Dant et al., 2013). However, in international franchising multi-unit arrangements commonly grant territorial rights to the franchisee from the outset. Specifically, two types of multi-unit franchising are used in the international arena:

i. ***master franchising***, in which the franchisor contracts with the master franchisee, giving them the right to offer units to sub-franchisees within a specific territory which may or may not be exclusive.

ii. ***area development franchising***, where the franchisee is permitted to develop multiple units across a designated territory. Area development franchisees are often adept at dealing with local market issues, however, this may depend on the size of the territory and the nature of the franchisee organisation.

Sometimes, master franchising and area development franchising are seen as being the same, but it is not the case. In master franchising "the franchisor grants the master franchisee the right to sub-franchise the franchisor's concept to others within an exclusive territory, creating a tripartite franchise relationship" (Doherty and Quinn, 1999: p. 7). Notably in area development franchising, a sub-franchising right is not present and the development of the franchise system in the market is undertaken by the same franchisee; the franchisee must possess resources sufficient to do so.

Advantages of Multi-Unit Franchising in General

There are several advantages common to multi-unit franchising in general. First, it can lead to economies of scale associated with monitoring expenses as the role of ensuring contractual compliance at the store level is passed downwards to the franchisee (Ryans et al., 1999). The franchisee does not face geographical and cultural distance, which could well reduce the efficacy of franchisor-led monitoring processes overseas. Second, the mode allows for rapid market penetration in a selected geographical region. Considerable resource sharing with a capable franchisee facilitates the spread of the franchisor's proven business concept in their territory (Alon, 2006; Zaid, 2010). Third, because the franchisee is native to the specific region or country, it provides critical support to the franchisor, in terms of local market and environment knowledge. The managerial skills for working with local personnel and cultural knowledge of business practices and political aspects that the franchisee has can facilitate franchise expansion (Ryans et al., 1999).

Specific Advantages of Area Development Franchising

According to the International Franchise Association, an area development franchise provides all the general advantages of multi-unit franchising such as the potential for accelerated growth with less investment or capital demands upon the franchisor. In addition, it may lead to additional cost savings for the franchisor due to the fact that area developers typically have prior experience with the system and no franchisor sales staff are needed for designated territories. Another advantage over master franchising is the greater degree of direct control over the franchisee and the development territory.

Choosing a Franchise Partner

Many franchisors prefer to do business with established companies (e.g., retailers in their own right) (Grewal et al., 2011; Zwisler and Wallman, 2010). From the franchisors' perspective, multi-unit ownership comprises dealing with one partner in a specific geographical area and allows better coordination whilst also delegating the franchise concept, brand and all operations to experienced franchisees with appropriate resources at hand (Daley, 2010). Nonetheless, when a franchisor puts itself in the position of contracting with a larger, more established franchisee, it will need to treat the franchisee as true partner.

The Research Team

Professor Mat Robson, Professor of Marketing and Principal Investigator for the project: Mat's teaching and research interests focus on international, strategic, and relationship marketing. He has published in many journals of international repute. Mat is also a Co-Investigator on the ESRC-funded Consumer Data Research Centre

Dr Vita Kadile, Research Fellow: Vita is a full time researcher in the Marketing Division. Her research interests focus on international marketing, strategic marketing, entrepreneurship and exporting. She previously worked as a marketing manager in a large hotel.

Dr Kathryn Watson, Research Impact Manager for Leeds University Business School. Kathryn supports academic teams on a number of projects (Consumer Data Research Centre, Cities theme, Diversity and Inclusion as well as this project). Kathryn co-ordinates impact case studies and supports the research impact agenda for the business school as well as coordinating research grant applications.

Professor Jeremy Clegg, Jean Monnet Professor of European Integration and International Business Management: Jeremy's research interests and experience in international business are extensive. He is particularly interested in the determinants of FDI, market entry and European integration. He has worked on several projects relating to China and both inward and outward investment.

2015

Leeds University Business School

Maurice Keyworth Building

University of Leeds

Clarendon Road,

Leeds, LS2 9JT.

http://business.leeds.ac.uk/

Contact email: research@lubs.leeds.ac.uk

Blog: http://business.leeds.ac.uk/blog/

All photos in this report were taken personally by the research team during the fieldwork in the Middle East