

# Resources and competences for franchising innovation

## Recursos y competencias para la innovación en franquicias

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#### ABSTRACT:

In Brazil, franchising invoices R\$55 billion/year; there are 71,950 franchised units of 1,380 chains.

Entrepreneurs prefer franchising for the support and lower firm mortality, especially during these times of financial crisis. The Resource-Based View regards resources, capabilities and expertise to create competitive advantages. Which resources and competences can provide franchising innovation? and how can one sustain the competitive advantages of these innovations? The propositions reveals: (P1) Professionalization of the franchise chain can generate advantages in terms of innovations; (P2a,b) Franchised entrepreneurs can generate innovations and use knowledge management to spread innovation; (P3) Networking generates innovations in franchises; (P4) M&A within the chain create competitiveness that generate innovations; (P5a,b) An organizational culture that encourages entrepreneurship generates innovation.

**Key-words:** Franchising, Entrepreneurship, Innovation.

#### RESUMEN:

En Brasil, el franchising factura R\$ 55 millones/año; hay 71,950 unidades de 1,380 cadenas. Los empresarios prefieren el franchising por el apoyo y baja mortalidad, sobretodo durante estos tiempos de la crisis financiera.

La Resource-Based View considera recursos, capacidades y la maestría de crear ventajas competitivas. ¿Qué recursos y competencias pueden proporcionar la innovación en franchising? ¿y cómo puede uno sostener las ventajas competitivas de estas innovaciones? Las proposiciones revelan: (P1) La profesionalización de la cadena de franchising puede generar ventajas en términos de innovaciones; (P2a,b) Los empresarios franqueados pueden generar innovaciones y usar la dirección de conocimiento para extender la innovación; (P3) Gestión de redes genera innovaciones en franchising; (P4) F&A dentro de la cadena crean el espíritu competitivo que generan innovaciones; (P5a, b) una cultura organizativa que anima el espíritu emprendedor genera la innovación.

**Palabras clave:** Franchising; Emprendedor; Innovación

## 1. Introduction

The franchising system is based on a contractual relationship between two parties: the franchisor and the franchisee. Thus, a franchise is an alternative to diversification. It can be regarded as a cooperative strategy that firms adopt to reduce risk and share expertise. This relationship implies in transactions involving a series of tangible and intangible resources. The role of the franchisor is to support the establishment of a new franchise through training, product supply, marketing plans and finance. The franchisee is responsible for selling the franchisor's products and services (Gillis, 2007; Shane, 2005; Combs and Ketchen, 1999b; Mahoney and Pandian, 1992).

It is clear that many entrepreneurs' rising interest in franchising in the last few years implies in creating alternatives for those entrepreneurs that want to go into business through brands and know-how consolidated by franchisors, as this helps to reduce the uncertainty of a new business. Other franchise benefits include gains due to greater access to technology, offered by the franchisor; help in getting financing for the venture's expansion; and a lower cost of monitoring and controlling units, as compared to what having a single shop entails. The benefits of franchises are often greater than those of regular businesses, mainly because the system provides a model for partnership enterprise management in which there is a greater exchange of information and innovative practices, in those markets in which the franchise chain operates (Shane, 2005; Shane and Hoy, 1996).

Global franchising data shows that the United States are the leaders in this market in international terms, with more than 760,000 franchised units that generate 18 million jobs and move US\$1.53 trillion a year in the economy (IFA, 2008; Dant, 2008). Brazil stands out for its franchise sales of some R\$55 billion, with more than 71,950 units franchised by approximately 1,380 chains, of which 90% are genuinely Brazilian. This accounts for the generation of roughly 600 thousand direct jobs and, according to estimates, almost 2 million indirect jobs. The growth rates of Brazilian franchising stand out, reflecting a rising preference for this business model. From 2007 to 2008, franchise sales grew (20%) and the number of new franchisors increased (10%), as did the number of franchised units (15%). Given the present international financial crisis, it is expected that demand for pre-formatted business, such as franchises, will grow (Melo and Andreassi, 2008; ABF, 2009). Even though it is an important sector for the economy, and a type of entrepreneurial activity that has been drawing a rising number of entrepreneurs, the Brazilian franchising sector is still short of in-depth scientific research. However, one current study that covers domestic and international scientific production on franchising points out the need and the opportunities for more analysis of this sector (Melo and Adreassi, 2008).

Among the approaches used in recent years in franchising, an important one is the theory of the scarcity of resources, which clearly explains the limitations of entrepreneurs that want to expand their businesses and adopt the franchising model. Through this strategic choice, economies of scale are achieved more easily and growth rates are better (Oxenfeldt and Kelly, 1968). However, this approach does not explain a franchise chain's competitiveness: how resources should be strategically selected and developed, the competences needed for outstanding performance, and the support and competitive advantage that ensue from the said resources, capabilities and competences (Barney, 1991; Prahalad and Hamel, 1990; Wernerfelt, 1984).

Focusing the discussion on the competitiveness issue, we see that both the resources and the competences of franchises can generate different performances in their markets of operation. On the other hand, resources and competences that are hard to copy, scarce and valuable become strategic assets. These are the assumptions associated with the resource-based view of the firm (RBV). Among these resources, brand reputation and the number of operations and routines carried out by the franchisor become crucial to the competitiveness of franchises (Barney, 1991; Gillis, 2007; Lafontaine and Shaw, 2005; Amit and Schoemaler, 1993; Caves and Murphy, 1976; Kaufman and Eroglu, 1998).

However, there are few studies involving both franchising and RBV. In recent years, franchises have been run based on the traditional point of view of the theory of agency and resource scarcity, as mentioned above. New discoveries and contributions to franchising can be found using RBV, especially regarding the resources traded and franchisor decisions that lead to better chain performance (Gillis, 2007).

When discussing competition between firms and the creation of competitive advantage, it is important to underscore the role of innovation. Innovation in franchising is extremely important given the competitive environment in which we live.

Understanding the resources and competences developed and traded among the players in a franchise is the main concern of this discussion; this includes the role of franchisors and franchisees. Kaufmann and Eroglu (1998), Dyer and Singh (1998), Bradach (1997), and Castrogiovanni et al. (1993) are authors who emphasize the importance of innovation in franchising chains. Mainly because the franchise can be seen as an outstanding source of innovation in a chain, but one that demands that franchisors' governance mechanisms ensure that these innovations can be enjoyed by several franchisees, in order to enhance competitive advantage and avoid the chain's stagnation.

In trying to find the franchising system's links, we encounter certain research questions. **First, what resources and competences can promote innovation in franchising chains? Furthermore, what competences and resources can sustain the competitive advantage of these innovations?** RBV is an approach that looks into these questions in depth, primarily because it focuses on determining resources and expertise in the development of competitive advantage. Therefore, it can provide support for franchise competitiveness (Barney, 1991; Prahalad and Hamel, 1990; Wernerfelt, 1984; Gillis, 2007).

This paper aims at generating proposals regarding resources and competences that can lead to innovations in franchise chains and provide support for competitive advantages. The paper is grounded in a theoretical review of the development of RBV and on the main relevant discussions over the last few decades; after charting this, we will specifically consider the use of RBV in the field of franchising, and proposals involving franchising and innovations will be presented, followed by some comments in the final thoughts section.

## 2. Theoretical review

### 2.1. The Resource Based View of the Firm (RBV)

The cornerstone of RBV was established by Penrose (1959) as a means of dealing with the **resources required for firms to grow**. The discussion held was based on principles that can lead to the growth of firms and built in the variables of growth speed and duration. On the other hand, an analysis of available resources is required to sustain this growth and to generate expansion in the desired direction. Resources are taken to mean all physical assets traded in the firm, as well as the human resources that will manage these changes and provide products and services within the organizations.

Though RBV is based on a vision of an organization's in-house resources, neither the macroeconomic environment nor the external setting is neglected, as they are responsible for the business's internal changes. However, what is lacking is a more in-

depth view of outside firms and of certain limitations regarding the professionalization of management and the technological developments that will become crucial in the current competitive situation.

Although the work of Penrose (1959) gained prominence only as of the 1980s, well-known scholars such as Wernerfelt (1984) and Barney (1991), who refer to his work, generated the dissemination of this approach and its assimilation by the strategy and entrepreneurship areas. Throughout the 1990s, different studies on the resources of firms endorsed the analysis and thereby generated greater credibility for this debate (Prahalad and Hamel, 1990; Bates and Flynn, 1995; Bowen and Wiersema, 1999; Brush and Artz, 1999; Combs and Ketchen, 1999a).

The work proposed by Wernerfelt (1984) concerned the development of **tools for the analysis of firm resources** and he addressed the strategic issues related to these resources. This debate regards the relationship between profitability and the use of these resources, as well as management over time. Wernerfelt (1984) uses a model that encompasses five competitive forces to conduct an analysis based on resources rather than just on products, as originally proposed by Porter (1980). In this comparison: **(i) General effects; (ii) Resources barriers; (iii) Attractive resources and, (iv) Mergers and acquisitions.**

The work of Wernerfelt (1984) contributed substantially to the study of firm resources, thought it was heavily criticized by Priem and Butler (2001) in a publication that the journal Academy of Management acknowledged. Among the arguments of these authors, there is the issue of whether the model proposed by Wernerfelt (1984) would lose much of its value by not being empirically tested.

In the early 1990s, RBV added to the discussion of strategy (Barney, 1991), examining the sources of **support for competitive advantage** based on firm resources and capabilities according to their **(i) value, (ii) scarcity, (iii) imitability and (iv) replaceability**. According to this author, RBV replaces traditional approaches to competitive advantage. Firstly RBV considers that firms in the same industry can have heterogeneous positions due to resources that they control. Secondly, these resources cannot be perfectly traded between firms. Within these two points, sources of competitive advantage to be explored both by firms and managers can be found.

At the same time, Prahalad and Hamel (1990) launched a discussion on the responsibilities of corporations and heightened the debate on the strategic resources of organizations, gaining greater prominence after publishing the book *Competing for the Future* (1994), which became a bestseller in subsequent years. Wernerfelt (1995) is one of the authors that recognizes that the work of Prahalad and Hamel was of paramount importance to disseminate RBV-related concepts to managers.

Prahalad and Hamel (1990) analyzed organizations metaphorically as a great tree, with a varied structure in which the trunk and main branches represent the essential products; the smaller branches represent business units; and the leaves, flowers and fruit represent the end products. The root provides nutrition, support and stability for all; these are the **core competences**. They are developed within an organization according to their use and shared among departments by means of the firm's organization processes. They are able to link existing businesses and work as an engine for new business and

technical standards. Thus, one can argue that organizations with basic competences that lead to competitive differences in their market of operation eventually act as leaders in areas where their competences can impose standards upon these markets (Prahalad and Hamel, 1990).

According to Hamel and Prahalad (1994), several years are needed to develop global leadership in a particular field, and consistency is of fundamental importance to this development. Therefore, teams with high service turnover or high total rates of turnover will have difficulty developing new competences. Managers unprepared for the development of new powers make a company waste effort, yet fail to build new competences. On the other hand, companies that can distribute their competences among different sectors or the dynamics of business units have a greater chance of becoming competitive. Finally, it is necessary that managers maintain ongoing dedication to the administration of core competences and their protection and defense. Hamel and Prahalad (1994) make certain recommendations, stressing that competences can be corrupted due to lack of investment and can even become fragmented when delivered to stakeholders that have been unable to develop them as partners.

**After this brief survey, we will discuss historical RBV in regard to the main issues and then advance along this discussion before we consider studies in the field of franchising, in search of a deeper understanding of its merits.**

## **2.2. The Resource-Based View and Franchising**

One of the first works that dealt with the resources of franchise chains goes back to Oxenfeldt and Kelly (1968). According to them, franchising is one of the options of firms that wish to expand in the face of a shortage of resources. This restriction on resources can be characterized by the unavailability of financing, staff and even information on local markets. Given these limitations, several resources can be supplied by means of a franchising system.

During the course of the years, many authors have tried to discuss the scarce resources and how they relate to franchising. The work of Combs and Ketchen (1999a) is one of these sources. It addresses shortages of capital and the restriction of resources such as labor, management experience and knowledge of the market in opting for franchising. The franchisees are seen as sources of low-cost capital for the franchisor, as opposed to bank loans and other forms of traditional financing. These authors suggest a more in-depth view of new theoretical perspectives and RBV, as this might allow one to establish a link between organizational capabilities and competitive advantage, providing new sources of franchising analysis.

According to Windsperger and Dant (2006), it is necessary to take into account the shortage of firm resources before **franchisors redirect the franchise chain or convert franchise units into their own units**. This process is based on the maturity of the chain; over the years, the franchisor acquires a rising knowledge of local operations and financial resources. Research findings indicate that these resources are intangible (information, financial and managerial) and may be the moderators of this redirection.

In a study involving retailers, the discussion is **redirected to retailers' decision to open or maintain their own units** (Alon, 2001). This study indicates that the more

units a retailer has, the more difficult it will be to keep control; therefore, franchising is recommended. In short, retailers with high growth rates and a lot of available resources use franchising less than large retailers with low growth rates. Small retailers with high growth rates must consider strengthening their resources, such as their brand, and then opt for franchising.

Ketchen and Combs (2003) developed a hypothesis **as to why firms embrace franchising**. This hypothesis relies on a theoretical survey dealing with the scarcity of resources and the theory of agency. The scarcity of resources, age, size and corporate growth rate particularly influence the adoption of franchising. According to the agency theory, franchising is an interesting option because of the lower cost of monitoring subsidiaries. Resource scarcity explains the reason for resorting to franchising, but once the chain has grown, a different reality develops, requiring additional analysis. RBV can provide support for such a development.

Gillis (2007), in his doctoral thesis, goes deeper into the unfolding of RBV and relational theory in order to **explain the tendency to prepay and its effects on performance**. More precisely, Gillis examines how franchisor resources affect the willingness to prepay and the consequences of this interaction of resources for franchisor performance. The resources considered are related to brand strength, operational routines and managerial expertise. RBV indicates an underexploited new theoretical approach to franchising studies, but with significant power to interpret the relations between franchisees and franchisors in resources transaction.

Castrogiovanni, Combs and Justis (2006) endorse the above discussion while trying to **identify factors that influence changes in the inclination to franchise**. This discussion involves traditional theories such as the agency theory and resource scarcity, although RBV stands out for its explanatory capability. The firm's expertise development might take years and therefore it is in these skills that the competitive advantage may be fomented. In this sense, RBV is a better choice than other traditional theories.

In a discussion involving the theory of resource shortages, the agency theory, RBV and institutional theory, Combs, Michael and Castrogiovanni (2004) look for **explanations about initiation, propensity and performance in franchising**. The results show that the theories of scarcity, resources and agency have strong explanatory capabilities. On the other hand, RBV supports the identification of differences between the resources and capabilities of firms, especially in terms of the inclination to franchise. Although RBV is important to explain innovation, the study does not go further into the franchising segment.

Combs and Ketchen's (1999b) debate examines the critical issues of **cooperation for resources** in restaurants using the franchise system and those that do not use it, in the light of the RBV theory. This cooperation is attractive to franchisors because it allows them to increase their market share and helps them to obtain information about local markets through their franchisees. This sharing of resources can be understood as a strategy to cope with resource limitation, allowing firm growth. The resources considered strategic such as brand reputation or the franchisor's experience can be positive for performance in this cooperation between firms. Particularly in this research, the authors found that the brand aspect is the key to performance in this cooperation,

although the study shows that franchisor's experience is not necessarily linked to better resource management. However, conflicts are common, and in some cases cooperation is not an efficient way to exchange resources.

However, a group of researchers analyzed the lack of experience in franchisees management of new firms that adopted the franchise system. Nevertheless, a group of researchers points out newly-franchised firms lacking experience from the franchisor's part. The main issue is how human resources are developed in this process of chain expansion, given that franchisees cannot be treated like conventional workers, since they aspire to participating in the business. Through RBV, these researchers considered the development of human resources as an agent to create competitive advantages in franchising. (Stanworth et al., 2004).

Knott (2003) identified in his research the **routines of franchising chains, such as franchisor-defined standards**. These routines, which can be **valuable resources** for performance, may lead to competitive differences; however, Knott analyses the mechanisms required for this sustainability based on RBV. He indicates, in these routines, the individual abilities that encompass the organizational behavior and the knowledge output resulting from this relation. In franchising the routines respect hierarchies, in which the franchisor provides assistance to franchisees, who should follow the rules set by the former. For the franchisees, the routines can be seen as informational resources transferred by the franchisor to local management, the latter being willing to pay royalties in exchange for this information. On the other hand, the main source of competitive sustainable advantage comes from explicit practice (converted into information, agreements and incentives provided by the franchisor) that is not easily copied by competitors when implemented as a package by the franchising chain.

**This analysis of the theoretical frame of reference has not identified any publications that have discussed the RBV perspective in depth and its implications for resources and skills where franchising innovation is concerned. On this basis, this proposal hopes to complement existing studies on franchising through the proposals that will be introduced next.**

### **3. Development of propositions**

Intangible resources may contain a number of components capable of generating sustainable competitive advantage in terms of innovation in franchising chains. In franchising we use several intangible resources that result in the expertise developed in each franchise. The franchisee is responsible for developing many attributes prepared by the franchisors. One can state that the relations with the customer is an important responsibility to be developed, aiming at building customer loyalty. This loyalty is awarded in accordance with the standards of quality set by the franchisors and maintained by the franchisees, who are in charge of their performance in local markets. Moreover, one should mention the development of human resources by franchisors, which should mainly provide training for franchisees and their employees so that they can ensure the standards of customer service quality (Sorenson and Sorensen, 2001; Windsperger and Dant, 2006).

Therefore, a full understanding of the chain and the competences developed over the years, regarding the selection of franchisees, franchise layout, products and the strength of the brand, are intangible resources. The development of this knowledge generates the franchise's expertise. This can help reduce costs and improve the quality of service, and is also a source of competitive advantage that enables firms and individuals to develop competences that are valuable for their chains (Klein and Leffler, 1981; Norton, 1988; Kacker, 1988; Coliseum, 1994; Barney, 1991; Castrogiovanni *et al.*, 2006).

These intangible resources are difficult to copy as they integrate a number of management practices that are often not restricted to a few people; they involve the assignments and functions of many players, such as franchisors, franchisees and franchising chain staff (Polanyi, 1962; Windsperger and Dant, 2006).

Consequently, managerial positions are very important in the pursuit of competitive advantage, considering the added capability of understanding and choosing which attributes and competences the organizations should develop in order to adapt quickly to potential opportunities. The lack of a competent body of managers may undermine support for the differences gained (Barney, 1991; Prahalad and Hamel, 1990). Given these issues, in franchises many managerial duties fall upon the franchisor, who takes on the function of chain manager. The franchisee is responsible for local management, which also requires competences for managing the local staff.

As a result we can regard franchisors as the “top management team”, whose market and management expertise can pave the way to innovation, especially when they comprise heterogeneous teams. It is worth highlighting the importance of the expertise brought to the table by these franchising executives who coordinate the franchisees, preparing them to generate superior performance within the chain. Decisions taken by the group manager will lead to better coordination of resources among firms (franchisees). This will bridge the firm's limitations more easily due to access to resources that may guarantee competitive advantage. Therefore, resources and competences that are difficult to copy, scarce, and valuable become strategic assets that provide competitive advantage for franchises (Combs and Ketchen, 1999b; Bantel and Jackson, 1989; Conner and Prahalad, 1996; Teece *et al.*, 1997; Schilling and Steensma, 2002; Amit and Schoemaker, 1993).

**As a result of this and based on the material previously discussed, we established our first proposition:**

**P1: The professionalization of franchisors is an intangible resource that can generate sustainable competitive advantage for innovations by the franchising chain.**

The performance of local entrepreneurs as franchisees is crucial to franchising chains. These franchisees are intangible resources, capable of adding information to the franchisors, providing them with a supply of products and services appropriate to their markets of operation and, along with that, generating innovations. This local action promotes emerging innovations, which, if properly managed by franchisors, can be used by other franchisees in the same chain (March, 1991; Sorenson and Sorenson, 2001; Thompson, 1994; Bradach, 1997; Windsperger and Dant, 2006).

The importance of the changes proposed by local franchisees is of paramount importance, because the geographical dispersion of the franchise chain can lead to a situation in which the standards determined by the franchisor may require adjustments to fulfill the needs of the local customers. Standardized procedures are not sufficient for better chain performance; diversification may be required and will happen as a result of the enterprising actions of the franchisees. The exception concerns homogeneous markets, in which franchisee action is not the key, since many modifications do not apply to the franchisor's directives (Minkler, 1992; Kaufman and Eroglu, 1998; Sorenson and Sorenson, 2001).

What stands out is that, unfortunately, many innovations developed by franchisees are not communicated to the franchisor. The franchisor is responsible for stimulating internal debate among the franchisees, developing a better relationship with a view to generating more trust and reaping benefits from the identification and more widespread implementation of local adaptations.

The evidence presented by Gassenheimer *et al.* (1996) shows that proactive franchisees have a tendency to be concerned with the relations between others franchisees and the franchisors. Therefore, these enterprising franchisees have a greater commitment to the exchange of knowledge and are in a better position to access other franchisees' innovations.

On the other hand, in order for these innovations to become more widespread, the franchisors must set up knowledge management mechanisms and thereby replicate these innovations at the other franchise units under their responsibility. Knowledge management has the merit of encoding local tacit knowledge, transforming it into explicit knowledge; thus, one can bring it into franchise and disseminate this knowledge to other franchisees (Nonaka, 1994; Nonaka and Takeuchi, 1995).

The concept of a learning organization employed by Senge (1992) can be used in the context of the relationship between franchisor and franchisees. To get better results in a franchising chain through the participation of franchisees, they have to be able to bring improvements and innovations to the franchising chain. According to this concept, knowledge management emerges as an alternative in the search for innovations; one can derive changes in routines, improvements in procedures and the development of new standards from the ability to adapt to local needs, all because of the exchange of experience between those involved (Cyert and March, 1963; Argote *et al.*, 1990; Sorenson and Sorenson, 2001).

However, knowledge management requires the development of human resources by means of stronger training over the years, which can enhance knowledge within a franchise chain. There are several ways to transfer knowledge, such as telephone consultations, meetings or coaching (Simonin, 1999).

The franchisees that develop local innovations can disseminate these practices during meetings held by the franchising chain from time to time, conveying to the franchisor, right from the start, techniques that can be implemented by other franchisees. When it develops the ability to propagate knowledge about innovations, the chain will develop a greater capacity for exploiting local markets (Gillis, 2007; Bradach, 1997).

**Based on what we have previously established, our second proposition is subdivided into two related topics:**

**P2a: Franchisees with enterprising profiles are intangible resources and are able to generate innovations in franchising chains.**

**P2b: Knowledge management is itself an intangible resource capable of creating a cycle of franchisee innovations.**

Relations between the firms are considered relational resources that add to the knowledge base of strategies and competences developed by franchisors and franchisees in their daily operations. Indeed, these relations improve the exchange of resources, competences and knowledge, strengthening the alliance between the parties involved and creating unique resources that are more valuable, rarer and harder to imitate. The maturing of these relations is extremely important for the franchisors and can lead to the chain under a franchisor's management raising its performance standards (Gillis, 2007; Dyer and Singh, 1998).

The relational perspective suggests that strengthening relations can reduce opportunism, increase the added value of the innovations coming from franchisees, provide increased standardization and reduce the variability of operations (Dant and Gundlach, 1998; Dyer and Singh, 1998). Nevertheless, the commitment underlying these relationships and the trust of customers and other stakeholders (agents) should be the key for relations success. This commitment and trust derive from (i) the provision of superior resources and solutions vs. other competitors; (ii) the maintenance of senior corporate values common to these partnerships; (iii) effective communication based on market knowledge and on the constant evaluation of these partnerships, and (iv) the avoidance of opportunistic maneuvers that will not provide competitive advantages because of their malevolent character. Additionally, managing relations require that the organization give up any imposing attitude vis-à-vis the market and that it invigorate its ability to address the circumstances of the groups involved (Morgan and Hunt, 1994).

Over the years, learning derived from these relations will provide improved clarity about which resources should be combined, generating more significant business opportunities for the groups involved. There are studies that show that relations built over time generate competitive advantages among the firms involved and are difficult for competitors to imitate (Dyer and Singh, 1998; Walker *et al.*, 1997).

These relational resources help to capture innovations from the franchisees and to disseminate them throughout the chain. There are two types of relational resources that apply to franchising. The first, the "knowledge sharing routines," deals with standards that allow for regular interaction among members of the franchise and transfer, recombine or even generate specific resources. It involves the regional consultants sent by franchisors to franchisees to support the dissemination of news in local, regional and national meetings. The second type of relational resource refers to the use of governance mechanisms. These mechanisms strengthen the security methods involved in the agreements signed by the chains' members, minimize transaction costs, and help to increase the value of innovation among franchisees (Dyer and Singh, 1998; Bradach, 1997).

Therefore, trust is a key factor when it comes to allowing the franchisees more autonomy, while the franchisor, on the other hand, can implement changes that are

accepted by the franchising chain, especially changes in routines, innovations, new promotions or changes in products and the delivery of services. The end result will be a larger number of innovations and quick processing by the chain (Gillis, 2007; Dant and Gundlach, 1998; Kaufmann and Eroglu, 1998).

**Based on the above, we establish the third proposition:**

**P3: The practice of franchisors and franchisees maintaining relations establishes sound competences in the area of innovation in the franchising chains.**

Starting in the 1990s, many mergers and acquisitions took place worldwide, sparking the questioning of the role of innovation in the face of this new organizational movement, given the intense transactions involving technological knowledge that helped to enhance firms' innovation potential. It is important to mention that up to then, the discussions involved the transfer of know-how and the capacity for technological development among the newly merged companies (Grandstad *et al.*, 1992; Beers and Sadowski, 2003; Sorensen, 2000; Cohen and Levinthal, 1989).

Through mergers and acquisitions, organizations can gain access to new resources that were previously limited or even difficult to develop internally. The peculiarities of the firms generate synergic actions, enabling access to new resources that may also be acquired through strategic alliances (Wernerfelt, 1984; Helleloid and Simonin, 1994).

One can analyze acquisitions in the light of another element, the fact that they work as an attractive alternative to R&D investments, precisely because they offer enterprises immediate access to new markets and dispense with internal innovations, which are therefore acquired through the firms that have become part of the group. As a consequence, there is no risk of internal development as developed markets are added. It is natural, however, that a developmental mentality will be required over time. In the short term, however, resource sharing will be dominant (Balakrishnan, 1988; Shelton, 1988).

Burgelman (1986) emphasizes an important issue: that both the growth and development of firms can be achieved through acquisitions and innovation. And because it has restricted resources, which is clearly the case of franchises, one of two possible directions is emphasized.

Having recently worked on this issue, Beers and Sadowski (2003) examine the relationship between innovation generation and the procedures for acquiring firms. According to these authors, the potential for innovation increases after these mergers, which generate a greater ability to launch new products and services.

One can revisit the experience of the pharmaceutical industry, which went through a strong merger and acquisition process in the last decade. For this industry, this process can mean cutting the R&D cost of drugs, which is extremely expensive because they require specialized resources, in particular research personnel, drug development time being as long as 15 years in many cases. Meanwhile, the pharmaceutical industry in many countries has been subject to competition from generic (unbranded) products. Moreover, broken patents add to the pressure to develop new drugs to be marketed under the protection of a patent (Morgan, 2001).

**Based on the points above, we establish a fourth proposition:**

**P4: Mergers and acquisitions among franchise chains generate new competences that foster innovations.**

Organizational culture encompasses a particular configuration of models of behavior, norms, values and knowledge of a given firm, which are conveyed over time to employees. An interesting case is that of François Dalle, the founder of L'Oréal, who contributed to the dissemination of enterprising values within the organization, by establishing an innovation-oriented organizational culture. The results of his concern with launching new products, services and activities centered on winning new markets are visible, in line with his enterprising managerial orientation (Fayolle *et al.*, 2008).

On the other hand, some authors point out that entrepreneurship can be characterized within the organization only if the behaviors and processes focus on the continuous recognition, evaluation and exploitation of opportunities by employees at all levels. Besides gaining, as a result, a pioneering position, the firm's innovation cycles will be stronger and will more easily overcome the usual risks faced by new businesses (Stevenson and Jarillo, 1990; Miller, 1983).

Barney (2001) highlights the creation of competitive differences, noting a particular aspect in firms: If there is a series of cultural values which are unusual in other organizations, one may say that there is a competitive advantage, as long as, evidently, these values contribute efficiently towards this organization's competitiveness.

On the other hand, a problem that firms face in the growth phase is growing bureaucracy, process control, and formality, along with reduced staff autonomy. These are complex issues that concern the orientation of the business with regard to entrepreneurship, involving above all corporate strategy, the management of human resources, and the organizational culture. In fact, the founder plays a distinctive role at the firm, having been responsible for the creation of values and for establishing an enterprising culture. One can see that in many situations, when there is greater autonomy among the staff and its functions are encouraged, this can lead to organizational development, resulting in changes that are beneficial to the hierarchical structure at play (Thornberry, 2001; Hofstede, 1985; Pinchot, 1985).

In sum, the organizational culture is metaphorically similar to a "chemical compound," whose formula is difficult to recreate because it is a collection of behaviors and values. The founder or even the organization's board are to be underscored as promoters of a proactive, ever-entrepreneurial attitude (Fayolle *et al.*, 2008).

**Based on what was seen previously, we arrive at our sixth proposition, subdivided into two:**

**P5a: An organizational culture that encourages entrepreneurship itself generates innovation in the franchising chains.**

**P5b: Organizational culture is a source of sustainability for the competitive advantage of innovations within franchising chains.**

## **4. Conclusion**

This paper discusses which resources and competences can help to produce a stronger innovation cycle in the franchising environment. Not only is it concerned with the generation of innovations but also with maintaining competitive advantages stemming from this strategic guideline which will foster innovation continuity.

The use of the theoretical approach substantiated in this argument stands out; it is important to point out that the theoretical approach used in this discussion is based on RBV, which has been widely used as the basis of academic studies in the field of strategy in recent years, because of its ability to deal with issues relating to the support of differentiation, competitive advantages, and the development of competences (Wernerfelt, 1984; Wernerfelt, 1995; Barney, 1991; Prahalad and Hamel, 1990).

Especially with regard to franchising, there are RBV related studies, directed mainly toward franchise-related issues, involving reconfigurations such as disposing of the franchisor's own units by franchising them and, inversely, franchisor acquisition of franchised units. Specific debate concerning RBV and innovation in franchising is still little examined and this paper hopes to have both contributed to this debate and generated arguments that can be pursued in greater depth by researchers interested in the field of franchising. To the managerial circles, represented by franchisors, the issues debated here may offer a range of resources and the development of competences aiming at achieving both innovation and competitive advantages. (Windsperger and Dant, 2006; Alon, 2001; Combs and Ketchen, 2003; Gillis, 2007; Castrogiovanni, Combs and Justis, 2006; Combs, Michael and Castrogiovanni; 2004).

Finally, we would like to comment on the application of the propositions developed in this paper. **The first (P1)** points out the need for the professionalization of the franchising chain agents, in particular of the franchisors. Given that most franchisees lack managerial knowledge, their dependence on the franchisor is greater, which means that a more proactive attitude from the franchisor's part is required in what regards setting the franchise chain standards. This is when the use of innovation tools is more intensely under the managerial team's responsibility. The franchise chain will enhance its professionalism with know-how and established standards of governance and thereby enjoy improved competitive advantages to support these innovations (Combs and Ketchen, 1999b; Bantel and Jackson, 1989; Conner and Prahalad, 1996; Teece *et al.*, 1997; Schilling and Steensma, 2002; Amit and Schoemaker, 1993).

**The second proposition (P2a, b)** highlights the franchisees' role in the innovation process. Franchises that emphasize the importance of franchisees with an enterprising profile lead the latter to perform better, as they will be proactive in their local markets. This is a key issue, since it is easier for the franchisee to recognize local opportunities than it is for the franchisor, especially with regard to international franchises or franchises in countries with significant cultural differences. The mechanism employed for this communication is knowledge management, which conveys information to the franchisor, who can then disseminate it among other franchisees (March, 1991; Sorenson and Sorenson, 2001; Thompson, 1994; Bradach, 1997; Windsperger and Dant, 2006; Cyert and March, 1963; Argote *et al.*, 1990).

Concerning the **third proposition (P3)**, the role of the practices that form the relations between franchisor and franchisees is outlined. The management of valid concerns among involved parties, especially those who have less decision-making power — in

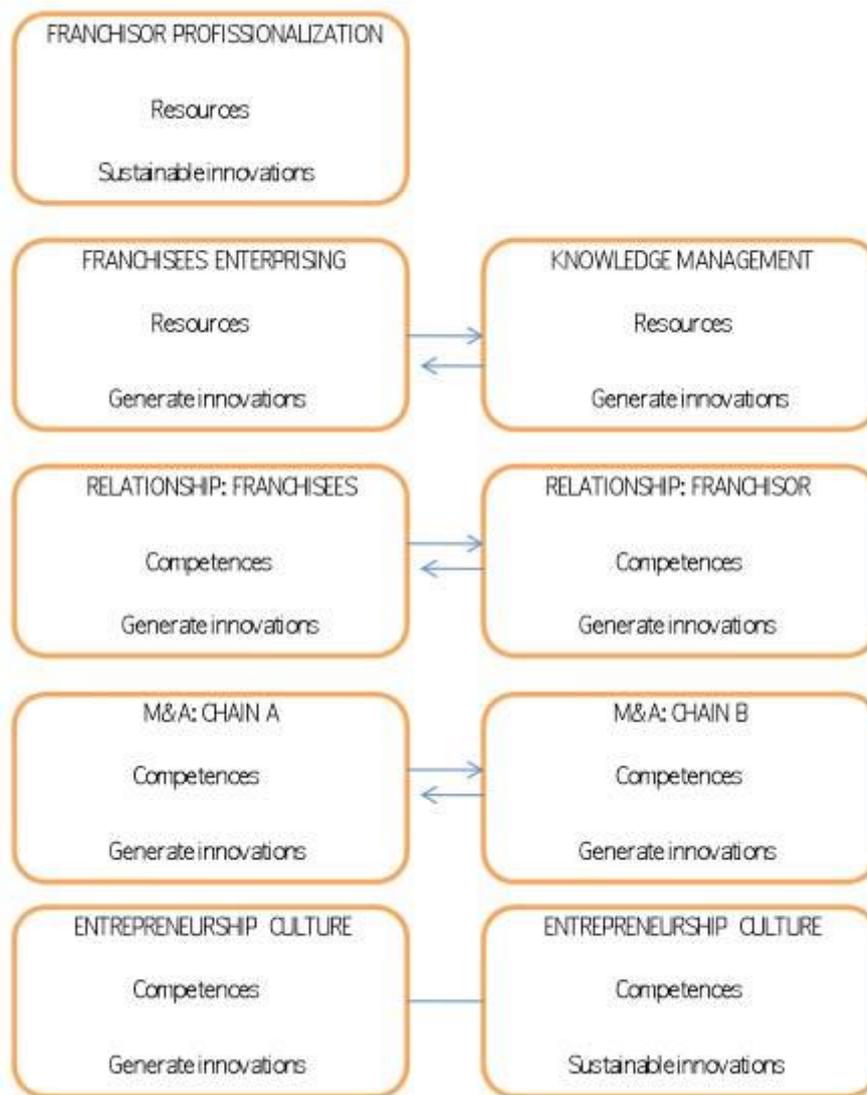
this case, the franchisees — will reduce common conflicts in the partnerships. Fewer conflicts and enhanced confidence in the franchisor should lead to more suggestions for modifications being proposed by the franchisees, as they will be more confident about being heard. All of this can lead to innovations in the franchising chain (Gillis, 2007; Dant and Gundlach, 1998; Kaufmann and Eroglu, 1998).

**The fourth proposition (P4)** discusses the role of mergers and acquisitions, which can create new organizational competences that the two firms would find hard to develop independently. Some of these competences can lead to innovation, given a greater sharing of resources among franchising chains. However, when it comes to joint actions between organizations, an observation has to be made: the risk of losing essential competences in the exchange of best practices is imminent. This may mar the skills developed throughout the years and may not ensure the use of these competences in the affiliates. Another possible negative effect is that the firm, by focusing on restructuring, can put innovation processes on a back burner. Therefore, it is appropriate to make an exception for the processes of mergers and acquisitions as related to the process of generating innovations. (Prahalad and Hamel, 1990; Hitt *et al.*, 1990; 1991; Wernerfelt, 1984; Helleloid and Simonin, 1994).

**The fifth and last proposition (P5a, b)** concerns the role of an enterprising organizational culture and the stimulating effect that a manager's or founding member's attitude can have on other members of the franchising chain. An enterprising culture allows innovations to arise easily and frequently among franchisees and employees. This is difficult for competitors to imitate and provides the firm the capacity to sustain the competitive advantages that come from innovation (Barney, 1991; Barney, 2001; Thornberry, 2001; Hofstede, 1985; Pinchot, 1985).

This way, following the proposition comments, the chart below displays, in short, the expected sources of innovation in franchising, as well as their respective resources and competences that which will promote this process:

Figure 1:  
Propositions – Resources and competences for franchising innovation



Source: Authors

Thus, we hope that this article contributes to the discussions within the franchising environment, especially as to what regards innovation-related issues. One should stress that these are merely propositions, which limits their applicability and calls for continued development of the model. As a suggestion for further work, we hope that the variables that make up each of these propositions can be more clearly defined, generating a model that may be useful in the construction of hypotheses and empirical testing. It would be interesting, in this later application, to use quantitative research methods, in particular surveys of Brazilian franchises. One could also include qualitative research in these further studies, with a view to developing a better understanding of the particularities that the survey might identify. Further issues, such as grouping franchises in accordance with the sub-segments in which they operate, might be examined, in order to investigate in more detail whether they are in line with the model under debate. However, we suggest that the research focus on franchise management, i.e., on the franchisor.

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