

Knowledge Sharing and Social Network in Franchise Chains

Rina Herani¹ and Arent Greve²

Abstract. The present paper is part of the ongoing research. The main objective of the present study is to investigate factors that motivate franchisors and franchisees to in relations as well as to share valuable knowledge across the networks. The in-depth interview towards franchisors, master franchise, and franchisees were performed. The major factors that motivate them to engage in relations and knowledge sharing practices are actors similarity, social capital (features laid in social structure), and regulation conformity tends to be the major factors that motivate/discourage franchisors/franchisees to engage in relations and knowledge sharing practices.

Keywords: knowledge sharing, social network, franchise chains

1. Introduction

Franchise systems exemplify a unique entrepreneurial business structure because they include several different organizations that are legally independent from one another, economically interdependent on each other, and operationally indistinguishable of each other (Parsa, 1996). This uniqueness leads franchisor and franchisee into dissimilar interest and goals but then should give rewarding understandings of knowledge sharing among franchisors and franchisees.

Both franchisors and franchisees hold intangible knowledge assets that would be beneficial if shared and implemented throughout the network chains. Nevertheless, much important information, such as innovation, developed by franchisees is not communicated to franchisors (Darr, Argote et al. 1995). Indeed, knowledge is sticky information that cannot be easily communicated and specified in contracts due to high transaction costs (Von Hippel 1994; Windsperger 2004).

2. Review of Previous Studies

Franchise dynamics have attracted scholars to develop several different research streams and different theoretical approaches for examining franchising (Meek, Davis-Sramek et al. 2011).

Nevertheless, there are several gaps in the previous literature on social network and knowledge sharing in franchising research that motivate the present study. First, major studies in franchise investigated the conflicts and opportunism problems that may present between franchisor and franchisee relationships; and entrepreneur reason for choosing franchise as organizational form (i.e. (Gassenheimer, Baucus et al. 1996; Combs, Michael et al. 2009; Davies, Lassar et al. 2011). Hence, motivation for sharing knowledge and establishing network in franchise chain are barely studied. Second, previous franchising studies commonly employed agency theory, resource constraint theory, and social exchange theory for examining franchise relationships (i.e. (Combs and Ketchen 2003); (Gassenheimer, Baucus et al. 1996; Davies, Lassar et al. 2011). These theories merely focus on the issues of franchisees' moral hazard, adverse selection problems, and free riding. Hence, it is necessary to employ theories that able to capture the reasons why actors engage in cooperating behaviour, such as knowledge sharing, with others. Lastly, concepts, theories and researches of franchise related topics mostly developed in western settings (i.e. (Baucus and Baucus 1996); (Gassenheimer, Baucus et al. 1996; Windsperger 2004; Blut, Backhaus et al. 2011; Davies, Lassar et al. 2011). Hence, a franchise research in Indonesia could provide rewarding insight of franchise in Asia setting. The main

objective of the present study is to investigate factors that motivate franchisor and franchisees to engage in relations as well as to share valuable knowledge across the networks.

2.1. Motivation to engage in relations with others

Franchise arrangements evolve mixed motive model in which contract partner must comply with formal contract but should embrace relational norms to advance shared interests (Williamson 1991). Franchisees are in the situation of paradox of embedded agency due to that franchisees embedded in the franchise system that have regulations, policy, and norms that fail to recognize franchisees' autonomy that may potential to contribute continued improvement and innovation into the franchise network.

Franchise networks' success depends to the systematic screening and matching of franchisees (Justis and Judd 1989; Ireland et al 2002). Franchisors typically stipulate specific skill and personal characteristics to ensure cooperative intent (Jambulingam and Nevin 1999). Besides financial capabilities, franchisor should carefully consider criteria such as cooperative intent, belief and skill of the potential franchisees or master franchise. Through this mechanism, franchisors ensure that franchisee will align their commitment and entrepreneurship in the franchise mutual cooperation such as knowledge sharing, maintaining the brand image, and sustaining the quality and standardization. Franchisors and franchisees decision to locate or to expand their business mostly focused on the density of the potential market. If an outlet has proven successful in one certain area, franchisors and franchisees tend to locate their new outlets in that area. The cluster of franchisees in certain are should encourage cooperation and enable knowledge spill over among them. Nevertheless, Ehrmann and Meiseberg (2010) found that embeddedness in the area that characterized with dense market that attracts many competing franchisees will decrease performance due to dense structures of franchisees increase cannibalization of sales. This embeddedness increase competition among franchisees and consequently reduces motivation to cooperate.

2.2. Motivation to share knowledge with others

There are two types of knowledge asset within franchise system, franchisors' and franchisees' intangible knowledge assets. Franchisors' knowledge is the system specific know-how and the brand name capital, while franchisees' knowledge more on the local market know-how as the franchisee's local marketing, human resource quality control, and innovation capabilities (Hall 1993); (Sorenson and Sorensen 2001). Franchisees are closer to their consumer that enables them to have a better understanding of local knowledge (such as taste, attitudes, values, and behaviour) than their franchisor (Davies, Lassar et al. 2011). This knowledge should encourage franchisees to seek innovative mean for local adaptation (Kaufmann and Eroglu 1999).

Actor similarity is factor that determines interpersonal network (Brass, Galaskiewicz et al. 2004). Similarity based on relational and organizational demography increased communication and social integration ((Tsui and Oreilly 1989); (Wagner, Pfeffer et al. 1984). Indeed, studies found that advice, respect, support network formed are shaped not only by the composition of the work establishment as a whole but also by the organizational demography at a person's own level or job title (Brass 1985; Ibarra 1992; Ibarra 1993; Ibarra 1995). Thus, similarity ease communication, increase the predictability of behaviour, and foster trust and reciprocity (Brass, Galaskiewicz et al. 2004). (Darr, Argote et al. 1995) studied knowledge sharing among Pizza franchisees in western Pennsylvania. There was a Pizza store that discovered innovation. They found that that knowledge is shared to other stores owned by the same franchisee but not to Pizza stores owned by different franchisees. The innovation then shared throughout the franchise chains by other actors (i.e. visiting franchisee, the franchisors' consultant) other than the franchisee who initially found the innovation. Indeed, they found that stores that closed or change owners were all single-store franchises. These stores unable to benefit from production experience from another stores (Darr, Argote et al. 1995).

In franchise system, both franchisors and franchisees should cultivate relational norms to leverage formal contract with franchisors as the central firm to coordinate the franchisees (Gassenheimer, Baucus et al. 1996). However, franchisees who have local information commonly face constraints to improvise because standardization of product and service is an essential matter in franchise system. Besides, franchisees are considered as opportunistic agents and tend to exhibit moral hazard problems (Baucus and Baucus 1996;

Davies, Lassar et al. 2011). Thus, franchisors reluctant provide autonomy for franchisees to make experiment and implement new practices. In return, this would discourage franchisees willingness to look for new opportunities, to envision new practices and subsequently to get other to adopt those practices.

3. Research Methodology

The present study use qualitative procedure for several reasons. First, the changes observed in the field of service business constituted complex setting in which causal dynamic were not immediately apparent and the motivation of actors were obscure (Elsbach and Kramer 2003). Second, the knowledge practices and network analysis involved historical processes. Such dynamic events are best analysed by using inductive approach that allows clarification of event sequences and the unravelled the overlapping of causal forces (Lee 1999). In depth interview able to capture not only the underlying assumption, but also the individual meaning and the insider's point of view of the organization (Geert 1973; Schein 1985). In the present study, interview will be performed to capture the participants', meanings and their point of view regarding theirs and partners' knowledge sharing practices and networks.

The researcher sent a letter to the franchisor to ask the participation. The sampling method follows snowball sampling. The researcher interviewed a franchisor then asked him to name active/passive (in terms of sharing knowledge) operational managers, master franchise, and active/passive franchisee. The totals of 6 interviews were performed which consist of 3 franchisors, 1 master franchise, and 2 franchisees. The present study selects Indonesia as the setting of the franchise network. Indonesia has experienced rapid growth of franchise business in the last 10 years. In 2000, there are 212 foreign franchises and 39 local franchises in Indonesia. The number of local franchises increases rapidly to be 450 franchises in 2007, 750 franchises in 2009, and 1200 franchise in 2010. While foreign franchises grow relatively flat, 250 franchise in 2007, 160 franchise in 2009, and 275 in 2010. The gross income of franchise companies in Indonesia in 2011 was Rp 120 trillion and expected to growth about 20% in 2012 (Indonesian Franchise Association 2012). These dynamic evidences should provide fruitful insight and worthy understanding of the knowledge sharing practices and network of franchise firms in Indonesia setting.

Specifically, the present study selects educational service franchise chains due to several reasons. First, the input and output of the business is knowledge. Hence, knowledge is a very critical resources and compelling franchisors to coordinate and to share the up to date knowledge among the network; Second, service business is characterized with heterogeneity/ or variability of the service being delivered. Thus knowledge sharing practices (i.e. training, standard setting, and quality assurance) are ultimately important for franchise chains in order to maintain its standard and image. Lastly, the dynamic of knowledge development and the intense of competition in educational service franchises lead to improvement or innovation that may encourage franchisors and franchise to share knowledge.

The study chooses Primagama as the case study. Primagama is an originally Indonesian company and market leader in formal education. Primagama was established in 1982 and then started to franchise its business in 2001. Primagama experiences significant growth in 2001 due to its franchise decision and currently has 759 branches.

4. Results

The interviews were transcribed and then coded by using Hyperresearch software. Franchisors and franchisees established connection with franchisees due to several reasons. Franchisor selects potential master franchise and franchisees primarily based on their financial capability. Besides, at the early adoption of franchise business format, the relations built based on the former relationship. Primagama allows franchisees to resign and offers them the ownership of Primagama's branch(es). By recruiting former employees, Primagama expects to have franchisees who understand the education business as well as trustable and committed partners.

Relations among franchisees commonly built based on several reasons, such as relationship history (i.e. former leader, former colleagues); personal closeness; similar commitment/ business vision; and intensity in informal meeting/communication; and altruism (i.e. humanist person). Franchisees have relations to

operational managers (representative of franchisor) and area manager (representative of master franchise) because they need solution; want to have second opinion from certain operational managers; prefer an approach from certain person; and perceive to be an expertise.

Franchisors share information of standard operation (SOPs) and policy to inform and to ensure that franchisees obey the determined regulations. The knowledge sharing practices among franchisees tend to be transferred selectively. A franchisee tends to share knowledge about his successful promotion programs to other branches belong to himself.

The franchisees reluctant to share knowledge that will improve performance of other branches belong to other franchisees. Franchisees are reluctant to share their knowledge with the nearest branches they feel that is the nearest branch is their competitors.

5. Discussion and Implications

The present study provides general understandings and short snap shot of knowledge sharing and social network in franchise chain. In general, the study found that factors of actors similarity, social capital (features laid in social structure), and regulation conformity tends to be the major factors that motivate/discourage franchisors/franchisees to engage in relations and knowledge sharing practices.

The study serves as the groundwork to develop and to pursue the main study. Furthermore, the main study interested to identify the pattern of knowledge sharing practice and social network in franchise chains in four different stages of firm's lifecycle, namely honeymoon, routine, crossroad, and stabilization (Blut, Backhaus et al. 2011). The main study will involves lifecycle theory due to that many of knowledge and network studies are static analysis, which only provide the 'snap shot' (Aldrich and Zimmer 1986; Borch and Arthur 1995). Thus, a dynamic study to understand the network of relationships and knowledge sharing in which the firm is embedded should provide a fruitful insight of what factors that motivate and how are the pattern formed.

6. References

- [1] Aldrich, H. and Zimmer, C. (1986). "Entrepreneurship through social network", in Sexton, D. and Smilor, R.W. (Eds), *Art and Science of Entrepreneurship*, Ballinger Publishing Company, Cambridge, MA, pp. 3 - 23.
- [2] Baucus, D. A. and M. S. Baucus (1996). "Consensus in franchise organizations: A cooperative arrangement among entrepreneurs." *Journal of Business Venturing* 11(5): 359 - 378.
- [3] Blut, M., C. Backhaus, et al. (2011). "What to Expect After the Honeymoon: Testing a Lifecycle Theory of Franchise Relationships." *Journal of Retailing* 87(3): 306 - 319.
- [4] Borch, O. J. and M. B. Arthur (1995). "Strategic Networks among Small Firms - Implications for Strategy Research Methodology." *Journal of Management Studies* 32(4): 419 - 441.
- [5] Brass, D. J. (1985). "Mens and Womens Networks - a Study of Interaction Patterns and Influence in an Organization." *Academy of Management Journal* 28(2): 327 - 343.
- [6] Brass, D. J., J. Galaskiewicz, et al. (2004). "Taking stock of networks and organizations: A multilevel perspective." *Academy of Management Journal* 47(6): 795 - 817.
- [7] Combs, J. G. and D. J. Ketchen (2003). "Why do firms use franchising as an entrepreneurial strategy?: A metaanalysis." *Journal of Management* 29(3): 443 - 465.
- [8] Combs, J. G., S. C. Michael, et al. (2009). "Institutional Influences on the Choice of Organizational Form: The Case of Franchising." *Journal of Management* 35(5): 1268 - 1290.
- [9] Darr, E. D., L. Argote, et al. (1995). "The acquisition, transfer, and depreciation of knowledge in service organizations: Productivity in franchises." *Management Science* 41(11): 1750 - 1762.
- [10] Davies, M. A. P., W. Lassar, et al. (2011). "A model of trust and compliance in franchise relationships." *Journal of Business Venturing* 26(3): 321 - 340.
- [11] Ehrmann, T. and Meiseberg, B. (2010), "Benefits of inner strength for franchise system expansion", *Journal of Marketing Channels*, Vol. 17, pp. 191 - 218.

- [12] Elsbach, K. D. and R. M. Kramer (2003). "Assessing creativity in Hollywood pitch meetings: Evidence for a dualprocess model of creativity judgments." *Academy of Management Journal* 46(3): 283 - 301.
- [13] Gassenheimer, J. B., D. B. Baucus, et al. (1996). "Cooperative arrangements among entrepreneurs: An analysis of opportunism and communication in franchise structures." *Journal of Business Research* 36(1): 67 - 79.
- [14] Geertz, C. (1973). *The interpretation of culture*, Basic Books: New York.
- [15] Hall, R. (1993). "A Framework Linking Intangible Resources and Capabilities to Sustainable Competitive Advantage." *Strategic Management Journal* 14(8): 607 - 618.
- [16] Ibarra, H. (1992). "Homophily and Differential Returns - Sex - Differences in Network Structure and Access in an Advertising Firm." *Administrative Science Quarterly* 37(3): 422 - 447.
- [17] Ibarra, H. (1993). "Network Centrality, Power, and Innovation Involvement - Determinants of Technical and Administrative Roles." *Academy of Management Journal* 36(3): 471 - 501.
- [18] Ibarra, H. (1995). "Race, Opportunity, and Diversity of Social Circles in Managerial Networks." *Academy of Management Journal* 38(3): 673 - 703.
- [19] Ireland, R.D., Hitt, M.A. and Vaidyanath, D. (2002), "Managing strategic alliances to achieve a competitive advantage", *Journal of Management*, Vol. 28, pp. 413 - 446.
- [20] Jambulingam, T. and J. R. Nevin (1999). "Influence of franchisee selection criteria on outcomes desired by the franchisor." *Journal of Business Venturing* 14(4): 363 - 395.
- [21] Justis, R.T. and R.J. Judd (1989), *Franchising*, South - Western Publishing, Cincinnati.
- [22] Kaufmann, P. J. and S. Eroglu (1999). "Standardization and adaptation in business format franchising." *Journal of Business Venturing* 14(1): 69 - 85.
- [23] Lee, T. W. (1999). *Using qualitative methods in organizational research*. Thousand Oaks, Calif., Sage Publications.
- [24] Meek, W. R., B. Davis - Sramek, et al. (2011). "Commitment in Franchising: The Role of Collaborative Communication and a Franchisee's Propensity to Leave." *Entrepreneurship Theory and Practice* 35(3): 559 - 581.
- [25] Parsa, H.G. (1996). "Franchisor - Franchisee Relationships in Quick - Service Restaurant Systems". *Cornell Hospitality Quarterly Journal*, Vol. 27, No. 42 - 49.
- [26] Schein, E. (1985). *Organizational Culture and Leadership*, Jossey - Bass: San Fransisco.
- [27] Sorenson, O. and J. B. Sorensen (2001). "Finding the right mix: Franchising, organizational learning, and chain performance." *Strategic Management Journal* 22(6 - 7): 713 - 724.
- [28] Tsui, A. S. and C. A. Oreilly (1989). "Beyond Simple Demographic Effects - the Importance of Relational Demography in Superior - Subordinate Dyads." *Academy of Management Journal* 32(2): 402 - 423.
- [29] Vonhippel, E. (1994). "Sticky Information and the Locus of Problem - Solving - Implications for Innovation." *Management Science* 40(4): 429 - 439.
- [30] Wagner, W. G., J. Pfeffer, et al. (1984). "Organizational Demography and Turnover in Top - Management Groups." *Administrative Science Quarterly* 29(1): 74 - 92.
- [31] Williamson, O. E. (1991). "Comparative Economic - Organization - the Analysis of Discrete Structural Alternatives." *Administrative Science Quarterly* 36(2): 269 - 296.
- [32] Windsperger, J. (2004). "Centralization of franchising networks: evidence from the Austrian franchise sector." *Journal of Business Research* 57(12): 1361 - 1369.