

International Franchise Partner Selection and Chain Performance through the Lens of Organisational Learning

CATHERINE L. WANG
LEVENT ALTINAY

Dr Catherine L. Wang is a Lecturer at Brunel University, Brunel Business School. She can be contacted at Brunel Business School, Uxbridge, Middlesex, UB8 3PH, UK. Tel: +44 (0) 1895 266712. Email: catherine.wang@brunel.ac.uk

Dr Levent Altinay is a Senior Lecturer in Hospitality and Tourism Management at the Oxford Brookes University, the Business School. He can be contacted at the Business School, Gypsy Lane Campus, Headington, Oxford, OX3 0BP, UK. Tel: + 44 (0) 1865 483832
Email: laltinay@brookes.ac.uk

Reference to this paper should be made as follows:

Wang, C. L. and Altinay, L. (2008). International franchise partner selection and chain performance through the lens of organisational learning. *The Service Industries Journal*, 28(2): 225-238.

International Franchise Partner Selection and Chain Performance through the Lens of Organisational Learning

Summary

This study aims to investigate how international franchisors engage in exploratory and exploitative learning in the partner selection process and the implications for chain performance. Based on a single embedded case study of a leading international hotel organisation, the findings reveal that the franchisor attempted at a balanced learning approach in response to challenges caused by high cultural distance in international markets. However, the 'crowd-out' effect of exploration and exploitation created a 'tension': exploration emphasising adaptation to local needs dominated the partner identification stage at country markets, whilst exploitation stressing standardisation and efficiencies dominated the partner decision-making stage at the division. As a result, a consistent brand image came at the cost of very cautious international expansion.

Keywords: International franchising, partner selection, exploratory and exploitative learning, chain performance

INTRODUCTION

Franchising is defined as “an organizational form in which a company (franchisor) grants an individual or another company (franchisee) the right to do business in a prescribed manner over a certain period of time in a specific place in return for royalties or the payment of other fees” [Elango and Fried, 1997, p.68]. International franchising offers an opportunity for market expansion to organisations (such as hotels and restaurants) whose services cannot be exported [Aydin and Kacker, 1980], and is acclaimed as a flexible organisational arrangement that permits franchisors to standardise some elements of international marketing strategies whilst modifying other elements to suit local markets [Sashi and Karuppur, 2001].

The performance of a franchise chain is commonly measured in terms of a consistent brand quality and an accelerated growth rate (i.e. a growing number of franchise properties) [Sorenson and Sørensen, 2001]. Well-managed brands tend to gain increased market shares because customers are willing to pay a premium price for a reputable brand for its ability to

achieve high customer satisfaction [Aaker, 1996; O'Neill and Mattila, 2004]. Successful brands can transcend national boundaries and extend the reputation gained in the home market to international markets [Sashi and Karuppur, 2001]. Hence, the system-wide adoption of a consistent brand and more efficient operational procedures is crucial to the competitive advantage of the franchise system [Norton, 1988b]. However, international franchising faces high uncertainty associated with international markets where political, economic and currency fluctuations are less predictable than in domestic markets [Sashi and Karuppur, 2001], and where the degree of cultural dissimilarity increases the perceived risks of international franchising [Welch, 1989; Eroglu, 1992]. When franchise chains face heterogeneous markets, system-wide standards frequently conflict with local market conditions [Sorenson and Sørensen, 2001]. Therefore, to achieve an accelerated growth rate, franchise organisations must adapt to local conditions by decentralising decision-making and allowing those who have the most relevant knowledge of local culture and market conditions to make local adaptation [Minkler, 1992]. The success of international franchising lies in striking a balance between standardisation and adaptation in order to maintain the power of a consistent brand image and attain the benefits of accelerated international expansion.

In addressing the need for a balanced approach to standardisation and adaptation, Sorenson and Sørensen [2001] examine franchising through the lens of organisational learning and contend that two types of learning (exploration and exploitation) bear distinct focuses on standardisation and adaptation that, in turn, influence the chain performance. Exploratory learning involves “search, variation, risk taking, experimentation, play, flexibility, discovery, innovation”, while exploitative learning entails “refinement, choice, production, efficiency, selection, implementation, execution” [March, 1991, p.71]. Hence, exploratory learning focuses on the development of new routines and allows the chain to

adapt to varied markets, while exploitative learning focuses on incremental improvement of existing routines and helps the chain to achieve standardisation and efficiencies [Sorenson and Sørensen, 2001].

Sorenson and Sørensen's [2001] study has shed light on how organisational learning could be adopted to effectively evaluate the implications for chain performance. Nevertheless, their study and a few other studies on chain performance [i.e. Shane, 1996; Combs and Ketchen, 1999; Michael, 2002; Combs et al., 2004] distinctively focus on the operations of franchise chains, i.e. post franchise relationship creation, leaving a glaring gap in the understanding of how franchise partner selection influences chain performance. Given that the resulting outcomes of partner selection have potentially far reaching effects on customer perceptions of the franchise system, effective cooperation in the franchise relationship and financial performance [Clarkin and Swavely, 2006], the lack of empirical insights on the role of franchise partner selection in contributing to the chain performance has caused a perturbing concern. The task of selecting international franchise partners is even more challenging because the cultural and social diversity may magnify the difficulty of assessing prospective partners. This urges studies of the international franchise partner selection process and its contribution to the chain performance.

The purpose of this paper is to investigate how international franchisors engage in exploratory and exploitative learning in the international franchise partner selection process and the implications for chain performance. We seek to make one contribution to the international franchising literature, i.e. to understand the direct implications of international franchise partner selection on chain performance and how franchisors balance learning efforts for the purpose of improved chain performance.

FRANCHISE PARTNER SELECTION AND ORGANISATIONAL LEARNING

Empirical studies of partner selection have given extensive attention to joint venture partnerships [e.g. Gerringer, 1991; Hitt et al., 2000]. Few empirical studies [i.e. Jambulingan and Nevin, 1999; Altinay, 2006; Clarkin and Swavely, 2006] have investigated partner selection with particular reference to franchising, but have primarily focused on partner-related and task-related selection criteria, such as financial strength, management skills, demographic characteristic, attitudes and personality, general business experience and industry specific experience. These studies have made significant contribution to the understanding of what kind of individuals or ventures are more likely be to selected by franchisors. However, little is known about the selection process occurred in franchise organisations and its implications for chain performance. Given that partner selection is one of the most important management functions in franchising, Clarkin and Swavely [2006, p.133] call on further research: “Hundreds of thousands of individuals have entered into these (franchising) agreements throughout the world, yet comparatively little is known about the preliminary steps of the selection process.”

The franchising theories make an indirect link between partner selection and chain performance. It is argued that a direct relationship exists between effective partner selection and cooperation between franchisors and their franchisees, and that cooperation plays an important part in the chain performance [Clarkin and Swavely, 2006]. Two leading theories, i.e. the agency theory and the resource scarcity theory [Fulop and Forward, 1997], offer theoretical insights on cooperative franchise relationships in view of improved chain performance. The agency theory [Eisenhardt, 1989; Elango and Fried, 1997] argues that the agency problem arises due to divergent goals between franchisors and their franchisees, given that franchisees may behave in an opportunistic fashion and pursue their own interests at the

expense of those of franchisors. This indicates that the chain performance in terms of a consistent brand image requires standardisation and efficiencies throughout the franchise system. Therefore, franchisors must recruit ‘quality’ and ‘right’ partners who are willing to cooperate and contribute to the goals of the franchise system [Taylor, 2000] and to adopt the system-wide marketing strategies, organisational routines and operating channels [Caves and Murphy, 1976].

Conversely, the resource scarcity theory views franchising as an organisation’s response to a shortage of the necessary resources required for its expansion, such as financial capital, labour capital, managerial talent [Norton, 1988a] or local market knowledge [Minkler, 1990]. Organisations use franchising to gain access to critical resources needed in order to rapidly create large chains and gain first-mover advantage, which initially takes the form of a lead in the number of retail outlets [Michael, 2003]. The higher outlet share yields market share [Reibstein and Farris, 1995], and market share is well recognised to affect profitability, especially in consumer goods [Buzzell and Gale, 1978; Szymanski et al., 1993]. Empirical evidence from the restaurant industry supports that such first-mover advantage exists and is likely to exist in any industry with a geographic component [Michael, 2003]. This indicates that chain performance is dependent on the ‘quantity’ or the ‘number’ of franchisees recruited into the franchise system.

Given that franchisors need to select partners to ensure the system-wide adoption of a consistent brand image to achieve standardisation and efficiencies and to pursue an accelerated expansion rate through opening new franchise outlets, their success relies on their capability of balancing the ‘quality’ and the ‘quantity’ of franchise partners. This can be demanding. In practice organisations that seek to protect strong brand names may be less

willing to franchise [Combs et al., 2004], and those that have the expansion rate at heart may jeopardise the quality of franchisees recruited. In diverse international markets, the personal characteristics, general business and industry-specific experience, cultural background and methods of financing a new venture can be varied [Gerringer, 1991]. Therefore, the challenge of selecting the ‘right’ international franchise partners is significantly amplified by the uncertainty and perceived risks associated with heterogeneous market conditions. To ensure a cooperative franchise relationship, franchisors must make efforts to understand local market conditions and learn to adapt to local needs during the partner selection stage.

March [1991] articulates that organisations as adaptive systems must balance two types of learning: exploration and exploitation. Exploratory learning bears a strong external orientation and emphasises breakthroughs of new knowledge and development of new capabilities, and hence is related to adaptation and more radical departure from existing capabilities. Exploitative learning focuses on tapping into internal, existing knowledge and hence enables standardisation and incremental improvement of existing capabilities. Research has found that both exploratory and exploitative learning are essential, and in volatile environments organisations are forced to strike a balance between maintaining stability and efficiency whilst adapting to rapid changes [March, 1991]. However, striking a balance is a difficult task since exploration and exploitation exhibit stark differences [Schildt et al., 2005]. Exploration emphasises learning by generating variation and inconsistency in performance, while exploitation is a directed search emphasising limited variety and short-term mean performance [McGrath, 2001]. March [1991, p.73] reckons that “compared to returns from exploitation, returns from exploration are systematically less certain, more remote in time, and organizationally more distant from the locus of action and adaptation The certainty, speed, proximity, and clarity of feedback ties exploitation to its consequences more quickly

and more precisely than is the case with exploration”. While rapid changes create a constant need to adapt and learn new skills, they also shorten the time given to exploit existing skills and capabilities [Eisenhardt and Brown, 1997]. On the other hand, organisations who engage in exploitative learning may encounter the problem of ‘competence trap’ that constrains exploratory learning [March, 1991; McGrath, 2001]. Exploitation may crowd out exploration [Benner and Tushman, 2002] and vice versa.

The competing effect and its challenges to the chain performance is evident in Sorenson and Sørensen’s [2001] study on the operations of franchise systems. However, little is known about how franchisors engage in exploratory and exploitative learning in the partner selection stage to contribute to the chain performance. International franchising seems to offer an aid to reconcile the needs for standardisation and adaptation [Sashi and Karuppur, 2001]. However, the competing force between the two types of learning associated with standardisation and adaptation indicates that the reconciliation of the goals of a consistent brand image and an accelerated expansion rate is a key aspiration for international franchisors. The success or failure lies not only in the management of franchise units, but also in the partner selection process that is under-researched in the literature. Given the above gap in the literature, we aim to answer the following research questions:

1. What are the processes involved in exploratory and exploitative learning in international franchise partner selection?
2. How do franchisors balance explorative and exploitative learning in the partner selection process to improve chain performance (i.e. maintaining a consistent brand quality and achieving an accelerated expansion rate)?

RESEARCH DESIGN

A single embedded case study of an international hotel organisation is chosen as the focus of the enquiry to allow multiple levels of analysis within a single case study [Yin, 1994]. This approach enhances the insights into this single case by providing greater richness and multiple perspectives in explaining firm behaviour. The case study organisation was a largest hotel franchise operator worldwide and owned by a conglomerate, which was a publicly listed company on the London Stock Exchange. The organisation was structured into three geographical divisions: the Americas, the Asia Pacific, and the Europe, and the Middle East and Africa region (EMEA). The original founder of the organisation was the inventor of the hotel franchise concept and as a result the company brought mass accommodation to the US [Clark, 1993]. The brand of the case study organisation had broad representation across the US and, albeit on a smaller scale, internationally [Knabe et al., 2000].

Purposive sampling was utilised to select the informants as well as the region for the investigation, since it enables researchers to select cases that best enable them to answer research questions and to meet research objectives [Saunders et al., 2002]. Purposive sampling is often used in small samples such as in case study research in order to select particularly informative cases. In this study an extreme case (the EMEA division, headquartered in London, UK) was selected because markets in this region tend to lack a 'franchising culture' which hindered the growth of some hotel groups [Finnie et al., 1999]. Focusing on this region would enable us to exploit the diverse international aspects of franchising. Further, the region appeared to offer enormous development opportunities for hotels with international brands: only 24 percent of the hotels in the EMEA region were branded, a much lower rate than 60 percent of branded hotels in the United States [Knabe et al., 2000].

Qualitative data were collected primarily through semi-structured interviews. Our sample intended to cover both the EMEA divisional level (where the partner selection decision was made) and the country market level (where the potential partners were identified by country managers). At the division our sample included Business Support Managers, Legal Counsels, Franchise Managers, Operations Managers, Technical Services Managers, Vice President (VP) Sales and Marketing, VP Development and Investment, VP Mergers and Acquisitions, and other senior people who were involved in the international expansion process. In the country markets our sample included Country Managers (based in Germany, France, Benelux, Turkey, UK and Ireland, Spain, Italy, Central Europe and Middle East and Africa, respectively). A total of 45 semi-structured interviews were conducted, each for one to one and a half hours. Open-ended questions (see Appendix I) were used to explore and probe the issues pertinent to international partner selection. In particular, issues related to franchise proposals recently accepted or rejected in countries including England, Ireland, France, Germany, Italy, Spain, Turkey and the Central European region were explored with informants. This approach allowed the consideration of case data from a number of divergent angles [Eisenhardt and Bourgeois, 1988]. Moreover, since different proposals were traced from the perspectives of different informants, it was possible to construct ‘stories’ about each of the decisions. This served to confirm or disconfirm the inferences drawn from previous ones thus improving the likelihood of accurate and reliable data. In addition, this approach enhanced the probability of capturing the novel findings emerged from different perspectives, thus adding rigor and richness to the findings.

Observations of 12 meetings in several country markets (i.e. Belgium, Germany, Spain and Turkey) and at the division were also used to check if the interview data accurately

reflected the real-time experience of participants involved in the process [Schein, 1996]. The observations included shadowing a number of key interview informants to get closer to their roles in reality [Yin, 1994]. Notes were taken to provide a condensed version of events.

Finally, company documents were also used as a complementary data collection method. These included job descriptions of the organisational members, international expansion proposals, annual reports, letters, memoranda, agenda, minutes of meetings, formal reports, publications and press releases, trade journals and newspaper articles about the case study organisation. The data were compared and analysed in conjunction with the findings from interviews and observations. Such triangulation of data was useful in increasing the richness of the case data and constructing the 'full picture' of the firm's international franchise partner selection and the role of organisational members in the process.

The transcripts of the interviews were used to perform a thematic content analysis. A preliminary analytical framework was devised to guide our analysis. This was a two-by-four matrix encompassing two stages of international franchise partner selection (i.e. partner identification and decision-making) as one axis and the three components of the theoretical framework (i.e. exploratory learning, exploitative learning and brand image) as the other axis. Data obtained from each informant were analysed separately to identify the emerging themes. Subsequently, the themes that emerged in each individual interview were compared across individuals to identify themes related to our proposed theoretical framework. Following this, themes, concepts and relationships emerged from the data were compared and contrasted with the extant literature on international franchising and organisational learning. The similarities and the contradictions identified were recorded as memos, which were then sorted

into batches and linked so as to create a theoretical outline of the connections across the categories.

FINDINGS AND DISCUSSION

The case study organisation set itself a target of becoming a major force within Europe by the means of international franchising. The organisation adopted a set of guidelines for partner selection, including strategic rationale, the market, financial analysis, assessment criteria of potential partners and properties (see Appendix II). Following specific guidelines helps to maximise the likelihood of developing a cooperative franchise relationship [Jambulingan and Nevin, 1999]. Potential franchise partners were real estate development companies, individual and institutional financial investors, bankers, intermediary consultants, hotel owners and hotel management companies. A formal selection process was also in place, involving two overlapping stages: partner identification in the country markets and decision-making at the company division. Each stage demonstrated the unique nature of organisational learning. These were identified in company documents and further supported by primary findings.

The Partner Identification Stage

Country Managers were considered to be the 'owners' of the process. They proactively identified potential franchisees and sold the organisation's brand concept and operational abilities to them. On a regular basis, Country Managers informally consulted the Senior Development Team and other departments at the division and passed on information of proposed projects for their initial assessment against the organisation's long-term objectives. Once Country Managers made a positive assessment on a potential franchisee, they

completed a formal market feasibility report and an initial assessment of the potential franchisee and submitted them to the division for final assessment.

The adoption of the franchise system was to minimise risks by avoiding investing significant capital resources, but the firm faced challenges in the different country markets. Literature suggests that markets in this region lacked a ‘franchising culture’ [Finnie et al., 1999], which was also evident in the interview data. One informant commented: “*In Italy or Spain, when you go to the market and propose a franchise and say ‘I have an international brand...’ a typical reaction is ‘How much money are you paying to put your brand on my hotel?’*” In Germany leaseholds reflected the traditional property investment practice and German investors were perceived as risk averse. Potential German franchisees demanded certain monetary guarantees if they established a franchise partnership. Although it is argued that experienced franchisors are less likely to encounter unmanageable risks inherent in international expansion [Eroglu, 1992], the franchise organisation perceived high risks in its international expansion due to cultural distance that posed threat to its further international expansion within the region.

To recruit a growing number of franchisees and ensure an accelerated growth rate, Country Managers, who were either local nationals or had lived long enough in the host country or region to know the local culture and the business context, played a major role in the adaptation to local market needs and involved a great deal of exploratory learning. Demonstrating a high degree of intuition, personal interaction and creative problem solving, Country Managers proactively approached potential franchisees and constantly educated them. The VP Development and Investment stated: “*We are educating the investors about the value of franchise and management contracts in a hotel environment - what value it*

would bring to them as an investor. If they have a brand, we explain to them why they should give up the existing name to convert to our brand - what value our brand brings.” In addition, Country Managers also constantly made suggestions to the division about the differences of each country market and suggested new ways of doing things to suit local markets. They dedicated to developing new procedures to fit local demands.

The differences among country markets seemed endorsed by the division, as VP Investment commented: *‘The company had to put a guy into a certain key market, because the way Spanish do business is completely different from the way German do business and completely different from the way English do business. It is not only in the way they do business but also the way the investment is structured is completely different.’* However, suggestions for adaptation to local needs were often regarded as idiosyncratic knowledge and of little value by the division, because it is not easily transferable to other franchised units that operate in different environments and hence carries an inherent risk to the standardisation and efficiencies of the franchise chain [Sorenson and Sørensen, 2001].

The Partner Decision-making Stage

The Committee at the division formally assessed franchise proposals, undertook risks and financial analysis and made final decision on the suitability of potential franchisees. The Committee consisted of a cross-functional team of experts in operations, legal, development, technical services, marketing and franchise services. Franchise partner selection is process-intensive, and it is practically impossible to separate marketing, legal, financial, operational and other issues in the decision-making process. It is argued that cross-functional teams integrate all relevant expertise and link the strategic and operational learning processes [Mahajan et al., 1994]. Further, cross-functional teams lead to a higher thoroughness of

learning as the different functional group members develop a shared interpretation of information [Blazevic and Lievens, 2004].

The findings revealed that the decision-making stage was characterised by exploitative learning that focuses on existing knowledge, helps to maintain consistency and standardisation and hence achieve efficiencies [Sorenson and Sørensen, 2001]. During informal discussions informants stated that the organisation aimed to deliver products with worldwide standards, such as those achieved by McDonald's and Coca-Cola, that would allow international customers' expectations to be met. However, some prospective partners did not always understand the logic of franchise partnership and the importance of brands and brand standards. The findings offer further evidence of a potential 'agency problem' [Eisenhardt, 1989; Elango and Fried, 1997]. This clearly was a risk factor for the organisational members and in particular, for the senior decision-makers who aimed to ensure that firm-specific advantages were appropriated and preserved by franchisees after the establishment of partnerships. Maintaining the brand image was driven by marketing concerns and ultimately customer perception of franchise products and services.

However, the findings of this study reveal that the nature of international expansion did not justify a standardised strategy and a purely corporate-driven decision. Both Country Managers and people from the Senior Development Team stated that international expansion was market-driven and therefore "opportunistic". One of them explained the nature of the business as: "... *I have yet to see any international expansion plan that basically says 'I am going to have these hotels in the market, in this city in the next five years' and it is achieved. Unfortunately, international expansion is opportunistic.*" Setting strict boundaries, therefore, limited the organisation's ability to bring its resources into the alignment with the diverse

environment and created frustration among its organisational members. This decelerated international expansion and closed doors to a wider market coverage. These findings provided support to Sykes and Block [1989] who argued that imposing standard procedures to avoid risky moves may also lead to missed opportunities. The findings are also consistent with Sorenson and Sørensen's [2001] empirical findings that the conflicts are a 'battle' between the objective of achieving efficiencies of the franchise chain through the implementation of standard practices and that of an accelerated expansion rate of the chain through adaptation to local markets.

Further, this study illustrated the unique nature of the conflicts between explorative and exploitative learning in the international franchise partner selection process. The competing force between them to some extent divided the organisational members at the country markets and senior decision-makers at the division. Country Managers displayed a strong orientation toward local adaptation and a high degree of exploratory learning to achieve an accelerated expansion rate, while senior decision-makers focused on exploiting existing knowledge and making incremental changes to achieve standardisation and efficiencies and hence a consistent brand quality. The distinctive focuses caused the 'tension' at the two organisational levels. The division attempted to control the 'quality' of prospective franchisees and projects by imposing standardisation of information transmission through standardised project and market reports, but this indeed aggravated the tension. Although Country Managers found that the standard format useful and helped avoid re-inventing the wheel, they also pointed out that decision-makers did not understand the 'subtlety' of local situations and in many occasions the rejection of a franchise proposal was because the Committee member lacked understanding of the country markets and the proposed projects. In addition, Country Managers who possessed first-hand rich information about the proposed

projects were considered unnecessary for participation in the formal partner assessment and debate at the Committee. This concurs with the general concern on imposing standardisation when international markets are diverse [Anderson and Gatignon, 1986; Minkler, 1992; Sorenson and Sørensen, 2001].

The Chain Performance

It also became apparent that the franchise organisation had two performance targets: maintaining the brand quality and achieving an accelerated growth rate. Although both performance targets were considered important to achieve a growing market share [O'Neill and Mattila, 2004], the senior decision-makers gave top priority to brand consistency. The VP Development and Investment explained how proposed projects should be compatible with the company's strategy and financial criteria: *"It is not difficult to find a building, even finding a hotel; it is very difficult to find one that financially can provide us with what we believe we require looking ten or twenty years forward. The hotel business is always long-term; the end result will be there for twenty years and is going to develop a revenue stream."*

The performance targets and their strategic rationales were established at the company division level. Accordingly, the franchising and brand strategy was developed at the division, and was subsequently communicated to the country markets in an explicit form, i.e. the average size of target hotels, the number of hotels to be developed and the rate of expansion in particular country markets. Although the senior decision-makers at the division believed that a consistent brand strategy and performance targets were communicated throughout the chain, the interpretation of such strategy and performance targets differed in the country markets. Country Managers were well informed of the 'number' of hotels to be developed and were also rewarded for the 'number' of successful proposals that they submitted, but

were not accessible to the nuances of the franchising and brand strategy. Consequently, Country Managers were heavily driven by the ‘quantity’ side of the chain performance - the number of proposals to be submitted and approved. At the surface, Country Managers seemed aware of the importance of a consistent, standard brand image throughout the franchise chain and hence the ‘quality’ of potential franchisees. However, such awareness also seemed to be ‘learned’ from past rejections of proposals, rather than based on clear communications of the franchising and brand strategy between the division and the country markets.

CONCLUSIONS

The franchise chain performance has been the concern of both the practitioners and the academics in the marketing field. It is widely recognised that inconsistent service quality causes low customer satisfaction that, in turn, both damages the brand reputation in the eyes of customers and affects franchisees’ willingness to sign up and/or stay with a brand [Prasad and Dev, 2000]. Prior studies develop a comprehensive understanding about the strategies that a franchisor could pursue in order to integrate existing franchisees to the wider system and ensure that they contribute to the attainment of system-wide goals [Dewhurst and Burns, 1993; Sorenson and Sørensen, 2001]. However, these studies primarily focussed on the practices that could be implemented after the establishment of the partnership, and how the partner selection practice could contribute to the chain performance remained under-researched. The findings of this study revealed that appropriate partner selection is vital to chain performance and has direct implications on the chain’s brand quality and growth rate.

Further, prior literature has established that developing a set of partner selection criteria is important for a co-operative franchise relationship [Jambulingham and Nevin, 1999; Clarkin

and Swavely, 2006; Altinay, 2006]. None of these studies, however, answer the question of how franchisors learn collectively and select partners that could contribute to the consistent service standards and customer satisfaction across the chain. The findings of this study showed that exploitative learning in the partner selection process is critical to the franchisor's goals of maintaining a consistent brand image. Exploitative learning helps the franchisor organisation disseminate system-wide standards and procedures and ensure that franchisees are well integrated to the wider chain. Exploratory learning is particularly important for the growth rate since it helps the franchisor organisation respond to the cultural distance in different country markets and minimises the risks of agency problem resulting from the franchisees' lack of franchising culture.

Whilst recognising the 'crowd-out' effect of exploratory and exploitative learning, previous literature highlights the importance of interrelating and blending them in order to maintain stability and efficiency whilst adapting to rapid changes [March, 1991; Sorenson and Sørensen, 2001; Schildt et al., 2005]. However, none of these arguments are specific to the franchise partner selection context. The findings of this study indicated that the case study organisation attempted to a balanced learning approach in response to high cultural distance in the international markets. However, the competing force between exploration and exploitation pulled the organisational members at the country markets and the division toward different focuses. Country Managers who were geographically closer to the market conditions were dedicated to exploration and adaptation to local opportunities for an accelerated expansion rate at the expense of consistent brand standards. On the other hand, the Committee at the division were devoted to exploitation and standardisation in favour of a consistent brand image. To balance the 'quality' and 'quantity' of franchisees recruited, the Committee at the division imposed standardisation in transferring information about

prospective partners and projects from country markets to the division. This resulted in a 'tension' between the two organisational levels and raised the questions about the strategic priorities of a franchise system, whether it is brand consistency or accelerated growth with high returns.

It becomes apparent that for a balanced approach, a franchisor organisation needs to encourage its employees at various levels to exploit both exploratory and exploitative learning at different stages of the partner selection process. It is also important that franchisor organisations clarify its strategic priorities and set consistent performance measures for the chain performance. Achieving a consistent brand image and recruiting a growing number of franchisees as required by the target expansion rate is not a smooth journey. This study highlights that organisational learning in the partner selection stage is equally, if not more, important than organisational learning in the management of existing franchisees [Sorenson and Sørensen, 2001]. Effectively balancing exploitative and exploratory learning in the partner selection stage precedes the effective management of franchisees that, in turn, leads to chain performance. The competing effect of exploration and exploitation leads to conflicts in the chain performance. This was evidenced by the high failure rate of proposal rejections that Country Managers experienced and felt frustrated about. As a result, the expansion rate of the franchise organisation was at jeopardy and a consistent brand image came at the cost of very cautious international expansion. Although Country Managers were more risk tolerant, the case study organisation demonstrated an overall risk-averse characteristics and favoured exploitation, which is recognised for generating steady performance [March, 1991].

The findings of this study must be viewed in light of limitations and boundaries. This study was based on a single case study. Although measures were taken to maximise the

reliability and validity of data collected and to include multiple perspectives of information, the findings only reflected the partner selection process of the case study organisation, and cannot be generalised to other firms. Despite this limitation, the findings have both practical and research implications for franchise marketing and for franchisors in pursuit of becoming a market-focused learning organisation. First, in search for ways to improve chain performance, franchisors must pay equal, if not more, attention to partner selection than the management of franchise units. They must go beyond simply adopting a set of partner selection criteria and guidelines, re-evaluate their learning processes in international partner selection and instil mechanisms to promote effective learning among different organisational levels. Second, despite the trend of globalisation, managers must adapt to local market needs whilst achieving economies of scale, scope and learning through standardisation. The success of franchise organisations lies in establishing a corporate brand image and making necessary adjustment to local conditions. Further, the success not only requires effective management of franchise units but also effective selection of franchise partners.

REFERENCES

- Aaker, D., 1996, *Building strong brands*. Free Press, New York.
- Altinay, L., 2006, 'Selecting partners in an international franchise organisation', *International Journal of Hospitality Management*, Vol. 25 No. 1, pp108-128.
- Anderson, E. and Gatignon, H., 1986, 'Models of foreign entry: a transaction cost analysis and propositions', *Journal of International Business Studies*, Vol. 17 No. 3, pp. 1-26.
- Aydin, N. and Kacker, M., 1990, 'International outlook of US-based franchisers', *International Marketing Review*, Vol. 7 No. 2, pp. 45-53.
- Benner, M.J. and Tushman, M., 2002, 'Process management and technological innovation: A longitudinal study of the photography and paint industry', *Administrative Science Quarterly*, Vol. 47 No. 4, pp. 676-706.
- Blazevic, V. and Lievens, A., 2004, 'Learning during the new financial service innovation process: Antecedents and performance effects', *Journal of Business Research*, Vol. 57 No. 4, pp. 374-391.
- Bradach, J.L., 1998, *Franchise Organizations*. Harvard Business School Press: Boston, MA.
- Buzzell, R. D. and Gale, B. T., 1987, *The PIMS Principles: Linking Strategy to Performance*. Free Press, New York.
- Caves, R. E. and Murphy, W. F., 1976, 'Franchising: Firms, markets and intangible assets', *Southern Economic Journal*, Vol. 42, pp. 576-586.
- Clark, J. J., 1993, 'Holiday Inn: new rooms in the inn', *Cornell Hotel and Restaurant Administration Quarterly*, Vol. 34 No. 5, pp. 59-67.
- Clarkin, J. E. and Swavely, S. M., 2006, 'The importance of personal characteristics in franchisee selection', *Journal of Retailing and Consumer Services*, Vol. 13 No. 2, pp.133-142.
- Combs, J.G. and Ketchen, D. J., 1999, 'Explaining interfirm cooperation and performance: Toward a reconciliation of predictions from the resource-based view and organizational economies', *Strategic Management Journal*, Vol. 20 No. 9, pp. 867-888.
- Combs, J.G., Ketchen, D.J. Jr. and Hoover, V. L., 2004, 'A strategic groups approach to the franchising-performance relationship', *Journal of Business Venturing*, Vol. 19, pp. 877-897.
- Dewhurst, J. and Burns, P., 1993, *Small Business Planning, Finance and Control*. Macmillan.
- Eisenhardt, K. and Bourgeois, L. J., 1988, 'Politics of strategic decision-making in high velocity environments: toward a mid-range theory', *Academy of Management Journal*, Vol. 31, pp. 737-770.

- Eisenhardt, K. M., 1989, 'Agency theory: An assessment and review', *Academy of Management Review*, Vol. 14, pp. 57-74.
- Eisenhardt, K.M. and Brown, S. L., 1997, 'The art of continuous change: Linking complexity theory and time-paced evolution in relentlessly shifting organizations', *Administrative Science Quarterly*, Vol. 42 No. 1, pp. 1-34.
- Elango, B. and Fried, V., 1997, Franchising research: A literature review and synthesis, *Journal of Small Business Management*, Vol. 35 No. 3, pp. 68-81.
- Eroglu, S., 1992, 'The internationalization process of franchise systems: A conceptual model', *International Marketing Review*, Vol. 9 No. 5, pp. 19-30.
- Finnie, M., Bevan, N., Eadie, G., Collyer, G. and Noble, S., 1999, 'Bass: Hospitality Tense'. *Deutsche Bank*, 5th October.
- Fulop, C. and Forward, J., 1997, 'Insights into franchising: a review of empirical and theoretical perspectives', *The Service Industries Journal*, Vol. 17 No. 4, pp. 603-625.
- Gerringer, J.M., 1991, 'Strategic determinants of partner selection criteria in international joint venture', *Journal of International Business Studies*, Vol. 22 No. 1, pp. 41-61.
- Hitt, A. M., Dacin, T. M., Levitas, E., Arregle, J. and Borza, A., 2000, 'Partner selection in emerging and developed market contexts: Resource based and organizational learning perspectives', *Academy of Management Journal*, Vol. 43 No. 1, pp. 449-476.
- Jambulingan, T. and Nevin, J. R., 1999, 'Influence on franchisee selection criteria on the outcomes desired by the franchisor', *Journal of Business Venturing*, Vol. 14 No. 4, pp. 363-395.
- Kaufmann, P. J. and Lafontaine, F., 1994, 'Costs of control: the source of economic rents for McDonald's franchisees', *Journal of Law and Economics*, Vol. 37, pp. 417-453.
- Knabe, R., Cumming, R., Hargreaves, E. and Purdy, M., 2000, 'Bass: Hot on the heels of the brewing disposal'. *Dresdner Kleinwort Benson Research*, 10th August.
- Mahajan, J., Vakharia, A. J., Paul, P. and Chase, R.B., 1994, 'An exploratory investigation of the interdependence between marketing and operations functions in service firms', *International Journal of Research in Marketing*, Vol. 11, pp.1-15.
- March, J., 1991, 'Exploration and exploitation in organisational learning', *Organization Science*, Vol. 2 No. 1, pp. 71-87.
- McGrath, R. G., 2001, 'Exploratory learning, innovative capacity, and managerial oversight', *Academy of Management Journal*, Vol. 44 No. 1, pp. 118-131.
- Michael, S. C., 2003, 'First mover advantage through franchising', *Journal of Business Venturing*, Vol. 18, pp. 61-80.

- Michael, S.C., 2002, 'Can a franchise chain coordinate?', *Journal of Business Venturing*, Vol.17, pp. 325-341.
- Minkler, A., 1990, 'An empirical analysis of a firm's decision to franchise', *Economic Letters*, Vol. 34, pp. 77-82.
- Minkler, A., 1992, 'Why firms franchise: a search cost theory', *Journal of Institutional and Theoretical Economics*, Vol. 148, pp. 240-259.
- Norton, S., 1988a, 'Franchising, brand name capital, and the entrepreneurial capacity problem', *Strategic Management Journal*, Vol. 9, pp. 105-114.
- Norton, S., 1988b, 'An empirical look at franchising as an organizational form', *Journal of Business*, Vol. 61, pp. 197-218.
- O'Neill, W. J. and Mattila, S., A., 2004, 'Hotel Branding Strategy: Its relationship to guest satisfaction and room revenue', *Journal of Hospitality and Tourism Research*, Vol. 28 No. 2, pp. 156-165.
- Prasad, K. and Dev, C., 2000, 'Measuring hotel brand equity: A customer-centric framework for assessing performance', *The Cornell Hotel and Restaurant Administration Quarterly*, Vol. 41 No. 3, pp. 22-31.
- Reibstein, D. J. and Farris, P. W., 1995, 'Market share and distribution: a generalization, a speculation, and some implications', *Marketing Science*, Vol. 14 No. 3, Part 2 of 2, G190-G202.
- Sashi, C. M. and Karuppur, D. P., 2001, 'Franchising in global markets: Towards a conceptual framework', *International Marketing Review*, Vol. 19 No. 5, pp. 499-524.
- Saunders, M., Lewis, P. and Thornhill, A., 2002, *Research Methods for Business Students*. FT Prentice Hall, London.
- Schein, E. H., 1996, 'Culture: The missing concept in organization studies', *Administrative Science Quarterly*, Vol. 41, pp. 229-240.
- Schildt, H. A., Maula, M.V.J. and Keil, T., 2005, 'Explorative and exploitative learning from external corporate ventures', *Entrepreneurship Theory and Practice*, Vol. 29 No. 4, pp. 493-515.
- Shane, S.A., 1996, 'Hybrid organizational arrangements and their implications for firm growth and survival: a study of new franchisors', *Academy of Management Journal*, Vol. 39, pp. 216-234.
- Sorenson, O. and Sørensen, J. B., 2001, 'Finding the right mix: Franchising, organizational learning, and chain performance', *Strategic Management Journal*, Vol. 22, pp. 713-724.
- Stanworth, J., 1995, 'Developing a Diagnostic Questionnaire as an Aid to Franchisee Selection', *International Franchise Research Centre Special Studies Series No.6*. University of Westminster Press, UK.

Stanworth, J., Kaufmann, J. and Dant, R. P. (Eds.), 1995, *Franchising: Contemporary Issues and Research*. The Haworth Press, Inc., New York.

Sykes, H. B. and Block, Z., 1989, 'Corporate venture obstacles: Sources and solutions', *Journal of Business Venturing*, Vol. 4 No. 3, pp.159-167.

Szymanski, D. M., Bharadwaj, S. G. and Varadarajan, P. R., 1993, 'An analysis of the market share-profitability relationship', *Journal of Marketing*, Vol. 57 No. 3, pp.1-18.

Taylor, S., 2000, 'Hotels', in Lashley, C. and Morrison, A. (Eds.). *Franchising Hospitality Services*. Butterworth Heinemann, Oxford. pp.170-191.

Welch, L. S., 1989, 'Diffusion of franchise system use in international operations', *International Marketing Review*, Vol. 6 No. 5, pp. 7-19.

Yin, K. R., 1994, *Case Study Research: Design and Methods*, Sage Publications, London.

Appendix I. Interview Subjects/ Questions

- What was the context of the particular franchise proposal? (Aimed to find out how an organisation identifies the international expansion opportunities in the market).
- Who was involved at what time during the franchise process and how? (Aimed to find out the key decision-makers and their roles).
- How was the proposal initiated? (Aimed to collect contextual data about the country or market from which proposals emerge).
- Who and which aspects promoted the proposal? (Aimed to find out the role of people in identifying franchisee opportunities and which factors are considered and interpreted by these organisational members whilst promoting the proposal).
- Who, and which aspects presented obstacles to the process, and if so how? (Aimed to explore the internal and external decision-making dynamics, particularly the international challenges faced by the organisation).
- How were these obstacles overcome (Aimed to explore how the organisation take decisions with regard to franchise projects).
- What was the role of organisational members in overcoming these obstacles and how do they select the potential franchises? (Aimed to explore how the organisational members select prospective franchise partners given the international challenges they face in different country markets).

Appendix II. The Franchising Decision-Making Guidelines

Strategic Rationale	<p>This section outlines how the project relates to organisation’s strategy for Europe, the Middle East and Africa. It covers the following:</p> <ul style="list-style-type: none"> • The reason for undertaking the project. • The organisation’s current position in the market. • The impact of the project on organisation’s position in this market and the extent to which it will give the brand a competitive advantage. • Details on key economic indicators for the country.
The Market	<p>This section provides a description of the market conditions for the hotel industry in the country/ region and describe the target market. Areas to be covered include:</p> <ul style="list-style-type: none"> • Stage of development of the industry in the country. • The market segment that is being targeted. • The main competitors. • The extent of investor interest in the hotel market. • Supply characteristics. • Demand characteristics and trends in rate and occupancy.
Financial Analysis	<p>This section covers a complete and thorough financial justification for the project including:</p> <ul style="list-style-type: none"> • Contribution to shareholder value: Net Present Value/ Internal Rate of Return. • Key performance drivers for the project’s success. • Return on investment (where organisation has invested money). • Degree of risk and potential downside/ exposure for the organisation.
Details on the Business Partners	<p>This section should provide information on the companies that the organisation is planning to do business with, including:</p> <ul style="list-style-type: none"> • General Background on the company. • Financial Strength. • Expertise in the hotel market. • The company’s strategy/ reason for undertaking the project. • How the company will finance the project.
Property Overview/ Key Milestone Sheet	<p>This section should include a brief description of the physical condition of the hotel(s) and cover any life safety issues.</p> <ul style="list-style-type: none"> • List key Project steps already achieved. • Outline key milestones to completion. Include time scale and responsibilities.

Source: adapted from company documents.