Governance of Franchising Networks, Cooperatives, and Alliances: An Introduction

Thomas Ehrmann®, Gérard Cliquet®, George Hendrikse© and Josef Windsperger®

®Institute of Strategic Management, Westfälische Wilhelms-Universität Münster, Münster, Germany
®IGR-IAE, School of Business Administration, Université de Rennes 1, Rennes, France
©Rotterdam School of Management, Erasmus University, Rotterdam, The Netherlands
®Center for Business Studies, University of Vienna, Vienna, Austria

There are many types of networks, such as franchise and retail chains, cooperatives, strategic alliances, joint ventures, and cluster relationships, that govern interorganizational transactions (Gulati, 2007; Cliquet et al., 2007; Hendrikse et al., 2008; Tuunanen et al., 2011; Hendrikse and Feng, 2012; Ménard, 2005, 2012; Grandori, 2010; Windsperger, 2012). This raises the issue of efficiency of governance of networks. This Special Issue is dedicated to developments in economics and management of networks, especially franchises, cooperatives, and strategic alliances.

A special feature of networks is that multiple independent firms have a stake in the development and outcome of the network. The multiplicity of independent entrepreneurs in a network results in incentive, control, coordination and knowledge creation problems that deserve special attention. The emphasis in the articles of this Special Issue is in line with this focus. The authors apply different theoretical perspectives on networks, such as transaction cost (TC) theory (Williamson, 1991, 2002; Marcher and Richman 2008), agency theory (Lafontaine and Slade, 2001; Blair and Lafontaine, 2005), property rights theory (Hart and Moore, 1990; Hendrikse, 2003; Baker et al., 2008), resource-based and knowledge-based theory (Kogut and Zander, 1992, 1993; Nonaka et al., 2000; Barney and Clark, 2007), organizational capability theory (Helfat et al., 2007; Teece et al., 1997), real options theory (Reuer and Tong, 2005; Leiblein, 2003; Tong and Reuer, 2007), and the relational governance perspective (Gulati, 2007; Dyer and Singh, 1998; Zaheer and Venkatraman, 1995). The Special Issue is structured into two parts:

Part I: Governance of Franchising Networks
The five articles dedicated to franchising advance and discuss new explanations for the plural form, the determinants of multi-unit franchising, the allocation of decision rights, the impact of intangible resources and explicit call options on the chain performance, and the degree of network integration.

Part II: Governance of Cooperatives and Alliances
The six articles regarding cooperatives show that cooperatives use their degrees of freedom in terms of ownership, decision, and income rights to tailor their organization to specific circumstances. This is shown empirically as well as theoretically. The five articles dedicated to alliances advance and discuss new explanations for the tendency to networks, the evolution of control and coordination.
functions in interorganizational relationships, the allocation of formal and real authority in joint ventures, the moderating role of leverage potential and relational polygamy for the value creation of relational investments in inter-firm alliances, and the impact of alliance portfolio management design on alliance performance.

FRANCHISING NETWORKS

Franchising is a contractual arrangement in which an upstream parent corporation, the franchisor, sells the right to market a product and/or service to downstream firms, the franchisees, usually in exchange for an upfront fee as well as ongoing royalties. In franchised chains, the individual outlets are run either by company managers or by franchisees who own and manage the outlet. The simultaneous use of company-owned and franchised units by a franchisor is labeled as ‘plural form’ in the franchising literature (Bradach and Eccles, 1989; Ehrmann and Spranger, 2004; Windsperger et al., 2004; Baker and Dant, 2008). Franchising firms differ considerably as regard the degree to which they rely on company ownership versus franchising—some chains are entirely franchised, whereas others have a large proportion of outlets owned and controlled by the company. Because franchising firms have to deal with both franchisees and managers, they have to use different incentives and monitoring mechanisms for actors with more or less equivalent jobs. The costs and benefits of different mixes of ownership and governance forms are at the core of franchising research.

In ‘Plural Forms—A Williamsonian Approach’, Menard studies why actors often choose to address and combine alternative modes of organizations—company-owned outlets and franchises. Building on older articles by Williamson, he extends the TC model by illustrating how the transaction at stake and the comparative benefits derived from alternative ways of coordinating assets necessitate different types of contracts. He identifies three determinants driving the use of the plural form in franchise firms: (i) ambiguity in the advantages expected from varying degrees of coordination/control over key assets; (ii) complexity making more difficult the governance of assets involved in the transaction; and (iii) strategic behavior with respect to modalities of coordinating the use of assets in relation to partners that can also be competitors.

Despite the obvious importance of chain composition, empirical research on synergies in the plural form is largely absent, and insights on performance implications of the plural form are equally scarce. In ‘The Prevalence and Performance Impact of Synergies in the Plural Form’, Meiseberg provides the first in-depth examination of the prevalence and performance effects of synergies. Detailed data from 122 chains document to what extent franchisors actually achieve synergies by using the plural form, and what types of synergies are most relevant in practice. The empirical analysis demonstrates that the synergies that franchisors seek and can actually realize are central determinants of the chosen extent of the plural form. Her empirical results also show that the relative importance of each respective synergy for coping with the four franchising imperatives—system growth, chain uniformity, local responsiveness, and system-wide adaptation—outweighs any generic explanations for chain composition as studied in previous literature. In particular, synergies that are provided by franchised outlets (rather than company units) are highly relevant for decisions on chain composition. The strongest impact on the extent of plural form stems from synergies realized by franchised outlets with regard to local responsiveness, uniformity, and system-wide adaptation. The article implies for the management of chains that not only developing cooperative norms in the chain is essential but also that franchisees should be selected such that they can provide relevant externalities to the chain.

Hussain, Perrigot, El Akremi, and Herrbach investigate the ‘Determinants of Multi-Unit Franchising’. Building on an organizational economics framework, the authors give an explanation for the percentage of multi-unit franchisees within franchise chains. Using TC theory, property rights view, and agency theory, they develop research hypotheses. They stipulate that franchisees’ transaction-specific investments have a positive influence on franchisors’ use of multi-unit franchising and that especially under a strong brand name, the franchisor relies on a higher percentage of multi-unit franchisees to reduce the free-riding risk. Their hypotheses are tested in the French franchising context by using a sample of 138 franchisors. The empirical results support their hypotheses. The combined application of different theoretical perspectives helps them to improve the explanation of the franchisor’s use of multi-unit franchising in the franchising literature.

Mumdziev and Windsperger, in their article ‘An Extended Transaction Cost Model of Decision Rights Allocation in Franchising’ include trust in transaction cost economics (TCE). This inclusion enables them to develop and test an extended TC model to explain the structure of decision rights in franchising. The empirical results show that the inclusion of trust in the TC model supplements the TC explanation of the allocation of
decision rights in franchising. On the basis of data from the German franchise sector, they find that environmental uncertainty has a negative effect on the allocation of decision rights to franchisees. Another finding is the positive effect that behavioral uncertainty has on the allocation of decision rights to franchisees. This result contradicts the traditional TC view. It implies that franchisors are more likely to delegate decision rights to franchisees when they encounter difficulties in measuring franchisees’ performance and controlling their behavior. Finally they show that trust has a moderating effect on the relationship between TC variables and franchisor’s propensity to delegate decision rights to franchisees. The study extends the franchise literature by developing a TC model of decision rights allocation and investigates the role of trust for decision rights allocation in franchising.

In ‘Real Options, Intangible Resources and Performance of Franchise Networks’, Gorovaia and Wind- sperger analyze the performance of franchise networks building on both resource-based and real options theory. They argue that the intangible resources of the franchisor and the intangible outlet-specific resources of the franchisees improve the performance of the franchise system. Adding a real options perspective, they argue that the franchisor’s use of an explicit call option in the franchise contract—that is, a clause stipulating the right to acquire franchise units—has a positive impact on both the franchisor’s managerial flexibility and the incentives for intangible investments, which should lead to improved performance of the franchise chain. The hypotheses, which are tested with data from the franchise sector in Germany, are partly supported. The novelty of the study is the common testing of resource-based and real options models of network performance in franchising. Specifically, this study contributes to the franchise literature as no prior study has applied the real options perspective to franchising.

Chaudey, Fadairo, and Solard use evidence from French distribution networks to investigate the ‘Network Integration through Franchised and Company-owned Chains’. Their sample consists of recent data from 949 French networks, which are active in a wide range of retail and services sectors. They examine the degree of vertical integration that increases from franchised chains to company-owned chains. Building on resource scarcity (signaling) theory, they hypothesize that the integration level of the network is positively (negatively) related to its maturity. Using agency theory, they conjecture that the integration level of the network is negatively related to the monitoring costs of the upstream firm and positively related to the brand name value. The empirical results of the article illustrate that the three explanatory variables, maturity, monitoring costs, and brand value, have a significant influence on the degree of network integration. In particular, it is shown that a firm’s choice of a company-owned or a franchising chain is negatively related to its resource constraints and monitoring costs, and positively related to the brand value of the networks. The result concerning maturity is in contrast to the prediction of the signaling theory.

COOPERATIVES

An agricultural cooperative is an enterprise collectively owned by many farmers (Feng and Hendrikse 2008; Hendrikse and Feng, 2012). Its main purpose is to serve the membership. They exist worldwide, in various sectors, and often coexist with investor-owned firms. Bijman, Hendrikse, and Van Oijen show in their article ‘Accommodating Two Worlds in One Organization: Changing Board Models in Agricultural Cooperatives’ that the 33 largest cooperatives in the Netherlands structure their decision rights in different ways. The ownership rights in cooperatives are formally allocated to members, but they may decide to allocate the decision rights informally to another party. The article distinguishes three allocations of decision rights between the board of directors (representing the members) and professional, outside managers: traditional model, management model, and corporation model. The latter model provides the professional management with relatively most autonomy. Cooperatives with the traditional board model are least diversified in their product portfolio, whereas cooperatives with the management model are most diversified. Traditional cooperatives outperform financially the other models, but sales growth of these cooperatives is lowest.

Cook and Burras investigate ‘The Impact of CEO Tenure on Cooperative Governance’. They establish in a sample of 461 cooperatives in the USA that long-tenured CEOs experience less board monitoring. This is primarily due to formal committees and procedural aspects of governance, such as boards of long-tenured CEOs meeting less often, engaging less in board training, having fewer executive sessions, and are less likely to include formal audit and member relations committees as part of their structure. The structure and the organization of the decision rights in cooperatives in the USA seem therefore to be related to the tenure of the CEO.
The article ‘Quality in Cooperatives versus Investor Owned Firms: Evidence from Broiler Production in Paraná, Brazil’ by Cechin, Bijman, Pascucci, Zylberstajn, and Omta investigates which governance structure provides higher quality. Quality is measured in terms of the incidence of chicken feet callus. Cooperative farmers turn out to deliver higher-quality products than the suppliers to investor-owned firms, despite that they invest less. A number of seller–buyer relationship characteristics between cooperatives and their members may be responsible for this result, such as higher dependence, lower buyer uncertainty, more market risk reduction, and more technical support than in the relationships between sellers and investor-owned firms. Cooperative management of the animal welfare problems associated with foot callus may therefore be more important for the level quality than the level of investment.

It is common in cooperatives in the Western world that members have (almost) equal voting rights and that the CEO is an outside professional. Liang and Hendrikse show in their article ‘Core and Common Members in the Genesis of Farmer Cooperatives in China’ that these features are different in cooperatives in China. The genesis of Chinese cooperatives is recent and massive, almost like a revolution. The number of cooperatives has increased from less than 100,000 to more than 500,000 in less than a decade. The genesis of cooperatives in China turns out not to be a bottom-up, collective action process of many small farmers like in many other countries. Entrepreneurial farmers and the government are crucial in the genesis of cooperatives. There are usually three or five core members in Chinese cooperatives, where one of these core members is the CEO. The core members dominate in these cooperative and have a substantial share of the ownership rights in the cooperatives.

Dietl, Duschl, Grossmann, and Lang develop a theoretical model in ‘Explaining Cooperative Enterprises through Knowledge Acquisition Outcomes’. The production costs are determined by level of generalizable as well as non-generalizable knowledge. A cooperative is a processor owned collectively by two suppliers. The suppliers differ in terms of marginal cost. The low-cost member receives a higher percentage of the cooperative’s profit than the high-cost member. The investor-owned firm is a monopsony processor dealing with the two suppliers separately. The cooperative is efficient compared with the investor-owned firm when the effect of generalizable knowledge on production costs is large and the distribution of income is skewed, but not too much, to the low-cost member. This is due to the cooperative’s ability to collectively acquire generalizable knowledge.

Huang, Fu, Liang, Song, and Xu determine empirically ‘The Efficiency of Agricultural Marketing Cooperatives in China’s Zhejiang Province’. The focus is on technical efficiency, which is decomposed into scale and pure technical efficiency. The empirical results show that there are substantial scale inefficiencies due to the small size of the cooperatives. Pure technical inefficiencies are even more important, that is, the same level of output can be generated by a much lower level of input. Local economic development, entrepreneurship of managers, and the human capital of members have a positive impact on the efficiency of cooperatives, whereas the financial leverage and the number of board members have a negative impact.

ALLIANCES

In ‘Tendency to Networks of SMEs—Combining Organizational Economics and Resource-based Perspectives’, Meiseberg and Ehrmann examine the impact of organizational economics and resource-based variables on the tendency to networks in small and medium enterprises (SMEs). Data from 348 German SMEs reveal that predictions from both theories play an important role for the tendencies of SMEs to network, yet organizational capabilities in terms of coordination and communication in alliances are more relevant for cooperation decisions than relationship-specific assets and monitoring costs. Specifically, their findings document the importance of SMEs developing coordination and communication capabilities to establish a culture of cooperation in network relationships. Consequently, this study takes a step forward to develop a more comprehensive analysis of factors influencing the tendency to networks in SMEs by combining organizational economics and organizational capabilities explanations.

In ‘Evolving Functions of Interorganizational Governance Mechanisms’, Sanchez, Velez, and Alvarez-Darque investigate the evolution of control and coordination function, as an interorganizational relationship evolves. Whereas control tends to mitigate agency costs, coordination serves the effective actual management of the interorganizational relationship, thereby facilitating value creation. Adopting a dynamic perspective by carrying out a longitudinal case study in a marketing channel, they explore the association over time between the gradual introduction of interorganizational formal governance, the evolution...
of both functions, and the evolution of the relationship. This study offers a significant contribution toward understanding the evolution of coordination and control functions in interorganizational relationships.

In ‘Formal and Real Authority in Interorganizational Networks: The Case of Joint Ventures’, Hippmann and Windsperger study the allocation of formal and real authority in international joint ventures by applying the view of Aghion and Tirole (1997). A partner has real authority when he has effective control over decisions, and a partner has formal authority when he has the right to decide. They show that intangibility of knowledge and uncertainty, because of environmental uncertainty and cultural distance, impact the allocation of formal and real authority between the joint venture partners. In addition, they provide some evidence that formal and real authority function as complements in joint venture relationships. Overall, this study contributes to the literature by presenting—to the best of our knowledge—the first empirical test of the Aghion–Tirole view on formal and real authority applied to interorganizational networks.

In ‘Value Enhancement through Value-Creating Relational Investments in Inter-firm Relationships—The Moderating Role of Leverage Potential and Relational Polygamy’, Yaqub integrates insights from TCE, value-exchange theory, and dependence perspectives to investigate the efficacy of value-creating relational investments in affecting certain revenue-enhancing behaviors in different context of supplier-buyer relationships. Specifically, this study extends the literature by examining the moderating role of leverage potential and relational polygamy on the value creation of relational investments. On the basis of 284 supplier-buyer relationships from Pakistan, the study shows that relational investments made by the focal suppliers in their intermediate buyers enhance relationship quality, which ultimately translates into an enhancement of revenues of the focal supplier firm. In addition, tests of moderating effects reveal that efficacy of the value-creating relational investments varies across different levels of leverage potential and/or the extent of relational polygamy. Consequently, this study explains the conditions under which value-creating relational investments have the greatest impact on the revenue enhancement in inter-firm alliances.

Neyens and Fæmø investigate in ‘Exploring the Impact of Alliance Portfolio Management Design on Alliance Portfolio Performance’ the design of the alliance portfolio management (APM) and its performance implications. They contribute to the alliance literature by identifying four first-order APM dimensions (formalization, hierarchy, specialization, and participation) and two second-order dimensions (mechanistic and organic APM) that explain how firms design the management of their alliance portfolios. In addition, they find that adopting an organic approach toward designing APM significantly increases alliance portfolio performance, suggesting that particular APM designs might contribute to building alliance management capabilities. In general, the study suggests that, with respect to the management of technology alliance portfolios, firms might benefit more from adopting a bottom-up approach, which emphasizes the integration of knowledge, autonomy, and participation than a top-down approach, which focuses on the institutionalization of knowledge, formalization, and specialization.

In conclusion, the articles featured in this Special Issue provide substantial insights into central governance issues of franchise chains, cooperatives, and alliances, and therefore are an essential contribution to the economics and management of network literature.

REFERENCES


