A Comparative Study of Transactional Cost Analysis in Franchising

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ABSTRACT

Franchising is a kind of hybrid organizational form, which is different from the market or hierarchy mechanism. The relationship between franchisor and franchisee is a special one because it lies in the intermediate range between employment and independent contracting. In the ‘hybrid’ organization governance, the franchise license agreement seems to embody much of the neoclassical rationale. It is born out of economic self-interest, desires to have a continuing long-term relationship. The basis for such a relationship is based on the asset specificity, i.e., the brand name in franchising. This paper explores how brand plays in the transaction cost analysis from the perspective of franchise relationship.

INTRODUCTION

Franchising is a kind of business format which has attracted lots of attention because of its lower risk of market entry and failure rate and it has developed for over 200 years. Today, many businesses adopt franchising as a growth strategy because of its basic characteristics such as high motivations from franchisees, resource constraint and so on. Therefore, franchising has become a world trend, not only well developed in industrialized countries like US and UK but also penetrating into developing country like Taiwan. In Taiwan, with the progress of internationalization and its strong purchasing power, many foreign franchisors and local franchisors have discerned this opportunity and invaded this market. Hence, one can see many franchised outlets in the Taiwanese retail market from 7-Eleven to Body Shop, 21st Century Estate Agency, McDonald’s and so on. Due to the prosperous phenomenon of franchising in the local market, many relative problems occur at the same time because this industry is in the growth stage of the life cycle. One of most important issue is on the transactional cost analysis to analyze the prevalence of franchising. The focus of transactional cost analysis is on brand, the asset specificity, which is the most valuable asset in the exchange behavior. Both franchisors and franchisees self-interested, therefore, the brand becomes the key point to maintain both party’s relationship. In this study, two different industries, the convenience store and estate agency will be examined. Most of the existing theories are examined from the perspective of western culture but in this thesis, the author tries to draw out contributions from the franchise ownership patterns in Chinese business culture. For this reason, the research was undertaken in Taiwan. Deliberately, two different industries, which typify the different faces of industry and different ownership pattern, namely, convenience store (product based) and estate agency (service based) are closely examined and compared. By a comparative research, the core issues- transaction cost analysis will be uncovered to find out the critical factors of how brand plays between franchisors and franchisees. Therefore, the aim of this paper is to uncover how the franchise brand plays between franchisors and franchisees from the perspective of transaction cost analysis.

LITERATURE REVIEW

Over the past decades, transaction cost analysis (TCA) has received an increased amount of attention from a broad range of fields, including sociology, organization theory, contract law, business strategy, corporate finance and marketing (Rindfleisch and Heide, 1997). Owing to TCA’s substantive focus on ‘exchange’, it covers a wide range of marketing phenomena. These fields include vertical integration decisions (e.g., Anderson, 1985; John and Weitz, 1988), foreign market entry strategy (e.g., Anderson and Coughlan, 1987; Klein, Frazier, and Roth, 1990), sales force control and compensation issues (e.g., Anderson, 1988; John and Weitz, 1989), industrial purchasing strategy (e.g., Noordewier,
John, and Nevin, 1990; Stump and Heide, 1996) and distribution channel management (e.g., Anderson and Weitz, 1992; Heide and John, 1988). Clearly, TCA plays an important role in marketing. The following section will first discuss TCA and then examine how TCA plays in franchising.

Firstly, we start with a brief overview of TCA and its origins. There are two institutional economic paradigms, which are new institutional economics and neoclassical economics. They have different views on the firm. Neo-classical economics view the concept of the firm as a production function (Barney and Hesterly, 1996). However, new institutional economics (TCA) views the firm as a governance structure. In the governance structure, TCA researchers have conceptualized three general types of governance structures: market, hierarchy, and hybrid or intermediate mechanisms. One of Coase's (1937) initial propositions was that firms and markets are alternative governance structures that differ in their transactional costs. Specifically, Coase propose that under certain conditions, the cost of conducting economic exchange in a market may exceed the costs of organizing the exchange within a firm. Williamson (1975, 1985) has added considerable precision to Coase’s general argument by identifying the types of exchange that are more appropriately conducted within firm boundaries than within the market. He has also augmented Coase’s initial framework by suggesting that transaction costs include both the direct costs of managing relationships and the possible opportunity costs of making inferior governance decisions. Williamson’s microanalytical framework rests on the interplay between two main assumptions of human behavior (i.e., bounded rationality and opportunism) and two key dimensions of transactions (i.e., asset specificity and uncertainty). Uncertainty can be categorized as environmental and behavioral uncertainty.

As far as the underpinning assumptions and dimensions of TCA are concerned, as mentioned, there are two assumptions about human behavior, which are bounded rationality and opportunism. Bounded rationality is the assumption that decision makers have constraints on their cognitive capabilities and limits on their rationality. Although decision makers often intend to act rationally, this intention may be circumscribed by their limited information processing and communication ability (Simon, 1957). According to TCA, these constraints become problematic in uncertain environments, in which the circumstances surrounding an exchange cannot be specified at the beginning (environmental uncertainty) and performance cannot be easily verified later (behavioral uncertainty). The primary consequence of environmental uncertainty is an adaptation problem, that is, difficulties with modifying agreements to changing circumstances. The effect of behavioral uncertainty is a performance evaluation problem, that has difficulties in verifying whether compliance with established agreements has occurred.

Opportunism is the assumption that given the opportunity, decision makers may unscrupulously seek to serve their self-interest, and that it is difficult to know a priori who is trustworthy and who is not (Barney, 1990). Williamson (1985) defines opportunism as “self-interest seeking with guile”, and suggests that it includes such behavior as lying and cheating, as well as more subtle forms of deceit, such as violating agreements. In franchising, the source of revenue is based on sales for franchisees. Therefore, franchisees may cheat on the sales in order to gain extra profit. The other possible situation is that franchisees purchase from unauthorized suppliers. This is because franchisees can get a better price or better payment conditions. Therefore, opportunism poses a problem to the extent that a relationship is supported by specific assets whose values are limited outside of the focal relationship.

Rindfleisch and Heide (1997) summarized the composition of transaction costs in the following Table 1.

<table>
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<tr>
<th>Table 1: The Composition of Transaction Cost</th>
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<tr>
<td><strong>A. Source of Transaction Costs</strong>&lt;br&gt;Nature of Governance Problem</td>
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<td>Safeguarding</td>
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<td><strong>B. Type of Transaction Costs</strong>&lt;br&gt;Direct Costs</td>
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<td>Opportunity Costs</td>
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*Source: Rindfleisch and Heide (1997)*
In the table, asset specificity creates a safeguarding problem (Rubin, 1990). Without appropriate safeguards, firms face the risks of expropriation (ex post) or productivity losses resulting from the failure to invest in specialized assets (ex ante). Environmental uncertainty creates an adaptation problem; the associated transaction costs include the direct costs of communicating new information, renegotiating agreements, or coordinating activities to reflect new circumstances. A failure to adapt involves an opportunity cost of maladaptation (Malone, 1987). Behavioral uncertainty leads to difficulties because of ex post information asymmetry regarding task performance. Information asymmetry also may exist ex ante, because of an inability to ascertain a party’s true characteristics prior to exchange. Typically referred to as adverse selection (Akerlof, 1970), this problem is more commonly associated with agency theory than with TCA. Doherty (1999) suggests that information asymmetry arises in the retail sector because of the significant amount of intangible assets involved, such as a strong retail brand and managerial technology, coupled with the complex regulatory, economic, social, cultural and retail structural boundaries which characterize the retail context. Franchising can overcome this information asymmetry problem by matching the local market knowledge of the franchise with the retail and brand know-how of the franchisor.

The basic premise of TCA is that if adaptation, performance evaluation, and safeguarding costs are absent or low, economic actors will favor market governance. If these costs are high enough to exceed the production cost advantages of the market, firms will favor internal organization. The logic behind this argument is based on certain a priori assumptions about the properties of internal organization and its ability to minimize transactional costs. Three specific aspects of organizations are relevant in this respect. First, organizations have more powerful control and monitoring mechanisms available to them than do markets, because of their ability to measure and reward behavior as well as output (Eisenhardt, 1985, Oliver and Anderson, 1987). Second, organizations are able to provide rewards that are long term in nature, such as promotion opportunities. The effect of such rewards is to reduce the payoff from opportunistic behavior. Third, Williamson (1975) acknowledges the possible effects of the organizational atmosphere, in which organizational culture and socialization processes may create convergent goals between parties and reduce opportunism ex ante.

Although the TCA framework poses the governance question as a discrete choice between market exchange and internal organization, the current version of the theory explicitly acknowledges that features of internal organization can be achieved without ownership or complete vertical integration. A variety of hybrid mechanisms have been identified in the literature, ranging from formal mechanisms, such as contractual provisions and equity arrangements (Joskow, 1987, Osborn and Baughn, 1990). Williamson (1985) notes, “Any problem that can be formulated, directly, or indirectly, as a contracting problem can be investigated to advantage in transaction cost terms.” Therefore, franchising can also be explained by transaction cost analysis because it is based on the contract between the franchisor and the franchisee.

As for how TCA may be applied to franchising, the franchise organization is a kind of hybrid organizational form that incorporates elements of both markets and hierarchies (Williamson, 1991). This is because in ‘market’ organizational governance, it is supported by classical contract law (Williamson, 1991), which is described by Macneil (1974) as “sharp in by clear agreement; sharp out by clear performance” where conflict or disagreement is ruled by a set of laws and where more formal terms supersede less formal. Clearly, this is not a form of governance that best characterizes franchising. The franchise relationship is long-term, and the parties to the agreement have interdependence whereas in discreet market interactions the asset focus is the individually traded item, and although assets such as a single purpose building and secret recipes are franchise specific asset, the principle specific asset in franchising is the shared trademark (Rindfleisch and Heide, 1997). Also, ‘hierarchy’ governance describes the individual firm as a nexus of contracts that resembles the market (Jensen and Meckling, 1976; Fama, 1980) but which must adapt through that and forbearance because of the absence of standing in the courts (Eaton and Joseph, 1988). Because the franchise relationship is an interorganizational form between two independent companies with access to the courts, it is clear that the hierarchical form of governance does not apply. In the ‘hybrid’ organization governance, the franchise license agreement seems to embody much of the neoclassical rationale. It is born out of economic self-interest, desires to have a continuing long-term relationship, and anticipates disturbances, specifically in the division of tasks, which gives the franchisor the discretion to implement change across the system for all franchisees. Therefore, it is clear that franchising is a hybrid organizational form and the excuse doctrine in contract law applies (Williamson, 1975).
In the franchise system, one of the advantages is “mass purchasing power.” However, instead of being able to purchase supplies less expensively through the franchisor, many franchisees found themselves paying exorbitant prices for supplies. One disillusioning study found that (1) the practice of requiring franchisees to purchase supplies from their franchisors is widespread; (2) franchisees believe they are being overcharged on their supplies; and (3) franchisees who must buy supplies from their franchisors suffer lower profits (Hunt and Nevin, 1975). From this point, one can doubt the cost of transaction within an organization. In theory, it should be cheaper, but actually, many franchisors overcharged on their supplies.

As to how to maintain a cooperative relationship, both parties will make tangible and intangible investments, such as equipment and training. As the relationship is based on a contract, once the contract expires, either party has the power to determine whether to continue in the relationship. Franchisees may terminate the relationship and transfer to other contractual systems such as a voluntary chain. This is because franchisees have already got the know-how to run a business. In the voluntary chain, the attraction is that franchisees do not need to pay royalties aside from the initial fee. Therefore, franchisees can absorb all the profits. From this point of view, franchisors have to think how to make franchisees undertake some specific investments in the transaction to stabilize the relationship, and make it difficult to transfer. Also, another important issue for franchisors is to maximize the channel efficiency. This is because in the competitive franchise market, there are many alternative brands for franchisees. As TCA applies to franchising through the assumption that both parties involved in the relationship are motivated by economic self-interest and will engage in opportunistic behavior to maximize their own position, how to maintain a good relationship which benefits both parties becomes a crucial issue.

**METHODOLOGY**

The method adopted in this research is a form of exploratory qualitative research, because the purpose is to provide insights and understandings of the nature of marketing phenomena (Malhotra and Birks, 2000). In addition, as a comparative case study, it compares the different stances to the issues examined (Jankowicz, 2000). The great advantage of the case study over other methods is that it attempts to be comprehensive, and involves describing and analyzing the full richness and variety of events and issues in the organizations. This case study is based on a comparison of franchises in the two industries, convenience store (CVS) and estate agency (EA) industries which typify a retail and service sector. As far as the sample frame is concerned, it is composed of eight national/international franchise brands in the Taiwanese retail market. Four of them are from the convenience store industry and the other four are from the estate agency industry. Within each brand, 3 interviews in each franchise head office and 10 franchisees from each system were selected to minimize the bias from just one or two interviews. Selection was based on stratified (national/international brand and personal network) and random purposeful (company phone lists and street visits) sampling methods. However, owing to difficulties of access, only 84 interviews were conducted (see Appendix 1), a success rate of 82%. Regarding the analysis, cross case and within case analyses were adopted to compare the collection of cases and to uncover the natural interactions and relationships between franchisors and franchisees. All the interviews were well recorded and transcribed.

**DISCUSSIONS**

Transaction cost analysis suggests that any problem that can be formulated, directly, or indirectly, as a contracting problem can be investigated in transaction cost terms. As franchising is a relationship based on a contract between the franchisor and franchisee; it can therefore be tested by transaction cost analysis. Transaction cost analysis suggests that the principal specific asset in franchising is the shared Trademark or the Brand Name. In the following section, some points were asked of both parties to examine the relationship from a transaction cost perspective.

1. **The cost of running a franchised outlet compared to a private brand**

Transaction cost analysis proposes that under certain conditions, the cost of conducting economic exchange in a market may exceed the costs of organizing the exchange within a firm. Also, this theory suggests that transaction costs
include both the direct costs of managing relationships and the possible opportunity costs of making inferior governance decisions. In theory, for franchising to be preferred, the transaction costs must be cheaper than through the market mechanism. From the franchisees’ viewpoint, we can learn whether it is in practice cheaper or not, or whether there are other reasons.

Let us see what the CVS franchisees said:

“The initial fee is higher but the ongoing cost is lower than traditional stores. Because franchisees have to pay part of the revenue to the franchisor, compared with a private brand the franchisee has to pay more out. But on the other hand, the brand can attract more customers.” (CVS1) (Franchisee 5-FC1)

“The cost of franchising is higher than the traditional store on the matters of decorations and employees salaries because the store is run for 24 hours. But the franchisee does not bear the cost of the inventory and he can order everyday.” (Niko Mart) (Franchisee 2-FC1)

“The traditional store will cost more than a franchised outlet, because a traditional store has to pay the suppliers the cost of products. As franchisees, we do not need to deal with that kind of work; it is done by the franchisor. What we earn is sent to us by the franchisor at the end of the month.” (CVS4) (Franchisee 2-FC2)

According to these comments, we learn that FC1 thinks the initial fee is higher than when operating a traditional store, because he has to pay the initial fee and decoration fee. But all other FC2 respondents think both costs are cheaper in a franchisee than operating a traditional store. The difference is mainly to do with the ownership and the sharing percentage, but generally speaking, franchising is believed to be cheaper and more efficient regarding merchandising, inventory and supplier management.

As to the EA franchisees, let us see what they said:

“The initial fee for a franchisee is higher than with a private brand. This is because that aside from the initial fee and guarantee deposit, the franchisee has to pay a royalty per month. The benefits of franchising are mainly the brand advantage, which helps franchisees attract more customers and information/experience sharing with other franchisees. A private brand has more difficulty being accepted by the public. Even so, the most important feature of all is whether the store manager and his staff can cooperate smoothly together with the same objective. If they can, then a private brand may outperform a franchised brand. As to the ongoing cost, there is no definitely answer; because that depends on how you operate the store, such as the salary system, store format, advertising and so on and each kind of running format has its own focus.” (EA1) (Franchisee 8)

“Being a franchisee, it is more expensive than being a private brand outlet in the short term. But for a long-term perspective, the franchised brand has a positive brand benefit. In other words, if a private brand wants to grow bigger, then the investment may be higher than with a franchised brand.” (EA4) (Franchisee 10)

The above statements are inclined to suggest that most single franchisees think that it is more expensive to be a franchisee, but there are advantages with regard to the brand, staff hiring, information sharing, merchandising and know-how. Some multi-unit franchisees, have different views, one franchisee said: “if I have five outlets, why not remain a private brand and endeavor to become the leading brand in the local market”. They could use the money (initial fee, guarantee deposit and royalty) to promote their private brand. Out of the four company cases, one became a multi-unit franchisee. This lead him in turn to initiating his own private brand.

Returning to CVS, multi-unit franchisees in CVS find it impossible to create their own branded stores because ownership is linked to the franchisor and they do not have experience in negotiating with suppliers.

From the perspective of transaction cost analysis, the franchise system makes franchisees invest more in the outlet. Does this mean that it is more difficult to transfer to an alternative brand? This is an interesting question and will be discussed later.

2. The importance of the brand

Aside from the cost of running a franchised outlet, another important consideration is whether the brand is worthy of being franchised compared to a traditional shop. All franchisees think that brand identity is a very important factor indeed in customers’ consumption patterns. The franchisees of CVS said:

“Yes, it is. For instance, the typical customer told me that he usually shops in 7-Eleven, and he would feel quite strange if he went to shop in other chain brands stores because the internal layout and atmosphere was always a little different” (CVS1) (Store Manager 2)
“No, I do not think so, I feel that there are two main factors influencing customers’ decision. First, they will identify a preferred chain brand and then decide which one is closer to it. This is because one of the important characteristics of the CVS is to offer ‘convenience’.” (CVS3) (Franchisee 5)

“Yes, it will be. For example, we are a subgroup of a milk company so that if customers want to drink that brand milk, they prefer buying at our outlets.” (CVS4) (Store Manager 1)

These views suggest that based on convenience, the first consumer priority is distance, followed by the brand. The brand is strongly influenced by the amount of advertising, but some customers still have preferences in their choice of brands. Traditional stores have already found it difficult to survive because the product lines, internal cleanliness, and customer services cannot compete with the chain brands.

For the EA, the franchisees had a different viewpoint:

“The brand name is an important criterion when customers choose the store outlet. People prefer those with high exposure on the TV or other media. As a result, franchised brands find it difficult to compete with the RC system where the advertising is much extensive than in franchised systems. However, from the perspective of competition between a RC and FC outlet, the FC outlet must outperform the RC outlet. This is because the high flexibility and long-term cultivation of the trading area.” (EA1) (Franchisee 4)

“Yes, it is, especially in the urban areas. However, if you cultivate your trading area for a long time, it makes no difference whether it is a RC or FC outlet. Also, with the RC, employees need to be rotated periodically; this is to their disadvantage because they cannot cultivate the area intensely and further, most staff of the RC is very young persons who have just graduated from university. With franchisees, most of the staff is experienced salesmen and as a result, if the brand factor is not, customers will count on the characteristics of the salesman rather than the brand. The reason why the RC brand is the leading brand in the market is its TV advertising, which is much more than the franchised brands. Customers were impressed by the media presentation.” (EA3) (Franchisee 4)

“The brand accounts for about 70% of the customers’ decision. The other 30% is up to the salesman’s ability. There are two special phenomena in the industry. One is professional knowledge and the other is selling skill. Generally speaking, most franchisors offer such kind of professional training, but in practice, what customers care about is whether the salesman is very zealous about their cases. As a result, the selling skill seems to be more important than professional knowledge.” (EA4) (Franchisee 5)

We note, therefore, that the brand is quite important to gain the customers’ trust in the first instance. Once a customer has identified the brand, then the following key issues are the skills and attitudes of the salesman. Also, the power of the brand is stronger in the urban areas. In the rural areas, personal networks seem more powerful than the brand name. In addition, some franchisees said that easy access to the store is an important choice factor, but then nearly all the important areas in the urban areas are occupied by chain brands. Franchisees also recognized that customers are not so familiar with the differences between the RC and FC systems. They just know whether it is a chain brand or not. A separate but important issue about the brand in the EA is that sellers care more about the brand than buyers. In other words, all agencies have to make efforts to gain the customers’ trust so that they can sell their houses.

Overall, compared with the CVS, the franchisees felt that customers in the EA care more about the brand because of the value of transactional safety. While for CVS, what customers emphasize is convenience. Another difference is that in EA, the local brands can still survive in all rural areas, but with CVS, all towns have already been invaded by chain brands, including the isolated islands. Hence, transaction cost analysis seems more useful in those areas with higher competition. In other words, in rural areas, hierarchy or market mechanism may be more likely to develop than a hybrid organization such as franchising.

3. The transference from one brand to the other

Transaction cost analysis suggests that franchisors have made franchisees undertake some specific investments in the transaction in order to keep a more stable relationship and to make it difficult to transfer. However, if the franchisor damages the relationship in some way or another franchise system offers a better package to the franchisee, then the original franchisee may transfer to another brand.

In the CVS industry, franchisees said:

“It is very difficult to transfer the brand because the store belongs to the franchisor. Also, the contract regulates that the franchisee cannot run another brand within a period of time after leaving the company.” (CVS1) (Franchisee 9)
“This does not arise because I would have to pay a further amount of money to the new franchisor and get used to the other system’s management. In the present system, if the contract period is expired, I do not need to pay anything, just continue to be the franchisee.” (CVS2) (Franchisee 9)

“It is very easy, although the contract regulates that the franchisee cannot run another brand within one year but many people do so and nothing happens. If the franchisee terminates the contract in the middle, the initial fee and guarantee fee will be expropriated by the franchisor.” (CVS3) (Franchisee 4)

From the above, we see it is not difficult to transfer from one brand to the other. But the premise is that the original contract must have expired. Otherwise, franchisees will loose out financially. Some franchisees pointed out that they are with a leading brand, so, it would senseless to transfer to an inferior brand. In the case where FC2’s property belongs to the franchisor, it makes the franchisees believe it is too difficult to transfer. In the case of FC1, franchisees have already paid the decoration fee for the store, as a result, the willingness of franchisees to transfer was very low. Many franchisees believe that every system is similar, so it is pointless to transfer.

For the EA industry, because ownership is independent, it is easier for them to transfer and the cost is relatively low compared with the CVS. This is illustrated by the following views:

“Now, it is very easy to transfer, but it has its cost. This is because I have used the brand for a long time and I have got a kind of identification with the brand although the franchisor is not perfect. For a franchisee, a new brand would be a challenge for employees and old customers, and you have to adapt to another kind of managing style.” (EA1) (Franchisee 1)

“Yes, it is very easy, some franchisors even give transferred franchisees the use of its brand freely for two years without paying royalties to attract other franchisees. So, there is vicious competition in the industry and what franchisors want is just money, nothing else.” (EA2) (Franchisee 3)

“It is very easy to change to another brand if you do not have a bad record in the industry. As to the old customers’ doubts, I just say that the service of Brand A is not as good as Brand B.” (EA4) (Franchisee 5)

Most of the franchisees in the interviewees thought that it is very easy to transfer the brand if they were not satisfied, but from the above statements, we can identify some benefits and costs if they did so. One benefit is that the franchisee can usually get a discounted initial fee or free royalty for a period of time. One cost would be that you have to explain to your customers and employees why you have made the change, and also, all the outlet’s hardware would have to be changed with the loss of your original cases. Even so, there were still many franchisees willing to transfer brands. According to the interviews, many of the franchisees now in the ChinaTrust and Century 21 networks were originally from HB or other RC systems. This is because they were not satisfied with the original franchisor, or those who worked for the RC wanted to be bosses and realize their vision.

Compared with the CVS, it is obvious that it is easier to transfer the brand in the EA industry because it is mainly related to personal interactions. However, such a high transfer rate also leads to conflicts between franchisors and the original franchisees, for instance, the original franchisee will ask why the new franchisors royalty is lower than the one he originally paid. The franchisor’s answer will be because now the industry is in recession so that they can negotiate special treatment. But old franchisees will combine together to protest about such treatment. This is typical of the vicious competition in the industry. As a result, transaction cost analysis could not be applied to such kind of case.

4. The protection of the franchisor’s brand

The brand is the most valuable asset of the franchisor; as a result, franchisors have to make efforts to protect the brand name and to promote it, rather than allowing it to become devalued by franchisees.

Hence, let us see what the franchisors said:

“Brand protection can be from two perspectives; the selection of qualified franchisees and ongoing monitoring mechanisms, based on store supervisors’ periodic visits. In addition, we will choose some stores to test the quality non-periodically. If a franchisee is not qualified by the test, then he has to attend re-training courses, otherwise, the parties’ relationship will be terminated. Between the franchisor and franchisees, there are regular meetings to communicate with each other.” (CVS1) (International)

All the other franchisors protect their brands from being damaged by regular supervision, and indicate that the followers do what the leading brand-7-Eleven does. What they do not all include is a mutual communication session.
The franchisees of the leading brand can go to the head office to talk with the management but that is not so with non-leading brands. As a result, the level of franchisees’ satisfaction is highest within 7-Eleven.

As to the EA industry, two franchisors said:

“Protection is based on the franchisor’s operational rules and norms. For example, the franchisor has got the acknowledgement of ISO 9002 and franchisees have to use the formula documents. In addition, before giving the franchise right, the franchisor has carried out a basic investigation of the franchisee. After those considerations, the interaction between the franchisor and franchisees is the next important feather of the relationship.” (EA1) (Local)

“In fact, the key point in protecting the brand is to deal satisfactorily with conflicts between franchisees and customers. This is because customers’ satisfaction derives from good service, and brand power from the satisfaction of franchisees. So, if conflicts arise between franchisees and customers, we will oblige franchisees to settle it as a service issue, but if conflicts arise from franchisees, then the franchisee’s area representatives will do the arbitrator. If there is a serious dispute, we will terminate the relationship.” (EA2) (Local)

From the above statements, we deduce that most franchisors use operational norms or contracts to regulate franchisees’ behavior. Only the franchisor of Rebar undertook monitoring similar to CVS but the frequency was not so high. The main reason for a lack of monitoring is that most EA franchisors do not have enough energy to do it. The result is that their particular brand power is not so strong as Rebar and results in a high transfer rate.

From a comparison of both industries, the common point is that both industries undertake precontractual and postcontractual checks to protect their brands. The difference is that the CVS companies carry out the franchisors’ policies thoroughly because the franchisors have carried out their duties, but the EA companies do not. This difference results in most EA franchisees being dissatisfied with their franchisors.

CONCLUSIONS

The use of transaction cost analysis reveals that brand and know-how are still the core values in transactions. If franchisees did not find the value in franchising, then the hybrid organization would disappear and be replaced by a hierarchy or market mechanism. In this research, most franchisees in the CVS industry thought that the cost of being a franchisee was lower than developing a private brand. In contrast, multi-unit franchisees in the EA did not think so. They preferred to create their own brands because they had the know-how and a management department, which served the same functions as the franchisor. So, to save costs and with a long-term perspective, they preferred to invest their money in promoting their own brand with the aim of becoming the market leader in the local area. Concerning the brand efficiency argument, both industries said it is very important but for different reasons. The CVS said ‘distance’ to the store is the main consideration, but in the EA, franchisees believed that ‘personal network’ is the most important factor of all. This latter view leads to a high brand-transferring rate when franchisees are not satisfied with the original franchisor. Another pull factor is that other franchisors lure franchisees by lowering the cost of transferring and franchisees are happy to take up these inducements. Finally, from this section, we can suggest that transaction cost analysis can be applied in a market characterized by fair competition, but where the market is subject to vicious competition, the benefit may be very low. Besides, franchisors in both industries agreed that brand protection could be enforced by precontractual and postcontractual preventative action.

REFERENCES

Anderson, E., and Weitz, B. A., (1992), The Use of Pledge to Build and Sustain Commitment in Distribution Channels in Journal of Marketing Research, 29 (February), 18-34.


### Appendix 1: The Details of Interview

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<tr>
<th>Brand</th>
<th>Local/International Franchise</th>
<th>Partner</th>
<th>Franchisee Interviewees</th>
<th>Franchisor Interviewees</th>
<th>Franchisee Characteristics*</th>
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* RC: Regular Chain (company-owned system); FC1: Franchise Chain 1 (the ownership of the store outlet belongs to the franchisee); FC2: Franchise Chain 2 (the ownership of the store outlet belongs to the franchisor)