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(Original scientific paper)

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THE IMPACT OF THE INTEGRATION OF DIGITAL MARKETING IN THE COMPANY STRATEGY OF FRANCHISES

Abstract

This article explores the long-term effects of integrating e-commerce into franchise networks. The study involved conducting semi-structured interviews with franchisees and franchisors in Italy. Short-term acceptance of e-commerce by franchisees is often influenced by power imbalances or contractual inertia. However, in the long term, franchisees are less likely to invest in franchise chains that do not involve them in e-commerce. Franchisors face the challenge of choosing between profit-sharing with franchisees or investing more in directly operated stores. It's noted that redirecting ownership could diminish the entrepreneurial value of franchising, which is vital for economic development, especially as multi-unit franchising becomes more prevalent internationally.

Keywords: digital marketing, franchising, e-commerce, entrepreneurship

JEL classification: M2, M3

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Introduction

Many franchisors introduced e-commerce platforms, assuring franchisees that it wouldn't negatively affect their businesses. Initially, this promise held true as e-commerce was small, with limited data and customer usage. However, as e-commerce grew significantly over time, franchisees began to worry about encroachment and their role in traditional retailing, feeling they might become mere instruments for franchisors to profit from e-commerce.

Research has addressed how to manage these concerns in the working relationship between franchisees and franchisors, that is caracterized by unbalanced power and that makes franchisees accept franchisor's decisions. Some research has already been done about how franchisors could communicate with them to prevent these perceptions from hurting the working relationship (Kremez, Frazer, Thaichon, 2019). What hasn't been explored yet is the long-term impact on store networks and franchisee willingness to invest. In the long run, franchisees feeling excluded from the e-commerce side of the business could lead to a shift in ownership, with more stores becoming directly operated. Currently, the percentage of directly operated stores is low, but this article examines the conditions that could change this balance and what franchisors should do to avoid the need to invest much more money in the channel.

1. FRANCHISING, ECONOMIC DEVELOPMENT AND SMALL BUSINESS ENTREPRENEURSHIP

Even countries with very different size and economic structure, like Italy and North Macedonia, share an important element in economic development. For example, in both Italy and the Republic of North Macedonia, according to the statistical offices of each countries, small businesses account for the largest share, with a percentage of more than 95% of active business entities and a fundamental role in economic development.

Unlike manufacturing companies that can cluster in industrial areas, service-oriented businesses, such as retail, need to establish multiple locations to be close to their customers. Clustering is achieved through vertical coalitions, often involving a leading company (franchisor) that licenses its format and brand to smaller retailers (franchisees). Franchisees play a vital role in representing small business entrepreneurship in retail. Franchising is seen as a means to enhance skills and promote entrepreneurship in retailing, recruiting both industry experts and newcomers as franchisees.

2. THE EVOLUTION OF A NETWORK OF STORES AND THE INTEGRATION WITH DIGITAL MARKETING

Many academic theories and approaches tried to explain why and how retail evolve (McArthur, Weaven, Dant, 2016). One of the few things we are sure about is that there is some kind of constant change in the structure and behaviour of retail companies in order to adapt to new competitive and technological opportunities, market changes, regulation constraints. If we take a retailing life cycle approach and consider how companies try to adopt technology innovation and match it with evolving customer behaviour, we then get to the conclusion that even for brick and mortar retail companies e-commerce is not an option: instead, it is a necessary and invevitable condition for most companies to operate and survive in nowadays mass markets. Thus, even companies that have an already established distribution channel structure, such as companies that have been developing and operating for many years a plural form of channel of both directly operated stores and franchised stores should develop some kind of e-commerce. In such a company an omnichannel approach should be developed, that is to say that the e-commerce should be integrated with the rest of distribution outlets and not just added to them.

The real challenge for most existing retailers is integrating digital channels with the existing retail structure. Any kind of change in the franchisor company strategy, that is nowadays usually related to digital transformation of the business model, should be evaluated not only for what regards the relationship with customers, but also for its impact on the franchisor-franchisee relationship, that has a mediating role between company activity and business results.

In literature, researchers discussed about the two different main roles of distribution channels, communication and sales (Lusch, 1979). Since the digital marketing strategy of companies almost always include an internet site for e-commerce, both roles are performed.

This double role has always been one of the strong reasons for monobrand stores: their mission is not only developing sales (that multibrand stores could do well, even if they tend to have a passive attitude in the market, as they wait for customers and use each brand opportunistically), but also creating a brand experience and attracting the right customer segments to the brand. But franchisees are now worried about franchisor's e-commerce getting sales from them. In that case, if a transactional website built and operated by the franchisor jeopardize and cannibalize sales of franchisees, such franchisees could be relegated to one of the two roles, the communication role, that does not produce profit but just costs for them.

According to EU legislation, such as that about vertical agreements (2022/720) and similar previous regulations, franchisees can operate a web site with some restrictions imposed by franchisors such that franchisees have to follow (even in the e-commerce) the pre-defined elements of the business format and cannot actively promote their e-commerce business out of their territory, so using it as an additional service for their customers. The logistic and cost complexity of running e-commerce properly are very high, with the consequence that franchisees do not nowadays tend to develop independent e-commerce very much. Different outcome is that on the side of franchisors, that were slow in adopting e-commerce but then, as we said, almost inevitably, decided to develop that new channel. This makes it such that territorial exclusivity granted with contractual clauses to franchisees gets "invaded" from the activity of franchisors. E-commerce channel sells products to customers who might be in the area where franchisees operate or could have been in touch with franchisees before.

3. ENCROACHMENT AND PROPOSED SOLUTIONS

The issue of encroachment has always existed even before e-commerce: when the franchisor or other franchisees open additional units in a particular area, existing franchisees often react negatively. This happens because when a franchise network grows, commercial areas become closer to each other: even if a certain franchisee X had been granted some kind of territorial protection in a town, the opening of another store Y in the closest town might be perceived by X as a source of danger of sales cannibalization.

E-commerce activity run by the franchisor increased this problem, because that system goes and operate with customers who can gravitate (live or work or shop) in the same area where a franchisee already operate: "through e-encroachment, a franchisor can capture franchisees' sales as if it were opening a huge company-owned outlet covering all territories" (Cliquet and Voropanova, 2016).

Semistructured interviews with 20 franchisees and 4 franchisors were done to analyze the possible solutions to prevent enroachment problems and conflicts between franchisor and franchisees.

The survival basis for the franchise network is that the transactional e-commerce website should sell the products to consumers at the same price as the stores, in order to avoid what franchisees would consider unfair price competition within the channel. It seems that this lesson has been learnt by all franchise companies, and all operators, both franchisees and franchisors, agree on that2.

The following taxonomy of possible degree of involvement of franchisees in the development of e-commerce were developed when analyzing the results from the interviews:

1) The first option is a centralised e-commerce that allows customers to shop on line and receive the product at home, charging them some money for the delivery. This would make the e-commerce product more expensive than the product purchased in a shop. This is what supermarket companies usually do.
2) A second option is a centralised e-commerce that makes customers do a "clic" (buy on line) and then collect (free of charge) at a franchised store. In this latter case the franchisee would benefit from the sale:
   2a) in one way, if the sale is then accounted for in his name;
   2b) or in another way, less interesting in the short term, that is to say that the franchisee would have the opportunity to get to know one more customer and eventually try to sell something else either that day or in the future.
3) A third option is a centralised e-commerce that allows customers to decide weather to 1) get the home delivery (not free of charge) or 2) clic and collect
4) A forth system that we have observed is a "centralised-decentralised" e-commerce, that gets franchisees involved in the system as the central web sites

[2] Of course things get more complex and very much conflictual when the franchisor also sells to multibrand e-distributors in wholesale channels, but in this paper we do not analyze this case, as we focus on monobrand networks where there are franchised stores and, in most cases, some directly operated stores.

diverts the contact to a decentralised web site (the web site which is managed by the closest franchisee to the customer home).

5) A fifth system that we have seen in the literature (but not observed directly, as it very complex and does not seem to be very popular neither among franchisors nor among franchisees) consists of giving franchisees the opportunity to be a shareholder of a new company dedicated to e-commerce (Terry, 2022).
6) One last option that have not yet been developed, but that is under investigation from a certain number of companies is about managing a centralised franchisor's e-commerce that, just for the e-commerce sales treats franchisees of the area from which customers come from (if there is a franchisee in that area) as some kind of agents, who will be granted a certaing percentage of the value of the sales; this would be a reward for the activity of brand promotion developed over time from franchisees who have been operating for many years in the area. This would align goals of franchisees with those of the franchisor and make franchisees perceive that they are part of the same business as the franchisor. Franchisees would perceive that they do not have to pay for the costs of e-commerce while obtaining some kind of "passive" (not doing any additional activity) profit. This would not make the issue of encroachment completely disappear (because the reward given to the franchisee would usually not reach the percentage of profit that would be gained by the franchisee on each sale), but it would create some more ground for synergy and channel cooperation.

4. THE CASE OF MULTI-UNIT FRANCHISING AND THE DEVELOPMENT OF E-COMMERCE

The case of multi-unit franchising started being analyzed in the literature as more and more franchisors followed this pattern of development, with franchisees running more than one store of the same network; researchrs tried to understand the degree to which multi-unit franchising was more or less efficient or effective than single-unit franchising, that was the iconic mom-and-pop franchising, where a franchisee would run one store and maintain maximum focus and the eyes of the owner on the store, with benefits from the point of view of agency theory (Kaufmann and Dant, 1996).

After more than a couple of decades since mult-unit franchising was analized as a specific form of franchising development, we can say that it has become the dominant growth mechanism for established franchising networks; in comparisor with single-unit franchising, multi-unit franchising has advantages from the point of view of both efficiency (costs) and effectiveness (revenues).

Multi-unit franchising can be developed both as a gradual sequential development or as a licence to develop a territory. In the former case, typical of Europe, franchisor decide to allow or even offer to open a new store to existing franchisees. Of course this system has the advantage of being able to select the best franchisees over time; franchisors can offer new growth opportunity to the franchisees who perform better from the different points of view, such as sales, efficiency, consistency with brand and franchisor's strategy. Over time this can be considered a very robust, even if slow, way to make the franchise network grow.

Differently from a sequential expansion, multi-unit franchising could be implemented as a licence to develop a territory; this is typical of US, where fast development is considered one of the most important matters and where there are strong investors that look at franchising not only as a way to run an entrepreneurial small business, but also from the point of view of investing money in large asset creation and management.

Whatever process through which multi-unit franchising is generated, it guarantees a lot of benefits that make it both very efficient and effective:

-Inventory management: when a franchisees run more than one store, a common inventory and wharehouse can be created. The cost of inventory can go down and the customer service (availability of the right product at the right time) can be improved.

-People management: the cost of training can be lower, as a lot easier are the systems to do training on the job and job rotation in a multi-unit franchising than in a single-unit franchising. Also, it is a lot smoother the way to cope with uncertainty and unplanned events, such as salespersons being sick or on maternity leave; in those cases, a mult-unit franchising can ask someone working at a store to go and work for some time at another store, without any need to sign new contracts or beaurocratic process, as it would be in the case of a single-unit franchisee. All this seems to be a much stonger set of people management elements in favour of multi-unit franchising, contrary to what researchers thought at the beginning of academic analysis on that kind of franchising: there was some scepticism on the ability of multi-unit franchisees to avoid the agency costs, that were one of the reasons considered at the root of franchisors' willingness to franchise the business. Within a number of stores of 4-8 stores, this seems not to be an issue.

-Cooperation attitude: about this matter, a debate in literature was not solved; on the one hand, entrepreneurs willing and able to risk the amount of capital associated with the development of large territories could be expected to have a more balanced power relationship with the franchisor and resist the influence strategies of the franchisor, being thus more reluctant to relinquish control on decisions about price, product range, location,.. (Kaufmann and Lafontaine, 1994). Other studies indicate that multi-unit operators are more willing to cooperate with franchisors, being more similar to them, for example in terms of agency problems and size: multi-unit franchisees "…are are surprisingly content to concede to franchisors' requests and accept their advice, perhaps because they encounter the same management issues as their principals (i.e., franchisors), which serves to further strengthen their incentives alignment" (Dant and Gundlach 1998, quoted by Kaufmann and Dant, 1998, p.14).

-Ability to understand market trends: multi-unit franchisees are entrepreneurs who have multiple stores and more interactions with the market, allowing them to form a more balanced perspective on trends and customer behavior. They are less influenced by isolated events in a single location, unlike single-unit franchisees, and should be listened to more attentively by franchisors. Additionally, they are better equipped to evaluate the long-term impact of e-commerce on their businesses.

Franchisors introduced e-commerce in recent years, initially with minimal impact on franchisees' sales. They portrayed it as a small operation, and due to the power imbalance, franchisees didn't strongly oppose it, even when franchisors centralized e-commerce and retained all profits. However, in recent years, the long-term effects on encroachment have become apparent, especially in large franchising networks with stores across many locations. Interviews with franchisors and franchisees highlight the need to consider different forms of franchising when launching e-commerce.

Multi-unit franchisees are much more worried about the encroachment between e-commerce and their (many) stores. The probability and the impact of franchisor-franchisee conflict can be much stronger in case of multi-unit franchisees; also, we know that the aftermath of manifest conflict can continue for very long (Winsor, Manolis, Kaufmann, Kashyap, 2012): so, it must certainly be avoided.

Multi-unit franchisees are more willing and open to engaging in various forms of collaboration between franchisors and franchisees regarding e-commerce. Consequently, franchisors with a high percentage of stores managed by multi-unit franchisees need to urgently devise strategies to involve franchisees in the e-commerce framework

5. THE OWNERSHIP REDIRECTION ALTERNATIVE AND E-COMMERCE DEVELOPMENT IN FRANCHISING

One of the two most popular explanation for franchising, together with the agency theory, was the resource scarcity hypothesis: according to this explanation, franchisors would not have the resources to develop fast a network of stores, so they would look for franchisees to do so. According to that theory, over time, in case of business success, franchisors would have taken back operation from franchisees and would directly operate (expecially the most profitable stores of the network) to obtain the full profit margin from the business and not just a franchise fee. This in fact does not extensively happen: most of the times, when franchisors decide to transform a franchised location into a directly operated store the reason is that the franchisee left or was not consistent with the franchisor format and with the brand strategy. In most other cases, franchisors continue to expand the network with the same pattern (pilot directly-operated stores and franchised stores), also trying to grow out of the national borders when possible. A strong reason is that franchisors want to keep on growing in the competitive environment and be able to defend a competitive position (which in most cases means getting stores everywhere and not just getting more profit from existing stores). Investing more resources in already operating stores would means slowing down that kind of growth.

And in fact even opposite cases has been found (Baroncelli and Manaresi, 1997) where some franchisors divested some of the pilot stores or some of the directly operated stores, to franchise them after launching the business in some specific location, to let franchisees manage better (agency theory explanation).

Thus, what we infer from our interviews is that franchisors in most cases do not see ownership redirection towards directly operated stores as the preferred solution for their company growth, but just as an extreme way in case franchisees leave or act not consistently with the business format.

In the short term, well-structured systems like franchising remained largely unaffected by the introduction of centralized e-commerce, primarily due to the stability provided by five-year contracts and the fact that single-unit franchisees often lacked immediate alternative projects. Additionally, multi-unit franchisees had substantial business operations that couldn't be easily transitioned to other ventures in a short period.

Interviews with franchisees revealed in the longer run a reduced willingness to continue investing when franchisors operated centralized e-commerce without involving franchisees.

Franchisees perceive that e-commerce has already or will eventually impact their sales, even if the evidence is challenging to prove definitively. Initially, franchisors asserted that centralized e-commerce would enhance brand visibility and benefit franchisees. Nevertheless, in the long term, especially after events like the COVID-19 pandemic that made e-commerce even more popular, questions arise about the role of physical stores, as customers sometimes visit stores to inspect products and then make online purchases. Many franchisees now fear their role will be reduced to that of showrooms with associated costs but insufficient corresponding revenues. This concern is especially pronounced among multi-unit franchisees who possess the resources and expertise to contribute positively to e-commerce development while maintaining and growing their brick-and-mortar store networks.

Conclusion

Multi-unit franchisees are more aware of the need to get someway involved in e-commerce and have more resources and skills to participate in the mechanisms to make e-commerce an opportunity for both the franchisor and franchisees.

The theoretical alternative to getting franchisees involved in e-commerce is a new wave of franchisors' direct investment in the store network needed to avoid losing market presence. But for different reasons franchisors might not be in the position to do so, expecially those whose business addresses mass segments that need capillarity of the distribution network3: the reasons are some lack of resources and a frequent specialization in manufacturing or product management rather in retailing.

If we take an general economic development perspective, an ownership redirection towards more direct investment into brick and mortar operations from franchisors (that would cease franchising to become retailers) would decrease the contribution of franchising to small business entrepreneurial development. The most important reason for which franchising has always been included in European Union block exemption regulation, being granted the possibility to do exclusive and selective distribution, is that it stimulate the diffusion and develpment of entrepreneurial activity, that is one of the bases for economic development of any country.

The power sources that franchisors should use to retale to franchisees and get them involved in e-commerce should not just be rewards and coercion, that create more tension and could make conflict become manifest, but the other three categories of the French and Raven taxonomy, such as expertise, identification and legitimation. This means that a percentage of the e-commerce business due to the business development activity of a franchisee in a territory, that would generate a perceived "passive" income for franchisees, might not be enough. The system to get franchisees involved would be better in preventing conflict if the power sources used were related to develop more business together, for example generating new capabilities and sales for the stores due to e-commerce relations with customers. And this latter involvement system would be very well accepted by multi-unit franchisees, as it would be more consistent with the nature of the entrepreneurial activity and attitudes of multi-unit franchisees.

[3] The most relevant companies operating luxury businesses have long ago (from the beginning of the nineties) taken the decision to sell products with the maximum level of control on the strategy and retail operations, that is to say that they almost always run directly operated stores and have cut franchising.

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