

Retail Franchisors Reap Superior Benefits Through Internal Co-Branding

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Executive Summary

Retail co-branding is an increasingly popular form of growth in mature business format franchises. This paper presents a study of franchised retail co-branding arrangements in Australia utilising a grounded theoretic approach building on previous case study research. Co-branding, agent theoretic and resource constraint arguments are analysed and found to be inadequate when applied to this phenomenon. The research reveals that the motivations for the development of internal co-brands into existing franchises include alignment of a suitable brand with existing retail formats and risk-averse behaviour. This research shows that co-brands are successfully created internally when franchisors are willing to modify the culture and concept of the original franchise brand in order to achieve system growth.

Key words: co-branding, asymmetrical relationships, concept development, evolution

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Introduction

Retailing activity dominates most franchising sectors and Australia is no exception. In 2008, there were 1100 business format franchise systems operating in Australia and some 44 percent of these were involved in retailing (Frazer, Weaven & Wright 2008). Retail co-branding within business format franchising has been a relatively recent phenomenon in Australia and given little attention in the literature. The focus of scrutiny has been *product* specific rather than *retail* or *organisational* co-branding although there has been a recent reflection in the literature on master co-branding with a peripheral organisational focus (Aaker, 2004; Kapferer, 2004). Alternatively, franchising literature focuses on reasons for companies to franchise, but does not adequately explain the occurrence of co-branding within this context or why mature franchisors significantly modify their retail offering from their original concept. Hence this study investigates the research question: *Why do franchisors create their own co-brands?*

Examples of retail co-branded franchising include arrangements between fast food operators and fuel retailers (such as Hungry Jacks and British Petroleum [BP]), and fast food and other retailing (such as Gloria Jeans and Borders and Subway and 7-Eleven). Franchising represents \$130 billion of the Australian gross domestic product (Frazer, et al. 2008). As most franchises operating in Australia are business format franchised, for retailing purposes this plays a significant role in the Australian retail marketplace. The expansion of franchising in Australia is represented by a similar growth in the incidence of co-branded arrangements (Frazer & Weaven, 2004; Frazer, Weaven, & Wright, 2006).

Co-branding

Many types of co-branding have been cited in the literature. For example, a *brand alliance*, *ingredient or component branding* are described as an association or combination of two or more individual brands, products and/or other distinctive proprietary assets (Hadjicharalambous, 2006; Rao & Ruekert, 1994; Simonin & Ruth, 1998), with *composite branding* as the practice of utilising two separate brands to introduce a new product (Hillyer & Tikoo, 1995; Park, Jun, & Shocker, 1996). *Retail co-branding* occurs when two or more brands combine to synergise a blended retail offering at a single location with each brand containing significant equity thereby attracting discrete target markets. The traditional assumption has been that the retail brands would be separately owned (Boone, 1997; Dahlstrom & Dato-on, 2004; Young, Hoggatt, & Paswan, 2001) but some franchised retail organisations are now creating their own co-brands as a more efficient strategy (Wright & Frazer, 2005; Young et al., 2001). Research strongly supports the notion that these alliances and co-brand creations can improve the competitive position of both brands when compared with a non-aligned strategy (Aaker, 2004; Boone, 1997; Desai & Keller, 2002; Kapferer, 2004; Keller, 2003; McCarthy & Norris, 1999; Simonin & Ruth, 1998; Washburn, Till, & Priluck, 2000).

Factors likely to be assessed when evaluating other retail brands for establishing co-branded relationships were explored with suggested antecedents as necessity, asymmetry, reciprocity, efficiency, stability, and legitimacy (Dahlstrom & Dato-on, 2004). These assumptions are supported in product specific co-branded arrangements but do not extend to franchise organisations (Wright & Frazer, 2007). Co-brands are now being created internally as part of a retail brand portfolio through strong alignment to the parent brand (Wright & Frazer, 2005; Wright, Frazer, & Merrilees, 2005). An example is the McDonald's Corporations' creation of

McCafe. Brand equity was nurtured internally through a co-brand strategy. However, discrete operations of McCafe have now commenced in locations focussed specifically on the McCafe target market. Hence, McDonald's restaurants and McCafe are now part of a brand portfolio controlled by the McDonald's Corporation (Wright, Frazer, & Merrilees, 2007). The McDonald's/McCafe example could be regarded as atypical of co-branding theory brought about by the need for McDonald's Corporation to create a new brand that best suited its needs in creating synergies across the brands for growth opportunities; large investments in systems and cultural re-alignment in order to attract separate market segments (Wright et al., 2007). This rejects current normative thinking in co-branding which states that brands with significant brand equity are more likely to be selected (Wright et al., 2007). Why is this so?

Franchising

Studies in franchising have focussed on the motivations for companies to franchise and explained the relationship between franchisor and franchisee either by resource constraints theory or incentives (Alchian & Demsetz, 1972; Hunt, 1977; Oxenfeldt & Thompson, 1969; Rubin, 1978). Subsequent pluralist expositions of mixed franchised and company owned operations supported full ownership redirection to the franchisor (Brickley & Dark, 1987; Caves & Murphy, 1976; Jensen & Meckling, 1976; Oxenfeldt & Kelly, 1969). Agency theorists discussed new directions for franchise relationships such as multiple unit franchising (Kaufmann & Dant, 1996). Signalling theory posits that franchisors manage the information flow and subsequent value attributes to potential franchisees by the structure and variation of franchise fees and/or the number of franchisor-owned outlets serving as a device to signal the quality of investments. Hence, knowledge asymmetries are created in organizational choice highlighting externalities of market imperfections (Gallini & Lutz, 1992; Lafontaine, 1993).

In the light of new strategies in franchising, such as co-branding, that present a radically new form of franchise arrangement, exploration of the motivations of this activity would seem prudent. The question is posed as to why this form of franchising has appeared in the Australian franchising sector and subsequently why franchisors choose to create and incubate their own co-brand? A discussion of the choice of research design adopted in this research is now presented.

Methodology

Constructivism was the chosen paradigm for this study because that position best provided the interpretive framework within which the research question could be explored (Charmaz, 2006; Eriksson & Kovalainen, 2008). The term ‘social constructionism’ (interchanged with the term ‘constructivism’) is used to describe an epistemology where both the researcher and the respondent receive information via their senses and use their minds to construct knowledge (Lincoln & Guba, 1985). The research design used in qualitative inquiry, especially that of grounded theory, situates the researcher in a world of experience where the elements of the paradigm (ontology, epistemology and methodology) are consistent with the purposes of the study and the nature of the inquiry (Goulding, 2002, 2005). Hence, the constructivist paradigm assumes the relativist ontology (multiple realities) with a subjectivist epistemology (where the investigator and participants/objects are interactively linked) and a naturalistic research procedure (which operationalises the constructivist paradigm). This process purports that the constructions (interpretations) can only be refined through interaction between and among the investigator and respondents (Lincoln & Guba, 1985).

Given the contemporary nature of the phenomenon of co-branding and its limited, but growing, appearance within the Australian retailing sector and the exploratory nature of the research question, a *grounded theory* method was adopted as the research tool by which data

were gathered and analysed (Charmaz, 2006; Locke, 2001). Grounded theory research is an appropriate design as this research focuses on a contemporary set of events, investigating phenomena over which the researcher has no control and the participants interact significantly with their environment. Further, the participants had expressed tacit knowledge about the activities which were under investigation. Therefore, this method allowed the investigation to retain the holistic and meaningful characteristics of the real life events (in an organisational setting) that were being explored (Locke, 2001). Initially, for this study, a single case was utilised that provided the basis for the broader investigation. McDonald's/McCafe was chosen as the initial case for theoretical, not statistical, reasons (Eisenhardt, 1989b; Goulding, 2002). This case was viewed as a collaborative venture, constructed to further the interests of the two brands in a planned, strategic format.

Data were collected from franchises representing the following brand combinations, McDonald's/McCafe; McDonald's/BP; BP/Wild Bean; and the Retail Food Group (RFG). RFG is a publicly listed company which owns the following Australian retail brands - bb's cafe, Donut King, Michelle's Patisserie and Brumby's Bakery. RFG commenced a program of co-branding in 2004. Similarly, BP has been operating Wild Bean Cafe in Australia since 2004.

From this initial stage the senior executives who were considered most involved in the co-brand process were contacted in each organisation. Nine senior executives, who were considered instrumental in creating co-branding strategies for these organisations, were interviewed and a further five strategic company documents reviewed. This was considered a

representative view of the phenomenon over all the franchise systems (Eisenhardt, 1989b; Goulding, 2002). Table 1 provides further details about these data sources.

Table 1 Data Sources

| Company | Respondent | Company documents analysed | Current co-branding relationships | Interview type |
|------------------------------------|--|---|---|-----------------|
| McDonald's | Vice-President Qld/NT | | McCafe/BP/Shell | Semi-Structured |
| “ | Operations Manager Qld/NT | | McCafe/BP/Shell | Semi-Structured |
| “ | Franchisee Qld (first suburban McCafe and ex-National Operations Manager) | | McCafe/BP/Shell | Semi-Structured |
| “ | Training Manager Qld | | McCafe/BP/Shell | Semi-Structured |
| “ | Development Manager Qld | | McCafe/BP/Shell/ Caltex/Mobil | Semi-Structured |
| “ | | Sales Building Investment Incentive Policy | McDonald's/McCafe | --- |
| “ | | McDonald's/McCafe Briefing Document | McDonald's/McCafe | --- |
| “ | | McCafe Briefing Document | McDonald's/McCafe | |
| BP | Regional Asset Manager (Qld) | | McDonald's/McCafe/ Wild Bean | Semi-Structured |
| “ | Regional Asset Manager (Vic, SA, WA) | | McDonald's/McCafe/ Wild Bean | Structured |
| “ | Regional Asset Manager (NSW) | | McDonald's/McCafe/ Wild Bean | Structured |
| Retail Food Group (RFG) | Director of Marketing | | bb's café/Donut King/Michelle's Patisserie/Brumby's Bakery | Semi-Structured |
| “ | | RFG Prospectus & 2008 Annual Report | bb's café/Donut King/Michelle's Patisserie/Brumby's Bakery | --- |

The grounded theoretic technique was then used to analyse this data (Goulding, 2005; Locke, 2001; Parry, 2004; Sekaran, 2000). Grounded theory is described as an inductive, theory discovery methodology that allows the researcher to develop a theoretical account of the

general features of a topic while simultaneously grounding the account in empirical observations or data (Glaser & Strauss, 1967). The generally accepted process of grounded theory analysis (Goulding, 2002; Parry, 2004; Strauss & Corbin, 1998) utilised in this research is as follows.

Initial data collection was obtained through semi-structured interviews (notes, recordings, transcripts) and field data (notes) as well as written correspondence, reports and memo's between senior executives (Douglas, 2003). These data were analysed through an *open coding* phase. Codes formed the basis for aggregation into concepts, or abstract/core categories/variables, through *theoretical sampling*. Labels were given to events, activities, functions, relationships, contexts, influences, and outcomes. This initial coding involved close scrutiny of the data. The aim of open coding was to begin the unrestricted labelling of all data and to assign representational and conceptual codes to each and every incident highlighted within the data. As the process moved forward, iterative reflection of that data already coded was considered so relevant new data could be collected. Coding continued until no new properties or dimensions of categories were found (Goulding, 2002; Locke, 2001; Strauss & Corbin, 1998). Table 2 lists initial categories.

Shaping constructs or theoretical coding (or sometimes known as axial coding) analysed the properties of categories and the relationships between them. This was then used to construct sub-core categories (detailed in Table 1), including which categories were causes, consequences, contingencies, co-variances, intervening conditions or contexts, around which other concepts revolved (Goulding, 2002; Parry, 2004). In particular, this interrogation of the data enabled the determination of dependent, independent, intervening and moderating variables (Parry, 1998; Spiggle, 1994). A *strategic organisational process* at the highest level

of abstraction was created. This grounded theory analysis ultimately derived a core abstract category (traditionally named a basic social process) that explains why franchisors create and nurture their own co-brands instead of partnering with other organisations (Glaser, 1992; Glaser & Strauss, 1967; Goulding, 2002; Wright & Parry, 2006). This core category is a single expression of the organisational process occurring over time.

Methodological soundness was achieved through standard measures to ensure construct validity and reliability (Carson, Gilmore, Perry, & Gronhaug, 2001; Goulding, 2002; Yin, 2003). *Construct validity* was addressed firstly by the use of multiple sources of evidence (triangulation of data) involving three stages of data collection: (i) semi-structured interviews with representative management within each franchise system; (ii) direct observation/interaction during the interview process; and (iii) perusal and analysis of company and/or respondent documents relating to each system. In addition, construct validity was obtained by establishing a chain of evidence with a database including case notes made from the interviews and observations, other documents that were collected during each case study, interview transcripts and analysis of the evidence. This database was maintained using the QSR NVivo software system which allowed for more sophisticated data manipulation than manual systems and gave extensive capability to code themes which lead to more refined saturation of categories. Finally, asking the key informants to review their interview transcripts (Eisenhardt, 1989b; Neuman, 2006; Yin, 2003) provided an additional check on the validity of the constructs used. Reliability was achieved through documentation of procedures, appropriate record keeping and making as many steps as transparent as possible (Carson et al., 2001).

Findings

This section presents the grounded theory. The three sub-core categories of expansion with risk aversion, brand tiering system, and maintenance of asymmetrical relationships are discussed and their relationship as key elements of an internalised co-branding strategy are revealed. The composition of the sub-core activities is shown in Table 2.

Table 2 Sub-Core Categories

| Sub-Core Category | Categories | Sub-Core Category | Categories | Sub-Core Category | Categories |
|-------------------------------------|---|---------------------------------------|--------------------|---|-----------------------|
| <i>Expansion with Risk Aversion</i> | Access to current franchisee arrangements | <i>Brand Tiering Selection System</i> | Brand equity | <i>Maintaining Asymmetrical Relationships</i> | Power |
| | Current staffing talent | | Brand trial | | Relationship conflict |
| | Current supply chain | | Brand leverage | | Strategic direction |
| | Limiting competition | | Co-brand design | | Legal considerations |
| | Minimising conflict | | Co-brand evolution | | Internal governance |
| | Capital incentives | | Parent brand | | |
| | | | Reinvigorate brand | | |
| | | | Location | | |

Expansion with Risk Aversion. Analysis of the data showed that franchisors were focussed on growth opportunities, wherever they might find them. As the organisations and markets (the franchisor operated in) matured, the foci changed from one of rapid geographic expansion with a simple, but rigidly managed concept, to a more adaptive and measured approach. Early external co-branded arrangements manifested as a co-operative, but distanced relationship based on the size and brand equity of each company. However, each organisation had different perceptions of how these arrangements developed and functioned.

The maintenance of expertise was paramount. This allowed for expansion to take place with as little risk as possible. For example, a McDonald's representative stated:

“... it's the McDonald's system running the food outlet. We don't have a service station franchisee (from BP) running the food outlet. It doesn't work!”

The BP representative also reinforced this notion stating *“In terms of McDonald's they are a separate businesses...”*

However, when combined with organisational and market maturity, the nature and composition of the external co-branded relationships became more difficult to manage and refocussed on internalised co-brand creations. All interviewees and data sources maintained a rigid focus on their own organisation's franchise arrangements, staffing and suppliers while building co-branded relationships.

The RFG representative stated there was no consideration of external brands in its co-brand arrangements. When asked why they focussed on areas of menu development of the current brands. Statements such as:

“I would say that the true marketing of product in the stores and the production itself are what both systems (Donut King & bb's) are concerned about internally. Certainly they are very close between the two of them. ...obviously an area where visitation from our service officer (makes it) easier to keep that franchisee under control (with national promotions) at that store for both brands...”

All organisations focussed on their area of expertise in the co-branded relationship. Weakening of this expertise was avoided at all times. From external co-branded relationships through to internal co-branding each organisation's relative position remained completely attached to the original franchise and business arrangements. Each organisation had different perceptions of how these arrangements developed and functioned, often with latent conflict. All organisations focussed on their area of expertise in the co-branded relationship. Weakening or altering this level of expertise was avoided at all times. This sub-core category

included the general aspects of franchisor expansion activities in the context of co-branding and highlighted that these activities trend away from the normal behaviour of franchisors. Franchisors developed a risk-averse attitude toward other external brands. Normal franchisor behaviour is described as risk neutral in the franchising literature (Eisenhardt, 1989a).

Brand Tiering Selection System. Organisational behaviour was considered because of the identification and selection process each franchise adopted for its co-branding partners. Analysis highlighted a complex decision making process for co-brand development that commenced at the embryonic stages of the external relationship through to the creation of an internally owned brand at maturity. Early associations with external brands presented multiple opportunities for lateral growth as the franchise system matured but these associations were viewed as a learning curve. Also, because of limited control over the co-brand association each franchise organisation looked internally to develop longer term more suitable alternatives. Franchisors trialled different types of brands, each time finding them unsuitable for partnership. A McDonald's representative stated that:

"It doesn't matter who it is. We go in with a lesser known ... company. An independent ...we have done, but it is not preferred because our branding is joined with a major brand of food/fuel BP/Shell."

A BP executive noted:

"The range of the offer (menu) was the minor element in the [co-brand] equation. The major problem was the inability of those other offers (brands) to pull enough business in. They couldn't pull the turnover within the time frame they were attractive to the public. If you wanted to get a minimum turnover of 10K per week - they couldn't pull those sorts of figures in the couple of hours that they worked."

RFG avoided external brand relationships stating:

"... [it] is ideally positioned to leverage its franchise management systems and national presence to achieve and take advantage of economies of scale through multi-brand ownership. In addition to assessing synergistic acquisition opportunities which would increase shareholder value, the Company is focused on driving organic earnings through continued and sustainable new outlet growth and driving Outlet Average Weekly Sales."

This would be achieved through a brand combination strategy derived from its own brand portfolio. McDonald's also purchased the Aroma's brand (in the UK) to include in its brand portfolio. However, the brand was subsequently sold as little opportunity was seen for successful integration. These examples highlight the differing brand strategies each organisation adopted regarding the evolution of its original concept.

This kind of organisational decision making has not been addressed effectively in both the branding and franchising literature. Branding literature has tended to focus on simplistic product co-branding and subsequent consumer perceptions of these co-brand constructs. Franchising literature has, for example, historically applied agency theory to explain franchise activities such as multiple unit franchising (replication of the original concept) but very little focus on the evolution of the franchise concept itself (Wright et al., 2007).

Maintaining Asymmetrical Relationships. Partnerships with external organisations required significant cooperation between participants to avoid conflict. As a result, the design and evolution of the co-brand structure was extensively planned and implemented. However, because of the friction created by inadequate fit between the brands and the master/servant relationship brought about by the site leasing arrangements each brand gravitated toward its own brands to form a longer term co-brand strategy. For example, when asked if McCafe could be included in the service centres co-brand arrangement (with BP) a McDonald's representative stated:

"We would prefer to have them there but BP won't let us. So you are appealing to a different type of person/traveller."

In response the BP representative commented:

“Since the evolution of the relationship in this period parking has now become a high priority. Many sites have adequate parking but customers are staying longer at McDonald’s and this adversely affects BP because potential customers for BP will drive past and not stop.”

These statements highlight the basis for friction (from both perspectives) in the externally based co-brand relationship.

Internal co-branding within each franchise system required extensive cooperation from franchisees in order for them to adopt the co-brand. Franchisees at this time could exert significant power toward the franchisor. This was manifested through financial and system concessions allowing franchisees to “do deals” that would not be a normal part of system activity. Co-brand concepts were also modified in order to be more attractive to franchisees.

The RFG representative observed that:

“Things are short-cutted in the fact that he [the franchisee] is making his donut product and he makes his muffin products at the same time. Everything is labour wise and anything else is a lot more beneficial in that way but the quality of customer service comes out of the brand, I don’t necessarily believe that he is doing anything better than anyone else...”

McDonald’s Corporation undertook an incentive program in its development of McCafe.

Company documents stated:

“The company will spend 50 cents in 2002 and 25 cents in 2003 on McCafe brand advertising for every dollar committed and spent by the Co-op on McCafe advertising in the respective year. The brand advertising will be spent proportionately in the TV markets advertising McCafe.”

Hence, co-branded arrangements required franchisors to move away from the asymmetrical relationships that formed the basis of their behaviour in each system to a more conciliatory approach, similar to the initial stages of franchising. Certainly successful franchise systems move to a more partnership based franchise relationship as they mature. However, franchisors continue to focus on power and control in the system to maintain an asymmetrical relationship (Hopkinson & Hogarth-Scott, 1999).

Conclusion and Significance

When the three sub-categories are viewed simultaneously it is clear that franchisors act to maintain power and control over their systems and are reluctant place themselves in a position of subservience by creating a retail co-brand with another franchise system. Further, they will revert to a complicated and costly process of creating their own co-brand to maintain control over their own concepts. This could be termed *risk averse symmetric growth*. This behaviour is not adequately explained by co-branding literature which states that external co-brand partners are selected because of brand equity each brand brings to the relationship (Wright & Frazer, 2007; Wright et al., 2007).

Further, in order for franchisors to create their own co-brand they behave in a similar manner to early stage franchise systems. Franchisors look to convince franchisees that the co-brand is worth adopting and thus modify the concept and costs. Throughout the process franchisors adopt a risk-averse behaviour to minimise conflict. Once the external and internal co-brands are established, asymmetrical behaviour recommences. This manifests itself in the form of standard monitoring operations and franchise sales. Standard monitoring operations include the re-establishment of staff training, supply chains and communications. Franchise sales and management includes the incorporation of the co-brand into relevant literature for prospective franchisees.

Some of the major findings in this research are as follows:

1. Franchisors will experiment with external co-brands to gain knowledge and experience.
2. Franchisors will maintain long term relationships with external tier 1 brands
3. Franchisors will create their own co-brands in order to maintain control intra-system.
4. Franchisors actively subsidise/modify the new concept in order to obtain rapid adoption by franchisees.
5. Franchisors focus solely on franchisees to adopt the co-brand. Modifying company owned outlets is not considered as a signalling tool.

A limitation of this research is its Australian context with the findings not necessarily generalisable to other settings. However, this research is significant because it seeks to explain the development of internal co-brands in mature franchise systems. This internal focus has not been previously explored in franchising literature. Moreover, this new knowledge may allow smaller franchise systems to replicate this behaviour at a far earlier stage of development, thus avoiding a costly learning curve.

Future Research Directions

Typically future directions would include suggestions to attempt an empirical study expanding and verifying the findings of this research. However, the population of franchisors provides only a small sample size of co-branded systems limiting the scope of any larger investigation. Significantly, it is the more mature systems that are successful in creating their own franchised brand portfolios with lesser known systems failing when attempting this strategy. Future research could focus on what these success factors are, and the franchisees perspective of the relationship in the process of co-branding.

In the broader franchise literature little has been discussed about the franchise concept itself with generally a tacit acceptance of a simple product/service or retail brand from which franchise systems develop. A study of concept development could provide insight into how systems (and the franchise relationship) evolve and change over time.

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