Infusing an Operational Perspective into Franchise Management

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Benjamin Lawrence and Jie J. Zhang argue that an operational perspective on franchise management combines, centralizes, and coordinates the franchise system, allowing it to thrive in the current digital economy.

Franchising is increasingly a driving force in the global service economy. Nearly three-quarters of US limited-service restaurants and 70 percent of the nation's five million hotel rooms are franchise-owned. Other service industries such as elder care and medical lab testing are also using the franchising model to expand quickly. Yet, the relationship between franchisors and franchisees is facing a future very unlike its past. Operational capabilities and innovations rooted in big data analytics, artificial intelligence, and deep learning are creating new opportunities for companies to gain a competitive edge in the service sector.[1] Are today's franchise systems up to the challenge of this transformation?

Both franchisors and franchisees must prioritize developing strong partnerships that invest in operational capabilities, including information infrastructure, customer relationship management, and distribution networks.

Recent research suggests that many franchise systems might not be prepared, primarily because they do not focus enough on the system's operational capabilities.[2] Indeed, the incentive structure of traditional franchising does not motivate network members to collectively invest in the wider system. To succeed in the future, both franchisors and franchisees must prioritize developing strong partnerships that invest in operational capabilities, including information infrastructure, customer relationship management, and distribution networks.

Chick-fil-A and Domino's Pizza are limited-service restaurant franchisors that exemplify different ways that successful franchise systems have built partnerships that invest in and benefit from network operational capabilities. However, operational capabilities are becoming more important in all service industries. The home services franchise group Neighborly understood the value of a network when it created a technology platform and customer engagement portal to support its twenty-seven brands and more than 4,800 franchises, providing plumbing, pest control, restoration, electrical, cleaning, HVAC, home inspection, and other home services. Combining service brands with technology investments in scheduling, lead generation, and customer relationship management (CRM) allows franchisors like Neighborly to improve customer experiences, delivering convenient and consistent online service, platform-wide rewards, and marketing programs. Despite being in different industries, Chick-fil-A, Domino's Pizza, and Neighborly franchisees all work to serve the end customer directly. At the same time, their franchise systems invest in operational capabilities that lower costs, improve customer experiences, and create competitive advantages in the new digital environment.

New Challenges, New Opportunities

Franchise systems are founded on an implicit win-win agreement. The common franchising tagline is, "Being in business for yourself, but not by yourself." Traditionally, franchisors manage system-level investments and brand management supported through the collection of royalty payments. Franchisees focus on operating efficiency, investing their own money to build and maintain their independently owned establishments. The franchisor and franchisees collectively invest in the brand, ensuring robust, consistent support from headquarters and smooth, profitable operations from outlets. Many of today's franchise systems rely too heavily on their franchisees to finance the network's strength by reducing their operation of corporate-owned outlets and outsourcing operational innovation to third-party vendors.[3] This failure to prioritize operational capabilities may be the result of franchisors' historical, and increasingly myopic, focus on marketing assets and branding. Financial markets, in turn, have rewarded this focus, giving higher returns to franchisors who pour resources into intangible brand assets at the expense of physical, corporately owned stores and operational infrastructure.[4] While refranchising corporate stores may not always be detrimental, it can be when franchisors stop investing in all system-wide, hard assets (e.g., system infrastructure and capabilities). Without enough system-wide support and investment, franchisees will flounder and eventually fail. Unfortunately, research in the field has tended to validate this singular focus on building brand assets, which we call the *marketing perspective*. More than a decade ago, research hailed exact replication as the key to success for franchisees, who could focus on local marketing and customer service while their franchisors used advertising royalty fees to promote a common brand identity.[5]

The Digital Revolution and Pandemic Changed Business as Usual

The rise of social media, combined with the democratization afforded by the Internet and smartphones, has brought about sophisticated digital approaches to outlet operations that are generally beyond the capabilities of individual franchisees. While the evolution of omni-channel retailing has accelerated in all sectors, no sector has been more affected than the restaurant industry. During the COVID-19 pandemic the restaurant industry had to modify its existing service model to allow customers to easily order and eat off-site. Despite the expense, many restaurants adopted the use of third-party technology intermediaries to serve consumers. A franchise system has a complex and dynamic relationship with its third-party intermediaries, which can be both cooperative and competitive. These intermediaries can benefit the franchise system by enhancing its visibility, opening up new markets, and boosting its orders. At the same time, the franchise outlets incur high commissions and fees and have less control over their consumer interactions in the digital age. The evolving marketplace has also given rise to new and innovative service offerings such as "ghost franchises." These rapidly growing brands, which exist solely in the digital realm, distribute meals by using the excess capacity of existing restaurants' kitchens, or specially developed ghost kitchens: food prep sites with no direct customer interaction.[6] They thrive on the power of integrated information systems, big data capabilities, and coordinated social media strategies. Like the delivery intermediaries Uber Eats and DoorDash, ghost franchises are an early warning sign for franchises trying to conduct business as usual in an increasingly digitalized environment. Our research suggests that, if franchise partners want to fend off the challenges fueled by the pandemic and technological advances, they must infuse their strategic thinking with an *operational perspective*.[2,7] This new management approach allows both parties to tap into the full potential of their partnership by emphasizing collaborative investment in operational capabilities and collective coordination. It ultimately helps the entire franchise network to become more efficient at both the system and local level.

Though one of the largest sectors of the franchise industry, restaurants have typically been late to adopt technology. Hotels have been comparatively more sophisticated in applying technology to operations, including reservations, yield management, and inventory distribution. Other franchise sectors, including financial services and real estate, have also incorporated information and communication technologies into their operations. The changes in the limited-service restaurant industry provide some general lessons on how to adopt an operational perspective.

Not all chains utilize franchising; some own and operate all their outlets. Corporately owned chains, Starbucks and Chipotle, are exemplars of how to jumpstart this shift to an operational perspective. To neutralize the threat of food delivery intermediaries, these companies invested in technology to keep up with shifts in customers' ordering habits and loyalty. Several trends in franchising point to the importance of such investments. One is a move toward larger, multi-unit franchisees that can afford to invest in increasingly expensive technology. Another is the consolidation of brands under large franchise holding companies. There are now dozens of franchisors that own a portfolio of brands. Restaurant Brands International, for example, owns Burger King, Tim Hortons, Popeyes, and Firehouse Subs which allows them to lower costs by leveraging common assets for several brands. Some franchisors, like Focus Brands, which owns seven brands including Jamba Juice and Cinnabon, have also adopted this portfolio model. The rise of these franchisor portfolio configurations in all industry sectors from automotive (e.g., Driven Brands) to home services (e.g., Neighborly) suggests a greater focus on leveraging integrated operations and technology infrastructure.

> This new management approach allows both parties to tap into the full potential of their partnership.

Infusing an Operational Perspective into Franchise System Management

Our work has shown that the geographic expansion of a franchise system results in a network with unique structural characteristics.[7] By having locally situated franchisee nodes, a central franchisor node, and standardized ties between them, a franchise system can take advantage of ongoing technology and market shifts (see Figure 1 for an illustration of a typical franchise network). Adopting an operational perspective means seeing franchise ties as a network instead of merely a dyadic franchisor-franchisee hierarchy. A network allows the franchisor to both multiply the return from partners' collective investments in new capabilities and improve its ability to interact with suppliers and customers.

Most importantly, a franchise network can take advantage of emerging opportunities for technology investment and accelerate its own innovations. Franchisees have valuable access not only to local markets but also to firsthand customer insight. They can innovate at the local level and then send ideas to the franchisor for further testing, standardization, and refinement. The franchisor, meanwhile, can use its centralized information technology (IT) and sophisticated data analytics to generate market intelligence and offer better solutions to the challenges franchisees face.[8] Meanwhile, the franchisor can channel franchisee investment in improving IT infrastructure and integrating operations at every level, from procurement to customer interactions, making the network ever stronger. When franchise managers focus on building these operational capabilities, it improves the relationship between the franchisees and the franchisor and drives standardization and innovation, to the delight of customers. Because they are at the center of the network, franchisors need to become experts at collating, managing, and analyzing consumer data, while sharing their discoveries with franchisees. In doing so, franchisors reward the franchisees' investment in system-wide infrastructure.

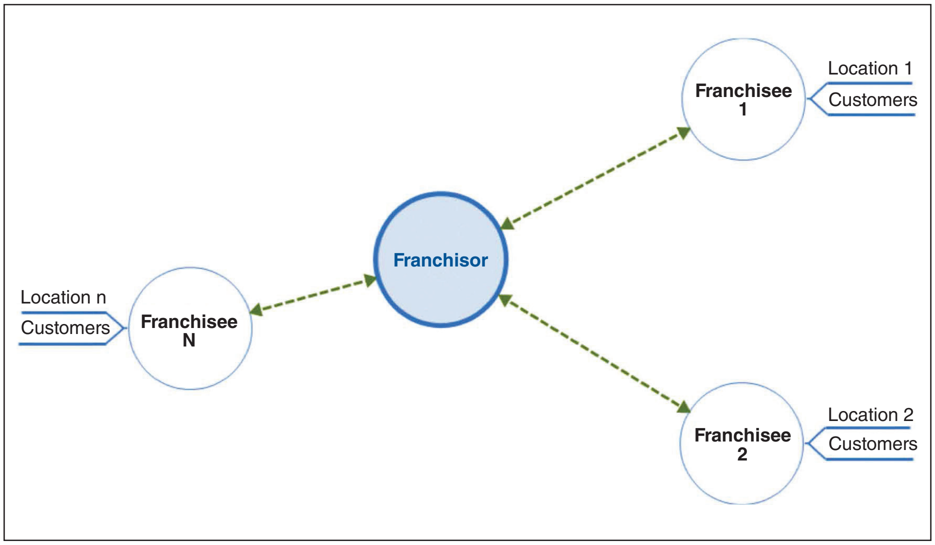
A franchise network with an operational perspective combines investments in a true collaborative partnership, centralizes investments in operational capabilities, and coordinates information sharing between all system members.

Combine, Centralize, Coordinate

A franchise network with an operational perspective *combines* investments in a true collaborative partnership, *centralizes* investments in operational capabilities, and *coordinates* information sharing between participants. A system built upon these three pillars will be ready for the challenges of today's service economy.

Given the multitude of services and products that franchise systems provide, the practical implementation of this framework can look distinctly different across franchise systems. Table 1 illustrates the implementation approaches taken by Chick-fil-A and Domino's, two leading franchise systems in the restaurant industry.

Figure 1: The franchise system is a network where a central node (franchisor) connects via standardized ties with multiple franchisee nodes in different locations.



Combine the Investments of All Partners

Franchising is often thought of as a marriage in which commitment and shared responsibility lead to mutually beneficial results. Both franchisees and the franchisors can reap rewards from investing in the firm's assets, but it is important that the franchisor's leaders consider the incentives for each entity. Franchisors traditionally compose franchise contracts with a focus on building and marketing the brand. As a result, they usually treat franchisees as licensees, or as a mere distribution channel, with the franchisor reaping increased royalties as revenue grows across the system. Franchisees, by contrast, are primarily interested in the profitability of their outlets. These competing incentives create a tension in the system as well as a suboptimal allocation of resources.[9] The current trend of reducing franchisor-owned outlets in favor of large, multi-unit franchisee operators exacerbates this tension.[10] In the worst case scenario, a full embrace of the marketing perspective results in a franchisor that manages and markets the brand to drive revenue while outsourcing all operational capabilities and service-level investment to third-party vendors and franchisees.

The operational perspective is different, driving revenue and reducing costs by focusing on shared operational excellence and investing in system-wide operational capabilities. As both partners' operational capabilities increase, the franchisees and their franchisor develop complementary strengths, improving the partnership. Both Chick-fil-A and Domino's pizza require their franchisees to be owner-operators. While this approach may initially slow growth and limit the number of multi-unit operators, it ultimately creates a healthy, interdependent franchisee-franchisor relationship that can improve long-term performance. Different companies, however, use different methods to cultivate commitment and shared responsibility. Chick-fil-A is unique in that it finances the building of its franchisee's outlets, which significantly lowers the entry barrier for

Table 1: Examples of an operational perspective on franchising

Operational Perspective	Chick-fil-A	Domino's
Combine		
▪ Franchisees join as long-term, committed operators. ▪ Franchisor invests heavily in operational capabilities.	▪ Franchisor screens franchisees on cultural fit and limits the number of franchisee-owned units to promote local ownership. ▪ Franchisor reduces barrier to entry by franchisees, funds site development, and shares in costs.	▪ Franchisor invests in delivery infrastructure and technology, limiting franchisee ownership to owner-operators.
Centralize		
▪ Franchisor develops operational capability centrally and amplifies the return by sharing it throughout the network.	▪ Franchisor invests in centralized operator support center and maintains control over operators and innovation (profit sharing, cost-sharing of investments, store design, and product development centers), increasing revenue by solving problems centrally and disseminating the resulting innovations.	▪ Franchisor invests in new system-wide technology in areas of delivery (Pizza Tracker, tailored delivery cars), ordering (mobile apps, voice ordering), and analytics, through a custom point-of-sale system.
Coordinate		
▪ Franchisees and franchisor collaborate to deliver better products and services for customers and enjoy the returns on a long-term symbiotic relationship.	▪ Franchise partners coordinate efforts and develop a repository of operational and on-demand service knowledge. Franchisor encourages mentoring of new employees and franchisees.	▪ Franchisor nurtures operational experts who can pursue one of two career paths: corporate business consultant or franchisee.

prospective franchisees who aspire to run their own stores. When franchisees eventually depart the system, they do not have assets which they can sell or pass onto other family members. Unlike most franchisees, they do not build up equity or ownership in their local outlets. Chick-fil-A's franchise partnerships are extremely cooperative to the point that they closely resemble relationships with highly incentivized store operators rather than franchisees. But the company has been so successful that its methods warrant further examination.

Combine through Acculturation

A privately held, family-owned business with very low franchisee turnover (less than 5 percent a year), Chick-fil-A is one of the largest franchise organizations. The company's approach to building compatible incentives and strengthening the franchisor-franchisee partnership is a great example of how to create a corporate culture of operational excellence. Chick-fil-A has developed a program of careful selection and acculturation to make its operations run smoothly.

Chick-fil-A offers potential franchisees easier entry than many firms, with a fee of only $10,000 to become a franchisee owner-operator. Franchise outlets with similar revenue potential in other systems require millions of dollars of investment. Unlike most franchise systems, Chick-fil-A invests its own capital into building stores, then leases them back to the franchisee. So instead of judging potential franchisees solely on their available capital, Chick-fil-A expands its pool of applicants, attracting those best suited to the company's culture. From this large pool of applicants, Chick-fil-A favors one-store owner-operators that want to invest in their local communities. The company allows a franchisee to join the system only after a rigorous selection process in which the applicant demonstrates a strong commitment to the brand. This careful selection gives the partnership a strong start.

Chick-fil-A supports this culture of collaborative partnership with a unique franchisee fee structure: "15 percent of franchised restaurant sales, less amounts charged to franchisees for equipment rentals and business services fees."[11] Chick-fil-A also takes 50 percent of its franchised restaurants' net profit. But if these fees cause franchisee outlets to experience a net loss, Chick-fil-A will reduce the operating service fee to neutralize the loss, protecting the franchisee. This fee structure offers franchisees several important safeguards, encouraging their commitment to the brand and their focus on operational excellence. Sharing profits also provides franchisees the opportunity to share in the cost of infrastructure and technology improvements, further strengthening their collaboration. The culture at Chick-fil-A thus builds trust, which helps both the franchisor and the franchisees overcome any hurdles that could lead to underinvestment and system-wide freeriding. Creating such a collective purpose also encourages franchisees to share innovations with other franchisees or with corporate employees, rather than horde information due to competitiveness.

Altogether, these franchise network characteristics foster a shared purpose that leads to a level of operational excellence that is unparalleled among other quick-service brands.[12] The Chick-fil-A model offers the low-risk benefits of a highly incentivized store-manager relationship coupled with high autonomy and growth potential for the franchisee. While this model of careful selection and enculturation is not unique to Chick-fil-A, the extent to which the franchisor and franchisees collectively invest and share in profits and losses makes it stand out.

Combine through Technology

Domino's Pizza has focused on achieving operational excellence through fast delivery. Founder Tom Monahan led the industry by making a thirty-minute delivery guarantee in 1984 that was the backbone of the Domino's brand. This focus on delivery speed has produced innovations such as an in-house, point-of-sale system called PULSE. Initially, PULSE was met with strong franchisee resistance, including a lawsuit over the company's insistence on implementing it throughout the system (see Bores et al. v. Domino's Pizza, LLC.) But after years of litigation Domino's won. PULSE created an integrated IT infrastructure across all Domino's outlets and fueled later innovations such as the pizza tracker, voice-activated ordering, and zero-click ordering.

Domino's developed these innovations in-house rather than outsourcing them to third-party developers. This decision allowed the brand to retain a competitive advantage over other brands because it could continually design a unique pizza delivery model. Domino's investments in IT infrastructure, data analytics, delivery technologies, consumer-facing apps, and reward programs make ordering as convenient as possible for customers. The brand's robust franchisee-franchisor partnership also benefits customers by increasing transparency and accountability. For example, Domino's customers can track their pizzas from ordering to delivery. Furthermore, Domino's ability to gather and share critical data such as customer demand and inventory levels across its system helps managers to make informed decisions at each site. By investing in technology such as drone and robotic delivery, franchisees can continue to compete with delivery intermediaries in the marketplace.

> This technology-enabled operational transparency and accountability model leads to a healthy cycle of investment, accountability, and performance for all franchise system partners.

Ultimately, Domino's franchisees both contribute to and benefit from the system-wide delivery infrastructure that the franchisor maintains continuously. And the return on these infrastructure investments is measurable thanks to the high visibility of the ordering and spending processes. This technology-enabled operational transparency and accountability model leads to a healthy cycle of investment, accountability, and performance for all franchise system partners.

Centralize for Efficiency

By combining forces with franchisees, companies can make the most of their centralized resources, improving their efficiency. Instead of focusing exclusively on building brand equity through advertising, the operational perspective focuses on building centralized knowledge, data analytics, and new technology that can be shared across the franchise network at a relatively low cost. Both Chick-fil-A and Domino's demonstrate how to develop capabilities centrally.

Centralize Operational Knowledge Improvement

Chick-fil-A also improved its customers' drive-thru experience. During peak hours, many Chick-fil-A outlets serve over one hundred cars per hour in the drive-thru. Both the company's success and its outlets' uncaptured potential are evident in its long queues because 60 percent of sales are from drive-thru customers. Chick-fil-A franchisees realised that not only could they increase their production speed, they could also reduce customers' wait time by improving the configuration of drive-thru lanes and redesigning ordering and delivery. The franchisees added face-to-face ordering via phone and iPad to their drive-thrus, which improved their overall throughput. This innovation was then fed back to the franchisor, where the Drive-Thru Innovation Team refined and standardized the service, even creating a mock drive-thru with actual automobiles at the corporate innovation center.

In 2012, Chick-fil-A launched Hatch, an innovation and learning center intended to strengthen its customer-, experience-centered culture. With designated work areas such as *nests* (learning spaces), *incubators* (working prototype restaurants), *coops* (collaboration areas), and *pens* (hangout space for architects and designers), Hatch was uniquely designed to foster the interchange of ideas among franchisees, researchers, designers, and staff while exploring new store layouts, services, and kitchen operations. Two years later, the company opened a second building called "The Kitchen," a space dedicated to food development.

At Hatch, the Drive-Thru Innovation Team tests how different lane widths and different ordering and delivery processes influence customer wait time, using drones to record process performance. Chick-fil-A's innovators have also developed new technology to facilitate outside meal delivery which allows workers to deliver to multiple cars at once. Other improvements include better weather protection for servers and, during the pandemic, an outside meal delivery process that ensured the safety of both servers and customers. The Drive-Thru Innovation Team develops all these solutions centrally, deploys them at individual stores, and then uses franchisee feedback to refine them.

Building a center of centralized problem solving for common franchisee challenges is not a small undertaking. However, the returns on such an investment grow exponentially as the company shares the resulting operational knowledge throughout the network.

Centralize Technology Investment

Former Domino's Pizza CEO Patrick Doyle popularized the notion that Domino's is a tech company that sells pizzas. This corporate identity reflects a laser focus on improving operational capabilities throughout the franchise network using in-house technology development.

From creating standardized pizza cartons in the 1960s to zero-click ordering in the 2010s, Domino's has proved its commitment to using technology to improve operational efficiency and customer experience. After pioneering online ordering in 2007, Domino's rolled out its Pizza Tracker in 2008, allowing customers to give their order a unique name and track it through production and delivery. Franchise customers and the operators thus became more visible to one another, which fuels efficient operations and accurately filled orders. Keeping current with consumer technology trends, the company launched a Pizza Builder app for iPad in 2014. This improvement maximized convenience for customers and made an enormous amount of data available to Domino's, which uses it to improve profitability and customer experiences at all local outlets. Domino's funnels this data through a system-wide information management platform to develop business intelligence such as "pizza profiles" for each customer. It also uses targeted advertising and predictive modeling to improve the performance of individual outlets. With delivery prediction models that input data, including customer counts and local outlet staffing, Domino's can apply big data analytics across the network, improving the accuracy of its predicted delivery times.

While individual franchisees may be the ones interacting with customers at the outlet level, they often lack the resources to invest in advanced technological infrastructure or conduct sophisticated analytics. Centralizing technology development and data analysis is, therefore, a valuable means of giving the entire system the best competitive advantage. By 2010, Domino's had invested in its PULSE point-of-sales system, an updated website, and data centers, all of which allowed managers throughout the system to make data-driven decisions. Furthermore, when Domino's uses its enhanced technological abilities to share up-to-date operational data with its franchises, it creates system-wide trust.

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Coordinate for Effectiveness (Better Product/Service for Customers)

Centralized development of new capabilities is closely linked with coordinated operations. Coordinating operations allows a franchise system to function smoothly and effectively in a dynamic environment because it emphasizes a healthy reciprocal relationship between partners who recognize the value of operational expertise. Gathering the expertise of franchise outlets, refining it through centralized analytics and innovation, and then disseminating it back to the franchisees is considerably more effective than taking a marketing perspective that views franchise outlets as a mere channel for distribution and marketing. The ongoing exchange inherent in the operational perspective not only increases operational knowledge, but also helps the company to nurture talent and connect with franchise network partners.

Coordinate through Knowledge Management and Exchange

A franchise company must share and disseminate information throughout its system if it is to succeed and improve continuously. Chick-fil-A internally captures, structures, builds, and reapplies knowledge which its Drive-Thru Innovation Team uses to solve problems. Simultaneously, the company evolves by assessing health content, integrating its processes, assessing performance, and ensuring that leaders communicate with workers throughout the franchise network. By so doing, Chick-fil-A

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can provide its franchise partners with a central knowledge repository in the form of its on-demand HELP service desk. Helping restaurants and staff get answers, solve problems, and identify opportunities, Chick-fil-A HELP is the linchpin in coordinating the exchange of operational knowledge throughout the system.

While explicit operational knowledge can be encoded into a repository, tacit knowledge resides in people. Chick-fil-A encourages organizational flexibility by rewarding individuals who move through different departments. The company even created a formal mentorship program to foster collaboration between departments. Because the process of becoming a Chick-fil-A operator is highly selective, many aspiring owner-operators start by working as either line employees in other operators' stores or in corporate operations. As corporate employees become franchisees, they take the social network and the knowledge they've already gained with them, strengthening the franchisor-franchisee relationship.

This model of knowledge repository and flexible human resource practices creates an important synergy within the organization, as the operational knowledge that is shared among partners enhances common understanding and reduces friction when workers move around the system. Furthermore, operational experts that experience different aspects of the franchise system expand the company's knowledge repository by learning from many perspectives and are better able to make tacit knowledge explicit.

Coordinate by Nurturing Boundary Spanning Operational Experts

Like Chick-fil-A, Domino's has also created spaces for collaborative engagement. In 2019 Domino's opened an Innovation Garage which allows employees from different teams to develop and test new ideas together. Domino's has also encouraged coordination through a talent management model that emphasizes the operational knowledge of both its corporate and franchisee partners. Domino's has long required prospective franchisees to be either operator-owners or have an operating partner on the ownership team. It also requires those operator-owners to have been store managers or supervisors for at least a year before they apply. Applicants must complete a franchise qualification process as well as all required tracks of Domino's Franchise Management School. Only then are they qualified to become franchisees.

Domino's further encourages operational excellence by providing management training programs for its corporate employees, ensuring that its future leaders have in-store experience. The company's Global Operation Leadership Development (GOLD) program, for example, is an accessible way to become a franchisee. A college graduate accepted into the GOLD program must complete course work and then work as assistant manager, store manager, and multi-store manager over the next five years. During this time, participants learn all aspects of operations management and corporate standards and interact with stakeholders either as internal business consultants or as franchisees.

By making franchisee-franchisor connections part of the selection process, nurturing those ties through training, Domino's encourages coordination in two ways. Because the partners already have a relationship, they can more easily coordinate with each other. And since they share a comprehensive understanding of operational excellence, effective communication, and objectives, their coordination is more likely to succeed. Domino's thus creates a virtuous cycle of sharing innovations and improves its operations throughout the franchise network.

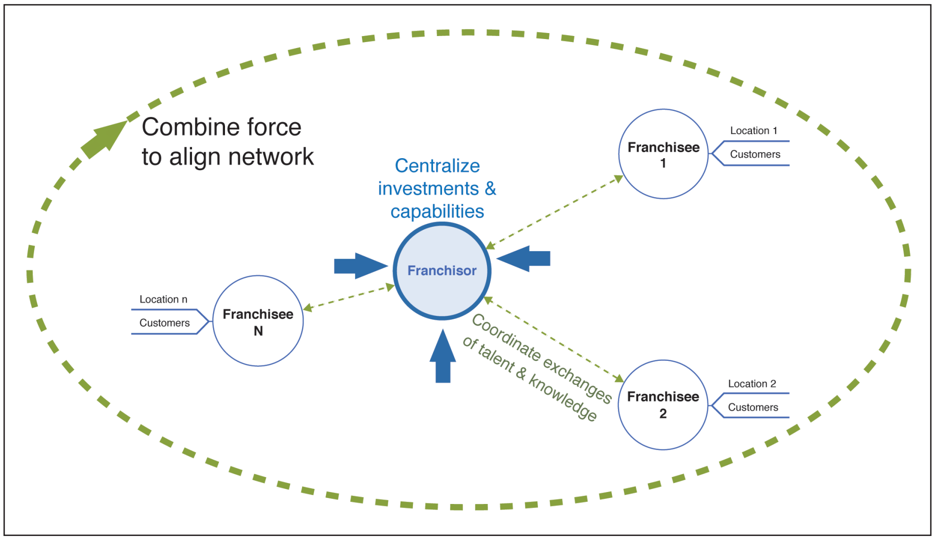
Operational Focus and Future Trends

In his seminal work on franchise organizations, Jeffrey Bradach underscored the symbiotic advantages of mutual ownership and investment in franchise systems.[13] Bradach suggested that franchise systems that have both corporate- and franchise-operated stores have significant advantages. We believe that when such organizations emphasize operational capabilities and share costs and technology, their advantages increase. Many modern franchise organizations, however, have abandoned this strategy, preferring instead to refranchise their corporate stores and outsource operational capabilities to reduce costs. By focusing on the brand as the primary driver of value, many franchisors have become sophisticated licensers instead of operational experts. We advise franchisors to refocus on the true benefits of the franchising model (see Figure 2).

Combine by focusing on long-term, mutually dependent relationships

We encourage franchise leaders to develop interdependent relationships that focus on the respective strengths of each partner.

Figure 2: An operational perspective of a franchise network that combines forces, centralizes capability development, and coordinates operational expertise exchanges in the system.



Franchisees are frontline agents of innovation and customer relations. They can gather and send back information to the franchisor. The franchisor, meanwhile, can test, standardize, and refine operational innovations at scale for the entire system. The interdependent relationship thus allows all partners to benefit from a scope that can take advantage of advances in artificial intelligence, big data analytics, and digital customer interfaces.

These interdependent relationships work best when each party is committed to long-term business growth. Some private equity firms have shorter time horizons and investment return mechanisms. Prospective franchisees therefore need to find franchisors that are interested in long-term, system-wide investment. Understanding each partner's time expectations is the first step.

> Prospective franchisees need to find franchisors that are interested in long-term, system-wide investment.

Franchisors also need to exercise judgment in finding ideal franchisees. The owner-operator model drives operational excellence in each unit, but other models exist as well. Large multi-unit operators may be better able to invest in system-wide upgrades and have the sophistication to make technical upgrades to all their units. Relationships between large multi-unit operators and franchisors, however, often resemble strategic partnerships in which a handful of large multi-unit operators maintain the operational expertise while the franchisor focuses on managing brand equity. Franchisors that wholly outsource operations to their franchisees and third-party vendors should exercise caution. Online travel agencies and food delivery platforms now wield significant power in the hotel and restaurant sectors. Occasionally, multi-unit operators can become large enough to resist changes from the franchisor, which can fuel system-wide conflict.[14] In such instances, it's critical to focus on a collective identity and culture that reduces barriers.[15] Viewing the system as a collective with a strong cultural core rather than as its disparate parts helps members to focus on the capabilities of the whole system.

Centralize by developing in-house operational capabilities and expanding the portfolio

Whenever possible, franchisors should develop operational capabilities in-house instead of outsourcing to third-party platforms. Though the immediate investment in customized operational solutions, such as IT infrastructure and innovation centers, may be greater, a long-term relationship affords more time to both recover these costs and reap the benefits. Such investments can insulate franchise systems against emerging high-tech intermediaries. As operational competencies such as delivery, customer acquisition, and online ordering have become more important, intermediaries that use tech solutions to fulfill these functions have grown more powerful. Franchise systems that control both the technical and operational capabilities are therefore more competitive.

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To achieve economies of scale, franchise systems may need to become larger or use a brand portfolio strategy that can apply investments over a greater number of brands and outlets. The hotel industry is a model of such changes, with several large players owning most of the world's branded outlets. To maximize returns on these centralized investments, franchisors should consider new configurations for expanding their network. The hotel industry uses soft brands, which offer a tailored customer-facing experience while integrating with the franchise network for the back-office functions. This allows local outlets to focus on customized solutions while benefitting from centralized capabilities.

Beyond the hospitality sector, flexible portfolio franchise arrangements that focus on centralized operational capabilities hold promise for longstanding societal problems. The healthcare industry is poised to benefit from just such a configuration. Taking a cue from the hotel industry, solo practitioners in optometry, dental, and primary care could tap into a central network's back-office capabilities while focusing on building personal relationships with patients. As artificial intelligence and robotics work to codify professional services, the application of franchising in these sectors of the economy, particularly for routine procedures, will grow.[16]

One of the latest service industry innovations offers yet another strategy for leveraging operational capabilities while scaling up. Franklin Junction, a digital platform described as the "Airbnb and Match.com of restaurants," matches companies with kitchens that have excess capacity.[6] These host kitchens distribute and serve a brand's products locally, serving a new market. The platform also helps restaurateurs apply advances in artificial intelligence and machine learning to improve customer acquisition, service, and profitability. This kind of innovation in franchise models is likely to continue. Domino's, for example, recently partnered with Uber Eats to facilitate delivery in the US and international markets.[17] Though Domino's resisted delivery ordered by third party intermediaries, this new agreement maintains Domino's delivery infrastructure and access to consumer data. Domino's strategic adjustment regarding third party delivery speaks to the changes in customer ordering behavior and expectations around delivery in the last couple of years. As a result, Domino's adapted their centralized IT infrastructure to this new reality. Some operational capabilities, such as data analytics, will continue to drive customer relationship management and product innovation and be kept in-house. Other capabilities such as app development are increasingly commoditized by advancements in machine learning and generative artificial intelligence.

Coordinate by Reducing Organizational Boundaries and Encouraging Cross-pollination

To reap the full benefits of long-term commitment and centralized operational capabilities, franchisors must disperse information throughout the system. Brands can engender the open exchange of ideas by having fewer barriers to coordination. Franchise systems should therefore establish collaborative spaces that incorporate innovations from their outlets and encourage cross-disciplinary teams to form under a shared governance model. A franchisee advisory council or an independent franchisee association could help to maintain the focus on making system-wide improvements, bridging the gaps between functions, and fostering an environment of mutual understanding.

Another way that franchisors can ensure the exchange of operational knowledge is to give corporate employees opportunities to become franchisees through internship or management training programs and reducing organizational boundaries. The initial investment needed to own an outlet nonetheless remains a significant barrier for franchisee owner-operators, so some franchisors are experimenting with ways to help with financing or reduce risk. These efforts allow for a greater diversity of franchise operators and offer more employees a path to entrepreneurship. Edible Brands, for example, introduced a Manage-To-Own Franchise Program in 2020, which allowed select candidates to earn equity toward ownership of their own Edible store. Yum! Brands, Inc collaborated with the University of Louisville and Howard University on a Yum! Franchise Accelerator focused on underrepresented people of color and women interested in the franchise restaurant industry. The ultimate goal of the program was to provide members of these underrepresented groups with an opportunity to become YUM! Brands franchisees.

Reducing organizational boundaries does, however, come with some risk. Franchisors must continually balance the tension between franchisee control and their own autonomy. Legal complications about joint-employer status and vicarious liability make it imperative that franchisees make all decisions at the outlet level. Franchisor's efforts to make best use of centralized capabilities and resources should therefore include provisions for autonomous decision making in individual stores.

Conclusion

Franchisors and franchisees need to combine, centralize, and coordinate their strategic efforts toward operational thinking. As the next wave of digital innovation in the service industry drives renewed competition in efficiency and effectiveness, franchisors will have to invest more to stay ahead of the curve. Securing buy-in for these investments, from corporate to the outlet level, is no easy task. It will require companies to rectify the mismatched incentives of the current franchise relationship, in which franchisees may freeride, dodging investment in central development, while asset-light franchisors chase revenue by recruiting ever more franchisees. Franchisors who adopt an operational perspective take a leap toward long-term success for their entire system. Companies that devise systems which thread the needle, retaining the benefits of a motivated network of independent franchisee owners while encouraging increased collective investment in operational capabilities will be the winners in this new franchising era. ■

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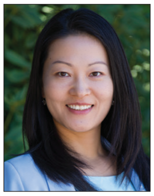

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Endnotes

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8. We recognize that the centralized investments fund the shared services discussed in Theodore Levitt's 1972 article titled "Production-line Approach to Service" (published in the *Harvard Business Review* 50, no. 5 (1972): 41-52). We decided to emphasize the "centralized" aspect of the shared IT and back-office services to reflect the importance of big data in operations in recent years. Centralized warehousing of data from customer, operations and the Internet enables additional insights and value through data analytics – a value-enhancing feature that is not as prominently stressed in his "shared" approach.
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