# TOWARDS UNDERSTANDING REAL ESTATE FRANCHISES IN AUSTRALASIA

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## Abstract

*This paper describes phase 1 of an ongoing study that explores the influence of business format franchising in the real estate agency sector in New Zealand and Australia. Using a multi stage methodology, that initially draws data from the narratives of principal directors and owners in two major franchisor organisations; the study investigates perceptions and experiences of building a franchised network. The initial results help explain why franchising continues to develop into a widespread, organisational business form in the real estate industry. Initial analyses highlights four key industry specific antecedents for the growth of franchising; individual business ownership; a rejuvenating process of acculturation; market share development and a division of responsibilities and core competencies that leads to business focus and the growth of parallel, co-dependent businesses that comprise real estate franchise systems. This pilot study precedes a wider exploration of real estate franchisors from four focal points and includes in depth case studies and quantitative survey of real estate franchise systems in Australia and New Zealand.*

## Introduction

Franchising is one of the most dynamic, fastest growing and least understood business systems in the world (Reynolds, 2002, p. 9). One of the reasons for the growth in franchising is a worldwide trend towards service-based economies including consumer desire for convenience and workforce specialisation (Naisbitt, 1985). As a collaborative business alliance, franchising is an important tool in the entrepreneur's toolbox, offering both a growth path for the franchisor and a small business opportunity, with apparent less risk for the franchisee (Knight, 1984, 1986; Kaufmann and Stanworth, 1995). To date academic research into the franchising phenomenon has ranged across industry sectors and has been largely multi disciplinary in nature. Researchers in diverse fields like marketing, law, economics, psychology and sociology have tackled franchising issues, however enquiry into why and how organisations and entrepreneurs use franchising as a key competitive weapon still poses many unanswered questions. The most debated area is the reason a firm chooses to franchise rather than expand through company owned units but there has been little attempt to examine the antecedents to franchising within specific industry settings. This initial study in the real estate agency sector answers that call.

Franchising, or more precisely, business format franchising is becoming increasingly important in the real estate agency business. In New Zealand (NZ) for example, there are approximately 572 franchisee businesses accounting for around 29% of all real estate agency businesses.[1] In addition there is a similar group including organisations like The Professionals and First National that are technically not franchises but which co-operate or network under a recognised brand and build joint marketing systems. There are currently 3,600 'franchised' real estate business units trading in Australia,

[1] Statistics gathered from The Real Estate Institute of New Zealand [Inc], *List of Licensed Real Estate Agents*, August, 2004. These totals represent all agency businesses that are currently trading under a franchise group name and are on the Institute's records.

representing 44.5% of all businesses[2]. Franchised real estate agents generated nearly half of a total income of $7.5 million in 2002-2003 (ABS, 2004) and there are 23 franchise groups affiliated to the Australian Franchise Association.

This paper presents details of the initial methodological approach and results from a pilot study exploring the reasons why some real estate organisations franchise their operations. It focuses on the perceptions and related experiences of the directors and owners of two large franchise groups from different origins - NZ and Australia. Following this introduction the paper briefly describes the concept of franchising and then franchising in the real estate agency industry in New Zealand and Australia. It considers the theoretical perspectives that inform both the questions posed and the methodological approach used in this pilot study. The initial research approach, and plans for the on going study approach, are then presented. Finally, the paper highlights some initial results from interviews with the franchisors, before drawing tentative conclusions.

**The Concept of Franchising**

Definitions of the franchise business form have continued to evolve and now appear centred on the explanation of Curran and Stanworth (1983) who contend that franchising is best described as:

> *A business form essentially consisting of an organisation (the franchisor) with a market tested business package centred on a product or service, entering into a continuing contractual relationship with franchisees, typically self financed and independently owner-managed small firms, operating under the franchisor's trade name to produce*

[2] In Australia, figures gathered by the Australian Bureau of Statistics group real estate agencies as 'franchised' if they belong to either a franchise group; a marketing group or a co operative.

> *and/or market goods or services according to a format specified by the franchisor.*

The '*franchisor*', according to Hisrich and Peters (1989) is the company granting the right; the receiver of the right is the *'franchisee'* and the right itself is the *'franchise'*. The word *'unit'* is common terminology in the literature for the individual franchise business. The relationship between the franchisor and franchisee is governed by a contractual agreement which can vary between industries (Kaufmann and Dant 1995; Kaufmann and Dant 1996). It is common for the franchisee to pay an entry fee (although this is not the case in the real estate industry) as well as continuing royalties based on a percentage of gross monthly sales (in the real estate case this is around 8-12%), and advertising fees to the franchisor.

At the heart of franchising lies an interlinked relationship, one that fundamentally changes the character of traditional small business (SME) ownership. Individuals who become involved in interlinked business forms are partners in an entity bigger than 'self'. By becoming a 'business owner cog' in a larger machine and an integral part of an organisation built on the concept of co-dependency there is an inherent ability to learn and develop by drawing on and adding to the skills and competencies of others. This idea, linked to the concepts of co-dependency and parallelism is discussed later in the paper.

**The Aims of this Paper**

This paper focuses on a form of franchising called *'business format franchising'* which not only distributes the franchise product or service through franchisee units (as in *'product distribution franchising')*, but also provides each franchisee with a standardised, proven operating business format.

Franchised businesses generate jobs for more than 18 million Americans or 8% of the private sector workforce (International Franchise Association [IFA]

Report 2004). 388,500 Australians[3] and 330,000 Britons[4] are directly employed in franchising. The latest 2003 franchising figures in NZ indicate involvement by 5% or 40,195 of the private sector workforce (Paynter, 2001). Considering New Zealand is a relative newcomer to the scene, having only had franchises since 1983 and then only established since 1990, the fact that it now has the highest number of franchise systems per capita in the world, is clear testament to the importance of franchising in the NZ economic and social context. Interestingly in 1996, New Zealand and Australia together recorded just 600 franchisors (Swartz, 1995) so the 2003 franchisor figures of 664 and 747[5] respectively indicate rapid uptake of the business form in Australasia.

Franchising appears to prevail in industry sectors ‘where efficient scales of operation diverge markedly between the production of a good/service and the production and development of the goodwill attached to it’ (Caves and Murphy 1976, p. 584). Martin (1998) suggested that any enquiry into why franchising exists must analyse the characteristics of industries where it is prevalent. In addition, industry effects represent potential confounding variables that have been largely ignored in research design thus far. Hoy & Stanworth, (2003) have called for this lack of specificity to be remedied and the real estate industry provides an interesting area in which to mitigate this research gap.

This study aims to explore the reasons why franchising has been successful as a growth mechanism for real estate organisations and to uncover some specific industry features that affect the growth and operationalisation of franchising in the sector. It deals with the following issues and poses the following questions:

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[3] Franchising Australia, 2002. A Report by The Franchise Council of Australia and the Commonwealth Bank
[4] The 2004 Nat/West/British Franchise Association Survey of Franchising
[5] The 2003 Survey of Franchising sponsored by The National Bank and organised by the Franchise Association of New Zealand and Franchising Australia 2002, the Commonwealth Bank Franchising Survey undertaken by Griffith University and sponsored by the franchising sector in Australia

- Do resource constraints, including a real estate firm's need for capital, managerial talent and intellectual resources, play any part in the decision to franchise at any time during system expansion?
- Do real estate firms franchise because the ownership of franchisee units in the system lessens moral hazard and any consequent degradation of system's quality standards?
- Are there industry specific factors that contribute to the decision to franchise in the real estate industry?
- How do real estate organisations use franchising to gain competitive advantage?

The questions are informed by some of the theoretical issues revealed by past research and the issues are discussed as they relate specifically to the real estate industry. In answering the research questions, this paper draws on the perceptions and experiences of key players in two large real estate franchise organisations, all of whom were intimately involved in the franchising decision process.

**Franchising in the Real Estate Industry**

Franchising is a highly significant strategy for business growth (Preble and Hoffman 1995) and presents real estate firms with a method of increasing their competitive advantage through growing a large network of independently owned real estate offices in geographically diverse locations. Most real estate franchises began with a single office, grew using the conventional business format of company owned units and then developed into franchise organisations because at some point franchising answered a strategic growth decision. Real estate agency in Australasia was traditionally carried out by small independent business operations, and yet in the 21$^{st}$ Century the type of inter-organisational relationships, typified by franchising, are beginning to dominate the sector.

Because the real estate industry is so competitive, the owners of small independent firms face many pressures. Real estate services are becoming increasingly specialised and delivered in differing, sophisticated modes. Local, national and international market boundaries are becoming blurred by advances in technology that allow industry participants to market property and company services, refer clients and instantly disseminate information via the Internet. Up to date market information and analysis is an essential part of everyday real estate work and access to this material can present the independent real estate office owner with time consuming extra work. Lack of knowledge or ability in these areas can lead to business failure or at least only allow a business to achieve marginal profitability. A study by Hamilton and Selen (2002), for example, makes the claim that in order to maintain competitive advantage and 'reinvent' (p.2); real estate businesses must develop a sophisticated web presence. Where there is a franchisor to drive technological advances, individual business owners will be less constrained by the need to gather the complex skills needed to adequately fulfil this challenge and more able to focus on core business competencies and profit generation.

Real estate franchise systems comprise a franchisor corporate structure that provides educational and training assistance, business development, personal development and all operational manuals, including office practice, sales and listing, management and motivational manuals. Furthermore franchisee owners are offered assistance with sales staff recruitment and retention and corporate re locations and inter-city referral networks. Individual business owner are given access to proven business systems and ongoing service team assistance from the franchisor. The franchise group corporate events management and active promotion of company pride and culture creates an atmosphere where teamwork, co operation prevail. It is difficult for independent real estate businesses to compete on this level.

Individual franchisee business owners are usually drawn from industry ranks where they have operated as independently contracted salespeople and through undertaking further education, have attained Associate status[6] or the ability to become a principal officer[7]. After experiencing sales contract work, and becoming acculturised within the industry and firm, suitable, potential franchisees are self seeded and company raised ready to operate their own franchisee businesses or bought into the system by conversion methods. This includes mergers and takeovers ranging from 'greenfielding'[8] to group buyouts. The franchised form is ready made to allow real estate franchisees who are experienced in the business to make substantial contribution to the franchise system. It is this supply of franchisees produced in the real estate brokerage business that ensures the franchise systems benefit from an ongoing flow of new blood and forms an industry specific variable. I discuss this issue that I have term 'acculturation' later in the discussion section. This phenomenon means the franchisor is confident in giving franchisees considerable leeway in business operation and the entire system stands to benefit from the development of any innovative practices that may result. The franchisors have mechanisms in place, mainly in the form of targeted meetings and discussion groups, to capture any innovative developments that might increase the competitive advantage of the system.

The real estate industry exhibits a number of features that encourage franchising. Market consumers, who engage in property buying and selling, are involved infrequently and face increasing complexity at transaction time. The need to source an appropriate property, understand local market conditions, quantify value, ensure resource compliance and structural soundness, as well as negotiate a complex legal contract, makes the process difficult for unwary and infrequent players. In these circumstances, participants require the services of the professional advice and assistance provided by real estate agents. Real estate agents have become the

[6] Directors of real estate firms must have attained associate status. In NZ this is called A.R.E.I.N.Z. and in Australia people who attain the required education level set down in state legislature can become principal officers and owners of a real estate business.
[7] In Australia, those who wish to own real estate businesses must attain principal officer status.
[8] 'Greenfielding' was described by one franchisor CEO as an intensive method of persuading individual real estate businesses to join the franchise system. This was applied in new geographic areas targeted for expansion.

‘gatekeepers’ of the vast majority of market information. At the same time, consumers may have difficulty evaluating the quality of alternative agents or the services they offer. Given these circumstances and where the process of gathering necessary information is costly to acquire, the assurance of a franchise brand name may be particularly beneficial to consumers.

At the pilot stage of this exploratory study, focus is on two of the biggest franchise organisations who were chosen because of their high value brand recognition and because they have different origins, one being a NZ organisation and the other Australian. Both franchisors have chosen to expand internationally at the same time as they move to increase their presence in their domestic markets.

**Theoretical Considerations**

Explanation of why companies choose to franchise is based on two classic positions: the agency view and the resource scarcity view. Agency view suggests that franchising overcomes the need to closely monitor the work and standards of a chain of dispersed business units and that lowered monitoring costs are seen as an antecedent to franchising across industries. Issues are raised in relation to moral hazard dilemma, or the temptation to shirk work responsibilities if a manager of a business is not the owner (Caves & Murphy 1976; Rubin 1978 and Brickley et al., 1991). Although franchising does not totally remove the moral hazard dilemma, it can be controlled by the franchise contract which divides responsibility regarding quality control and the risk bearing efficiency of each party. Because franchisees invest their own capital and are residual claimants or owners of the business with the ability to profit from the reversionary sale, their business effort is better assured. The franchisor benefits as well and overall costs associated with this benefit are lower than those where corporate employees are used (Hoy & Stanworth, 2003).

Empirical research has validated these claims in two ways. First, La Fonteine (1992a) reported that contractually defined compensation due to both the franchisor and the franchisee adjusts to reflect the effort of each party. Secondly, franchised units typically display higher profits (Sheldon, 1967) and lower payroll costs (Krueger, 1991) than company owned units. This could be accounted for by the greater effort expended by franchisees to both grow their businesses and to keep costs down by close monitoring of employees. In this way higher levels of profitability are achieved. Jensen and Meckling (1976) concur by pointing out that the moral hazard dilemma of shirking and prerequisite taking is more likely to occur amongst company owned units as managers have less to lose. In the real estate sector there has been some disagreement. It has been claimed that franchising has a negative effect on efficiency (Anderson & Fok 1998). Although franchised real estate firms were found to be more efficient in allocating resources, non franchised firms achieved greater scale and technical efficiency. Conversely, Lewis and Anderson (1999) found that in competitive market conditions, franchised businesses are substantially more cost efficient than their independent counterparts.

Franchising does appear to have some related cost issues though and these are associated with inefficient risk bearing features (Hoy & Stanworth, 2003). If a franchisee has a large proportion of his wealth and income tied to his unit's performance, his investment portfolio is relatively undiversified. This inefficiency generates two types of agency costs. Firstly a franchisee is less likely than a more diversified firm manager to make optimal investment decisions in the course of everyday business. Hoy and Stanworth (2003) argue that by his choice of a franchised business venture, the franchisee demonstrates this deficiency as opposed to a manager of a company owned unit. In practical terms this might lead to the franchisee being constrained by risk aversion to the extent that he or she does not make decisions to market, expand or expend capital efficiently. Secondly inefficient risk bearing may lead to high return expectation and this may potentially led to conflict over the amount of initial fee or on going royalty payments required.

The agency approach considers the possibility that the selection of non owner managers could be sub optimal in terms of managerial talent and business acumen. Where there are problems between the parties, business *hold up* can occur whilst contract renegotiation takes place. Franchising serves to ease these possible problems because as the franchisee benefits from the residual profits of their businesses, they are provided with considerable incentive to work hard. (Norton, 1988; Rubin, 1978). When the franchisee risks losing invested capital, he/she may be less cavalier in taking on the role in the first place, thus the quality of the management will be higher. *Hold up* problems are reduced because the franchisee risks loosing his/her contract for reasons of non compliance and thus risks loosing a major investment. In this way franchising enables better alignment of the needs of both parties, even to the point where the co-dependent relationship has been likened metaphorically to a symbiotic alliance (Dana et al., 2001). The profit stream anticipated by the franchisor depends on the performance of the franchisee and vice versa.

Other researchers examining agency theory have sought an answer to the effect of monitoring costs where there is wide geographical spread into unfamiliar markets (Carney & Gedajloviv, 1991) and where evaluation of local decision making presents a problem for the franchisor (Minkler, 1990). Both situations have relevance in the real estate context as systems spread domestically and then move to internationalise. Methods employed to mitigate these issues are discussed later in the paper.

In the real estate franchise systems studied, monitoring costs however are not an issue, because of the quality of the support systems that exist. It is taken for granted that the role of the franchisor is to continually monitor and assist the franchisee and the cost involved is an essential part of the overall costs involved in building business success. In this study, both systems A (SA) and B (SB) have sophisticated regional service networks of specialist employees who work closely with franchisee owners and monthly audits serve as a timely alert to any potential problems. Monitoring cost then is assumed as a necessary measure of ensuring ongoing brand quality and the real estate franchisors build in sufficient resources to carry this necessary cost.

Hoy and Stanworth (2003) discuss what they term ‘post contractual opportunistic behaviour’ (p. 66). This is said to occur because franchisees are assumed to be subject to a risk that franchisors will not adequately promote the brand name and conversely that franchisors face the risk that franchisees will cut corners or let the name down in some way. In relation to the later point it is possible that the contracting sales role position in real estate could jeopardise the brand name reputation[9]. If franchisors perceive a real opportunism risk, franchise contracts will only be offered to a select few and the entry costs will be high. If franchisees perceive a significant opportunism risk, it may be difficult to recruit franchisees into the system and there will be a resistance to paying the ongoing royalties. In real estate, franchisor risk is controlled by the quality support and training systems and franchisee risk is virtually eliminated by recruiting franchisee owners who have been ‘acculturised’. Furthermore brand affiliation means that the offerings of a local business take on the global features associated with the global brand. The global brand in effect vouches for the locally bound business, thereby providing it with recognition and reach (Yakhlef and Maubourguet, 2004). So it is in the interests of both parties to work efficiently and thereby to minimise risk.

The resource scarcity view considers that franchisors use franchising as a way to overcome constraints to growth that might include human, financial and intellectual capital in the form of management talent or trained management. This viewpoint was first formulated by Oxenfeldt and Kelly (1968-69) who argued that the value of franchising to franchisors was dynamic and changed over time. They argued that firms prefer company ownership to manage growth because firms can expect higher rates of return

[9] Income in a real estate office is derived from two basic sources, commission on sales and rental management fees. The quality of this income stream is in the vast majority of cases, the responsibility of independent contractors called ‘salespeople’. This real estate sales force performs the work under contract to the licensed agent or franchisee for a percentage of the commission earned and the performance of these salespeople will underpin each office’s success. So the franchisor can monitor the franchisee but is less likely to have any effective control over the salespeople. There are focused attempts by the franchise in the study (and franchisees) to provide as much support for salespeople as possible but in the final analysis brand quality, at least in the public mind, will hinge on an interface with salespeople. Perhaps this ‘cost’ is a feature of the real estate environment that franchising cannot overcome easily and whether the brand marketing that characterises real estate franchises can fully overcome this explored further in the on going study.

from company owned units – a view opposed to Sheldon's (1967) earlier conclusions. Franchising was considered most advantageous in the early growth stages when the demand to achieve economies of scale required rapid expansion, and progressed to being useful at later stages for the purpose of exploiting 'marginal locations' (p. 69). After a critical mass was achieved the firm's focus would shift to maximisation of each unit's profitability. The parent firm would then move to purchase the franchisee company so that ultimately a mature franchise system would return to a majority of company owned units.

Few longitudinal studies exist to prove the idea of 'reintegration' and top managers actually have little compulsion to create fully owned chains (La fonteine and Kaufmann 1994). When tracking the progress of the real estate systems in this study, there is no evidence of any desire to revert franchise businesses to company ownership. Over the course of their development, these real estate organisations focused on developing both individual business owners as entrepreneurs and a complex service delivery system of co-dependency. The organisations displayed a progression past saturation of the national market of origin to international expansion and the more mature each system became, the more franchisees were introduced into the system. This occurred through magnification of successful franchisees into multi held units, as well as through acquisition, merger and joint venture. The franchisors see themselves as being in the business of franchising, not real estate agency and both have massive, franchise system expansion plans for the future.

Gathering resources however, may be an antecedent to franchising in some sectors. Dant et al (1992) suggested that success of an organisation was dependent on human, intellectual, informational and financial resources but that these were hard to gather at an early stage, so franchising provided a ready and relatively quick means of attaining these critical resources through the franchisee. Financial capital is required for a successful launch campaign and for underpinning start up costs and providing working capital. The franchise organisation also requires knowledge of specific desirable locations for the franchise businesses to be established, as well as access to available labour. Finally the franchisor needs site managers able to implement the proven business format in separate geographic locations. Well chosen franchisees fulfil these requirements by being added to the chain. In the real estate sector franchisees provide specialist, local knowledge to assist customers and enhance system effectiveness. In this way franchisee businesses are the local arm to the global brand – parallel and co-dependent businesses. The concept of parallelism is discussed later in the paper.

The resource scarcity model finds favour in some empirical evidence showing that immature franchisors (those less than 10 years old) are affected by commercial credit market conditions in establishing franchisee units (Martin and Justis 1993). Combs and Ketchen (1999a) illustrated that financially strong franchise organisations were more likely to have company owned units. So the argument claiming that financial resource scarcity underpins the move to franchise is divided and factors related to age, system size and the desire to grow rapidly found no support in Combs and Ketchen's 2003 meta-analysis. Furthermore, Hoy and Stanworth (2003) largely refute capital resources scarcity and in their emphasis on agency issues support the earlier work of Rubin (1978). The conclusion negating the lack of capital resources as an antecedent to franchise concurs with information gleaned from the real estate franchisors in this study.

Brickley and Dark (1987) broached the issue of informational resource scarcity amongst franchisors and found that where there was uncertainty about locations, there was more likely to be franchisee units established. In the real estate industry this can be seen when franchisors expanding nationally and internationally, take over outside agency groups. In this way local knowledge and locally trusted companies are added to the system. When 'acculturation' is complete, the system brand is fully accepted into the locality.

Research on managerial resources scarcity is more problematic. It has been suggested that franchising enables managerial growth (Thompson, 1994; Shane, 1996a). This would appear to be different in real estate because the franchisor is constantly growing franchisees by encouraging further education and providing in house training courses. The regulatory requirements mean there is a constant supply of managers and potential entrepreneurs willing to take up the role of franchisee. These self grown franchisees provide a cost competitive source of human capital for the franchisor and their local market knowledge and ability to fit into regional locations helps spread the brand name smoothly throughout the country.

In reality there are combinations of effects underpinning the decision to franchise. Certainly there are specific industry antecedents. Reasons are based on the short run and long run incentives that typically face organisations at various growth stages from pre conditions to internationalisation (Cyert & March, 1963; Hickson et al., 1971; Quinn & Cameron, 1983). The link between franchising and growth stages is demonstrated by findings discussed in the final section of this pilot study and developed further in the on going research. There is evidence that young real estate firms in NZ see franchising as a means of expansion outside the original geographic area and then eventually outside the domestic market. Nevertheless, where geographic spread is limited and family value retention important, as is the case with Auckland's major real estate group, Barfoot and Thompson, company owned units are the preferred organisational form.

**Research Methodology and Approach**

This study employed two methods of data collection – narrative and case study. The directors and shareholders of two major Australasian real estate franchise groups were interviewed over a two month period between November and December 2004, using a semi structured interview guide. It was not possible to collect a bigger sample because of timing and accessibility issues just prior to Christmas, but the situation provided an excellent opportunity for a pilot study.

The main aim was to collect the personal stories of the informants as key decision makers in their respective franchisor organisations and to seek answers to the research questions. Three of the interviewees had been with their organisations from the time the decision to follow the franchise pathway was made and the other three were acquainted with the decision process and were now in controlling managerial positions. The informants were encouraged to relate their experiences in a conversational situation so that they revealed their real life stories of being a franchisor (Czarniawski 2004) and each informant's personal views of franchising were recorded. These narrative accounts were prompted by the researcher where necessary and recorded on audiotape. A total of 6 directors were interviewed in depth - three of the interviews were face to face and three were conducted by telephone. All the interviews lasted for between 45 and 60 minutes.

Each informant expressed 'familiar narrative constructs' (Miller and Glassner 1997, p. 99-111), based on a commonality of grounding in real estate culture, but it was the 'meaningful personal insights' (Riesman, 1993) that were most telling. Each conversation was then analysed to reveal the main themes, using conversation analysis techniques (Edwards and Lampert, 1993; Psathas, 1995; ten Have, 1998; Silverman, 2001). A structured process was closely followed in order to discover the participant's coproduced meaning using a coding analysis process. I began the process with some observations and then teased out themes that could provide answers to the research questions.

To eventually produce in depth, individual case studies of the organisations, archival documents, intranet material and observation will supplement the semi-structured questionnaires. By employing the techniques of Yin (1994) and Miles and Huberman (1994), my purpose will be to provide answers to the questions of 'how' and 'why' of franchising in relation to real estate franchise systems and to study the minutiae of each system. Such avenues of enquiry will provide further data to more fully answer the research questions.

Analysis of documentation and intranet material collected from each organisation will be by a three step process:

1. What does the text say?
2. Why does it say what it does?

3. What do I think of all this?

(Hernadi 1987)

**Findings and Analysis - Franchisor Perspectives**

Initial analysis of the data collected in the interviews showed real estate industry specific antecedents to franchising and suggest a potentially promising extension to existing theoretical development. The broad results reported below highlight some of the initial findings from the in depth interviews with the key decision makers in the two major franchise organisations.

Four broad antecedents to franchising in real estate were revealed, involving issues of market share, ownership; acculturation; and focus and parallelism. See Table 1 over. These four factors underpinning the franchise decision were considered to deliver competitive advantage in the highly competitive real estate industry sector.

Table 1

**Antecedents for Franchising Growth in the Real Estate Industry**

| *Antecedents* | *Key Effects* | |
|---|---|---|
| MARKET SHARE | Achieves expansion in the early growth stage in the domestic market | Competitive Advantage |
| | Allows Internationalisation at a later growth stage | |
| ACCULTURATION | Ensures supply of company trained people as franchisees | |
| | Allows addition of trained real estate groups through mergers and acquisitions | |
| | Ensures rejuvenation through entrepreneurial development and innovation | |
| OWNERSHIP | Rewards company entrepreneurs | |
| | Reduces potential moral hazard | |
| | Reduces monitoring costs | |
| FOCUS & PARALLISM | Franchisors focus on franchise systems and a global perspective | |
| | Franchisees focus on business performance and a local perspective | |
| | Businesses at local and global level exist parallel to each other and operate co-dependently | |

### *Market Share*

The real estate industry is highly competitive and gaining market share is critical for success. Both systems in the study reached a pre condition growth stage when franchising was seen as a way to increase market share because it enabled the growth of a widespread network of businesses, at first nationally and then outside the national borders. Once the brand was sufficiently recognisable, the developed business format could be cloned in independently owned agencies. System ‘A’ (SA) made the move to franchise as a natural development resulting from ownership changes in the early years. The intention was to develop into a large single brand company different from any existing real estate operation in NZ at the time. The directors decided the organisation should franchise and provide a chance for company managers to take ownership and develop their own entrepreneurial ventures under the company brand.

Financial backing was strong and loyal, capable and experienced people were in place to take over franchised offices. The initial move was made possible by leveraging established brand awareness, developed through trading since 1888, and that encouraged franchisees to feel confident about ownership. The pre condition to franchising for SA was company maturity and an established track record allowing expansion. This occurred by selling company owned offices to new franchisee owners and taking over existing outside companies by acquisition and merger. Other real estate business owners could be persuaded to join the system. Later at the internationalisation growth stage, this brand awareness enabled further system expansion. The trust developed amongst consumers, plus the quality systems ensured other groups were eager to join the system.

Strong links, both business and training related, built with individual company managers proved invaluable and have become the core values of franchise SA today:

*… I suppose in our case because we've had such a large company owned operation we had very strong links with our business owners and I think we had a strong training ethic and those ethics those basic values have determined the type of company we are today.*

The aim of System 'B' (SB) to be the biggest real estate franchise group in the Asian Pacific region meant focusing on rapid gains in market share and franchising provided a means to that end:

*…other reasons for expansion and looking into Asian markets were to see where these markets cross over with Australia, NZ and Indonesia. In the property market its only feasible for an agency to achieve 25% market share…there are no business models higher than that – so we work towards market share rather than actual office numbers…*

A director of SB expressed a belief that quality was based on market share:

*…each office has a geographical area that is monitored for market share purposes…there are benchmarks for all offices, measured in the number of salespeople to cover the area. The…system as we call it is essentially…we have the number of salespeople to cover the area, the number of sales appropriate to the market place…we ask that each franchisee has that requirement in place…*

The original owners of SB developed into a 50 strong office group by 1974 and had established a trusted and recognised brand throughout Queensland and New South Wales. It was recognised that the managers of each office would benefit from ownership and that the system could grow faster and wider throughout Australia by franchising. After having reached a level of administrative efficiency SB was able to expand geographically and moves to NZ and Indonesia exposed an even larger potential market. A concentration on market share is central to SB. The company philosophy is simple: a strong value added corporate franchisor organisation will provide investment security for the franchisees and enable faster system expansion. The future presents ongoing challenge. One director explained that in NZ, for example, there is still about 40% growth capacity and towards that end, during 2004 two new real estate offices per week joined the group. On the international scene, capacity is unlimited.

***Ownership***

A key antecedent to franchise for both systems in the sample was the issue of ownership. This was especially so for SA, where there was an strong emphasis placed on growing and developing company people who had entrepreneurial abilities. The original owners of SA (two of whom were interviewees in this study) felt that when the company had reached 90 company owned offices there was a pool of managerial talent requiring some extra incentive to ensure ongoing success. The best way to deliver this was by direct office ownership. One interviewee said:

> *… that a share of the pie (creating independently owned offices) would increase the organisation greatly.*

He expressed an individual viewpoint by relating:

> *I think any company owned business when you've got a large number of outlets, the outlets are never going to do as well with paid employees running them as they are when the people running them actually having a share in the business, and their name on the bank account. My great, great granddad was a butcher and he always told my dad if you want to run a successful butcher shop you need to have the owner behind the counter because otherwise a kilo mince weighs more. So you have to have the person who is responsible for paying the bills running it. And equally if you*

*don't' give the people in your business the chance to expand and have ownership of what they're doing they will leave and go somewhere that they can.*

This director was expressing an agency view. Besides there was pressure from some of the company managers to become owners:

*…we had a request from a couple of them (the company managers) to franchise…*

Ownership of the individual franchised offices in both systems was not only a reward for loyal managers, providing them with an entrepreneurial opportunity, but was also seen as a way of overcoming monitoring costs associated with maintaining consistency, quality and output amongst the company managed offices. If there was any moral hazard, like managers not putting in optimal effort, franchising was considered a way to eliminate this.

The decision makers in SA outlined that ownership led to increased output and better businesses based on pride of ownership. Ownership increases satisfaction and allows entrepreneurial growth, with some franchisees expanding their operations into multi unit mini chains. The individually owned businesses become assets that have considerable reversionary value. A noteworthy comments from a directors was:

*(I get)…a 'great kick' out of seeing people grow and become successful… I think desire for their own personal growth and their own personal growth will come through by either the franchise owner or it comes through by either them making money throughout the success of their franchise or by them adding value to their business or sometimes having a succession plan and obviously then on selling to somebody else or whatever it might be.*

Another director expressed the ownership issue in terms of people development:

> *…the people who I know in the group have a passion for the development of people. Real estate is a vehicle that, we all work in a real estate industry but it's not actually the fact that you sell a house and get paid that spins the wheels of people in the group, it's the fact that you're helping people achieve what they want to do and the development of people and the growth that you can help them have is what drives this group as a franchisor.*

Overall it was clear from the interview data that the directors of both franchise groups saw ownership as a ***pull*** to franchising in real estate, rather than a ***push*** response to negative issues associated with moral hazard described in past research across industries.

Ownership issues for SB differed from SA slightly. Rather than empowering people and prioritising individual growth, a franchised empire is seen more as a way of ensuring ongoing company and market share expansion. The directors believe that the best way for individual owners to receive benefit is through increased market share and better returns on their investment in the company brand. The move to franchise was clearly profit driven:

> *Our role as franchisor is … to add value to the goodwill of each individual franchisee business … we do that by attracting the best people to the group and in doing that we attract the best clients… this is a far more profitable method than inviting … people to sell with the group. We can express to people in the industry that … has a career path and that is essentially how we see our business growing – by having the best people in the industry…*

The franchisor sees franchising as being similar to a company public offering:

*…we looked at franchising a little bit like putting the company up for public offering without actually doing that per se … giving people a vested interest in a name for their business – like a public offering but to people who are industry based…*

Creating a lifestyle is seen as part of the ownership advantage, along with the challenge of running a successful business and creating an asset.

Monitoring issues were not foremost in the motives of either franchisor because both had established systems designed to ensure quality. These involved groups of business advisors, educational and motivational programmes and regular monthly audits of business activities.

***Acculturation***

Of particular interest in this study are the two notions of acculturation and parallelism. Acculturation involves the process of adopting and adapting - assimilation into the culture of first the industry and then that of the franchisor. Acculturation is a term I use to describe a situation that is central to the real estate franchise industry. It refers to the way in which new franchisees are grown within each real estate franchise system or acquired from existing real estate businesses bought into the system. SA, for example has a real estate academy which trains suitable people, who are part of the organisation, to become franchisees. A director commented:

*(We have our training academy) … to grow people into business ownership, that is a unique feature of franchising, growing to a degree that goes on. I think you need to grow your own people because if you don't they just leave, that's why we franchise and they become part of the culture, they are part of the culture. It is a lot easier having someone who's been with … for some time in a variety of roles, you*

*know a sales role, becoming a franchisor because they already are part of the culture. They know what …stands for. If you get someone coming in from another brand it can be quite hard for them sometimes.*

SB has a similar future leaders group. These people either start new offices or buy existing franchises where the owner is retiring or selling. Such internal acculturation means that real estate franchise systems have a constant source of new entrepreneurs ready and waiting to enter the system as business owners. Furthermore where the franchisor offers prospects like this salespeople have a clear career path to pursue if they are interested.

A further arm of acculturation reaches into the wider real estate environment outside the organisation when the franchisors seek to acquire or merge with other real estate groups. Here existing real estate industry companies, already part of the industry culture, are 'acculturated' into the new parent franchise system. The real estate acculturation process encourages the growth of franchising as a business form by providing an assured supply of qualified franchisee owners waiting to rejuvenate the system. A director explained how franchisee selection happens:

*We will franchise to talented people who have one or two years experience in selling, the system is strong enough to support them through the transition to management, ownership and expansion, so we are always on the lookout for talent. We just focus on the Jim Collins idea of getting the right people on the bus and the wrong people off. So we are always looking for the right people to get on our bus.*

### *Focus and Parallelism*

A further interesting factor that helps explain why both systems became franchisors in the real estate industry is what I term 'focus and parallelism'. 'Focus' refers to the fact that the franchise relationship gives each party – franchisor and franchisee - the opportunity to concentrate on core individual competencies, thus each becomes expert in a separate set of skills. There is a clear belief held by all interviewees that the system success and growth is based on a need to divide responsibilities.

The franchisors in the sample are focused on creating strong, value added franchise business systems and establishing the trade mark. They are in the business of franchising, not real estate. Both regard the quality of the system as paramount for growth because only a system of exceptional quality, that can deliver tangible advantage to franchisees in the form of a strong brand and proven business system, will attract outside agencies and new franchisee owners (Litz and Stewart, 1998). The franchisor shares computer systems, added products like insurance and mortgage facilities, and large databases with the franchisees. The franchisees seek to manage their business risk by aligning with a strong named service, leaving them able to focus on increasing the turnover of their businesses through dealings in a range of property services. One director felt that to have company owned and franchise businesses in the same group would create competition that would be unfair:

> *… that company owned offices could be seen as unfair and we are not competing with our business owners – we are not in the real estate business, rather in the business of franchising.*

Although division of responsibilities is a feature of franchising in general, the degree of separation in the real estate industry is particularly defined. Furthermore real estate franchisors do not have any company owned businesses. Franchisee owned businesses operate under their own company name, using the franchise brand name and corporate identity as a common unifying factor.

The ability to focus on core activities is fundamental to real estate franchise systems because focus builds performance; assures quality; builds business assets; builds brand; ensures renewal through attracting others to join the group and enables inter firm learning to occur. Real estate companies can therefore achieve competitive advantage through creating a situation that allows for the parallel growth of businesses:

> *We just keep working on the system that will develop our people and to do that we have to give them the best tools to do the job. So it just all goes round and round and round*

I use the term ‘parallelism’ to describe these two separate business identities that exist side by side in real estate franchise groups. The franchisor business endorses the service quality of a series of independently owned, locally bound franchisees, enabling them to tap into a client base by positioning themselves in the local market more quickly than they could do single-handedly. The franchisee endorses the brand. Thus two entrepreneurial ventures exist parallel to each other, operating in a co-dependent manner. Parallelism is perhaps best illustrated in the international operations of real estate franchise groups where two brands are recognisable. Franchised businesses are able ‘to draw on the strength of a globally recognised brand name, but are also faced with the challenge of managing two brands: the embraced global brand and the local one’ (Yakhlef and Maubourguet, 2004: 193). Real estate franchises allow parallel business venturing, where the sum of the whole is greater than the parts.

## Conclusion

This preliminary study seeks to explore franchising from the perspective of franchisors in the real estate industry and forms part of the first lens of focus on franchising in a specific industry context. Past research in franchising has been across industry sectors and largely quantitative in nature. An overall objective was to obtain and interpret fine-grained information in order to mitigate the research gap on industry specific reasons for franchising. This pilot study collected data on the experiences and perceptions of directors of two real estate franchise organisations to tease out four 'confounding variables' (Stanworth and Hoy, 2003) that help explain the reasons why franchising is growing strongly in the real estate industry.

The antecedents for the growth of franchising in real estate appear to include a variety of agency and resource constraint factors that are best accounted for by a desire to increase market share; provide ownership incentives to industry trained people and to allow for the growth of the franchisor and franchisee businesses as parallel and co-dependent businesses. These four factors help real estate groups to gain competitive advantage. The issue of ownership suggests that agency considerations are important and there was a belief amongst the interviewees that business ownership would encourage more effort and emphasise quality service. The brand reputation would thus be better served. Nevertheless, the franchisors still monitor this quality carefully. Sophisticated procedures, undertaken by corporate employees in each region, are in place in both the domestic and international market places. It is rare for franchisees to lose their franchise contract or fail to have it renewed. Moral hazard issues are controlled, as in other franchised industries, by details in the franchise contract and by business risk sharing between the parallel business operations. New franchisees are brought into the group through mergers and acquisitions with outside agencies as well as from the training academies and future leaders groups of each franchisor. As the groups grow new ideas and innovative methods are spread throughout the system.

The issue of franchising in the real estate industry needs further exploration and study. This paper is preliminary in nature and the discussions merely constitute a set of questions, suggestions and assertions that will be investigated further in the going study.

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