

# A relational performance model for developing innovation and long-term orientation in retail franchise organizations



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## ABSTRACT

A relational performance model is developed to show how innovation and long-term orientation can be evaluated and monitored within franchised retail service organizations. Using principles of justice from social exchange theory as a guide, our performance model measures how franchisee entrepreneurial passion (EP) and perceptions of fairness help to promote innovation and long-term commitment across retail franchise organizations. We test our model using data collected from one large U. S. retail service organization (\$5B+ annual revenue) and its independent franchise operators. We discover that targeting distributive justice (or fairness) helps to leverage the EP of the independent operators for promoting innovation, while both procedural and distributive elements of the organizational justice climate help to enhance franchisee's long-term commitment. Moreover, we find that retail franchise operators perceive organizational justice differently than do corporate district managers, which suggests several important implications for both research and practice.

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*This new organization structure will unleash more entrepreneurial spirit and more innovation across our system while bolstering what makes McDonald's a formidable leader in the industry: our incredible network of dedicated franchisees.*

—McDonald's Chief Administrative Officer Pete Bensen<sup>1</sup> on May 2015 restructuring

*Giving away free coffee—what a brilliant, creative idea from the geniuses in Oak Brook [McDonald's corporate headquarters]. Oak Brook management is out of ammo.*

—Anonymous McDonald's Franchisee quoted in the *Wall Street Journal*<sup>2</sup>

## 1. Introduction

Service franchise researchers (e.g., Altinay, 2004; Davies et al.,

2011) and practitioners have begun to consider how to leverage the potential of franchisee relationships for promoting innovation and organizational change. McDonald's Corporation explicitly stated in May 2015 that a cornerstone of its corporate strategy must be to provide the company with the ability to “unleash the entrepreneurial spirit” of franchisees in an effort to expand innovation and improve the company's performance. As one of the largest service franchise organizations in the world, McDonald's has over 35,000 locations worldwide with approximately 60% of these being operated as what McDonald's terms “conventional franchisees.” As McDonald's simultaneously announced the goal of having 90% of their global restaurant locations operating as franchised locations by the conclusion of 2018, understanding how to better leverage innovative resources trapped within their existing franchise network would seem to be a strategic imperative. Nevertheless, it is a challenge for these firms to know how to leverage the full entrepreneurial spirit that exists within a service franchise network, particularly when it comes to making changes to consumer services within such highly-structured organizational systems. Moreover, research suggests that franchisees and corporate managers may have different expectations about the franchise relationship or ideal form of the franchise organization (Grace et al., 2013).

Using insights from social exchange theory developed from entrepreneurship, marketing, and operations management literature, we develop a relational performance model that considers innovation and long-term franchise commitment as the two key

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<sup>1</sup> [http://mcdonalds.mwnewsroom.com/Corporate/news-stories/2013/McDonald-s-Announces-Initial-Steps-In-Turnaround-P#.VVTFKu\\_JXk](http://mcdonalds.mwnewsroom.com/Corporate/news-stories/2013/McDonald-s-Announces-Initial-Steps-In-Turnaround-P#.VVTFKu_JXk) accessed 3/11/2016.

<sup>2</sup> <http://online.wsj.com/news/articles/SB10001424052702304626304579508043282874718> accessed 3/11/2016

elements for driving ongoing strategic renewal and competitiveness in a widely-dispersed retail franchise organization. While franchise organizational networks formally codify operations to encourage network efficiency and operational consistency, these rigid structures could also hinder the development of innovation and long-term consumer-driven strategies if not properly managed. Consequently, franchisee perceived fairness is key to establishing trusting relationships with the corporate office (Shaikh, 2016), such that they are motivated to contribute their inherent entrepreneurial spirit to help drive and commit to ongoing innovative changes to enhance the service offering to retail consumers.

While there is still significant debate as to the similarities and/or differences between individual franchisees and more traditional entrepreneurs (e.g., Ketchen et al., 2011; Combs et al., 2009a, 2009b), service franchisee operators are typically considered to be ‘entrepreneurs’ (Shane, 1996; Sorenson and Sørensen, 2001 p. 713; Akremi et al., 2011, p. 930; Altinay, 2004; Ketchen et al., 2011). For example, franchisee-entrepreneurs demonstrate higher levels of risk-taking, opportunity identification, and innovativeness than do other types of managers (Cardon et al., 2009; Baron, 2008), so they should be inclined to support and promote new initiatives to enhance consumer services and improve product/service offerings. Yet, scholarship remains unclear about how companies can best take advantage of entrepreneurial passion (EP)—which Cardon et al. (2013) describe as an enduring and defining element of an entrepreneur’s fundamental self-identity. Because of the inherent conflict between organizational control (scripted processes, documented performance measures, established hierarchies) and promoting ongoing product and process innovation (freedom to explore, risk taking, brainstorming), many corporations struggle to understand how to best promote and monitor innovation in these systems (Goodale et al., 2011; Ireland et al., 2009; Kuratko et al., 2009).

Developing relationship-based performance management models that are useful for measuring the entrepreneurial potential of franchisees to champion newly-proposed innovations has proven to be a difficult task. For example, the *Wall Street Journal* recently summarized the findings of a McDonald’s franchisee survey

stating that “the franchisees who responded said McDonald’s needs to do more than give away products—the company, they say, needs to come up with innovations to juice the business.” One franchisee noted: “Oak Brook management is out of ammo.” Unleashing innovative efforts for consumers can be challenging because franchise networks rely heavily upon *existing* processes and standard operating procedures. These structures often struggle to create a climate for generating future, presently-unknown innovations (Solis-Rodriguez and Gonzalez-Diaz, 2012). Having a favorably-perceived organizational justice climate (De Massis, 2012; Barnett et al., 2012) is critical for facilitating voluntary, non-contractually obligated efforts on the part of the franchisee to promote and embrace change. It is argued that the relational climate itself between franchisor and franchisee – not just the nature of the formal contract – would be critical for establishing any enduring competitive advantages (Liu et al., 2007; Davies et al., 2011).

In this paper, we present and test a new relational model of enduring entrepreneurial competitiveness within a retail service franchise network. The model can be used to both develop and monitor the ongoing performance of new innovation efforts and the long-term orientation of franchisee operators. Firms may be able to ‘unleash’ the trapped entrepreneurial passion of intra-network entrepreneurs—in our case the service franchisees— by creating an organizational justice climate where individuals are willing to commit long-term to the partnership, and will exert the needed effort needed to promote innovative potential (Fig. 1). This model extends insights from extant organizational justice theory and consumer science research (e.g., Adams, 1966; Barnett et al., 2012; Shaikh, 2016) to analyze enduring entrepreneurial competitiveness within a typical retail franchise network. Specifically, the two main objectives of this paper are:

1. To determine if the perceived organizational justice and franchisee entrepreneurial passion help drive the two desired performance outcomes for developing enduring competitiveness in a retail franchise network: innovation and long-term orientation; and
2. To examine if franchisee operator perceptions of the

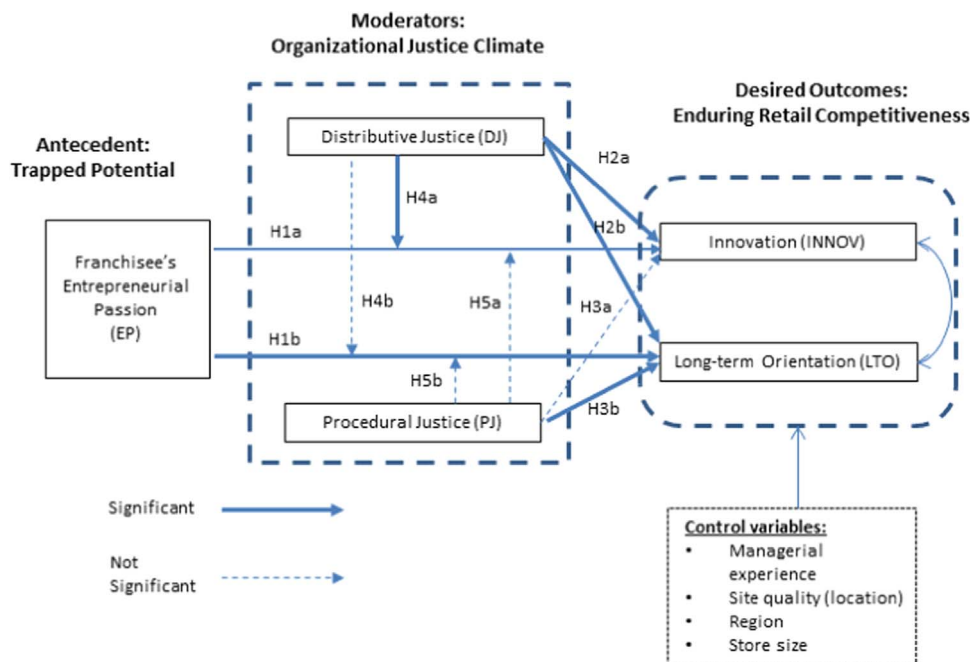


Fig. 1. Model specification and hypotheses. Note: H6a,b proposing an interaction between PJ and DJ on both outcome dependent variables (Innov, LTO) is excluded from the figure in order to improve clarity (see Eqs. (1) and (2) to see the full model under examination).

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